



**METHODS FOR ESTIMATING  
LOCAL AUTHORITIES' SPENDING NEEDS  
AND METHODS FOR ESTIMATING REVENUE**

Local and regional authorities in Europe, No. 74

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AND METHODS FOR ESTIMATING REVENUE**

Report by the Steering Committee on Local and Regional Democracy (CDLR)  
prepared with the collaboration of Professor Jens Blom-Hansen

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## INTRODUCTION

Methods for estimating local authorities' spending needs and methods for estimating revenue are important for the members of the Council of Europe in three respects:

Macroeconomic management by the central government may involve the economy of local authorities. In this case an accurate picture of local spending needs and revenue is crucial.

The administration of grants requires estimates of local authorities' spending needs and revenue for the calculation of the size of grants as well as for the distribution of grants among recipient local authorities.

Budgeting in local authorities requires precise and detailed estimates of spending needs and revenue developments.

This report provides an analysis and discussion of these three questions. The first section discusses the need for macroeconomic control of local authorities. This is done from a theoretical as well as from a practical point of view. Then, different methods to estimate local expenditure and revenue for macroeconomic control purposes are presented. Finally, the question of how to instrumentalise expenditure and revenue estimates for control purposes is discussed.

The second section analyses the extent to which estimates of local expenditure and revenue are necessary for the central government's administration of intergovernmental grants. The analysis encompasses the main types of grants and the requirements for their administration. The conclusion is that different types of grants require different types of estimates.

The third section analyses how estimating local expenditure and revenue matters for local authorities' own budgeting. First, the statutory framework for local budgeting is discussed. Then, three phases of local budgeting is analysed: Administrative preparation of the budget, political treatment and enactment of the budget, and implementation of the budget during the budget year. The conclusion is that estimates are crucial for budgetary purposes, but also that budgeting is a highly political process in which procedural questions are important for the use made of estimates.

A note on terminology: The level in the public sector which is responsible for local authorities varies between unitary and federal states. In unitary states the national government is responsible for local authorities whereas state governments assume this task in federal states. The report uses the term "national government" or "central government" to denote the responsible level in both cases.



## **I. THE CENTRAL AUTHORITIES' ESTIMATION OF THE LOCAL AUTHORITIES' SPENDING NEEDS AND REVENUE: MACROECONOMIC CONCERNS**

### **1.1. Introduction**

The European Charter of Local Self-Government recognises that macroeconomic management may necessitate some degree of national control of local authorities. Article 9.1 reads: "Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers".

This provision does not legitimise strict national regulation of the economic conditions of local authorities. Macroeconomic control of local authorities must respect the basic principles of local self-government, democracy and decentralisation of power. But the provision does recognise that the economic activities of local authorities must be compatible with national economic policy goals. The question is how important compatibility is and how it may be secured.

In the following, this question is analysed in greater detail. First, the reasons for macroeconomic control of local authorities are discussed. Then the question of how central authorities may estimate local spending needs and revenue for macroeconomic control purposes is discussed. Finally, different practical methods of instrumentalising estimates for macroeconomic control purposes are briefly presented.

### **1.2. Is macroeconomic control of local authorities necessary – in theory?**

According to traditional economic theory, economic policy has three functions: Stabilisation, allocation and redistribution. Traditionally, stabilisation is seen as a central government responsibility, because the economy of individual local authorities is so open that the effects of local stabilisation policies will be exported. Local stabilisation policies would thus be ineffectual.

Redistribution is also traditionally considered a central government responsibility, because local redistribution would give citizens, from whom wealth were to be redistributed, an incentive to move. Local redistribution would thus also be ineffectual.

However, according to traditional economic theory local authorities should be involved in the allocation task. Local authorities should be responsible for the allocation of local public goods while the national government should be responsible for national public goods. Local provision of local public goods will result in welfare gains because a closer congruence between citizens' preferences and provision of goods can be obtained.

If these theoretical guidelines could be followed, the central government would have no reason to interfere in the economy of local authorities. The problem is, however, that in reality it is difficult to keep the three functions of economic policy separate. All three functions may legitimise central interference in local affairs.

### ***Stabilisation***

As far as stabilisation is concerned local authorities matter in two respects. First, local authorities may behave in a pro-cyclical fashion and thus aggravate the swings of the national economy. The reason is that local expenditure and revenue are to some extent dependent on the country's macroeconomic performance. In boom periods the local income base increases and various types of local expenditure on income assistance decrease. In this situation local authorities have an incentive to reduce taxation or increase activity levels. In recessions the opposite effects occur: The income base decreases whereas expenditure on income assistance increases. In this situation local authorities have an incentive to increase taxation or reduce activity levels. The problem is that these types of reactions (known as "fiscal perversity") are pro-cyclical and strengthen the swings of the national economy. Macroeconomic management is thus made more difficult for the central government. The extent of cyclical dependency in local budgets depends on the tasks and income sources of local authorities.

The second reason why local authorities matter for the stabilisation task is that local service provision has implications for aggregate demand. In other words, the way local authorities handle the allocation task has consequences for the stabilisation task of the central government. If local authorities increase service levels in their institutions, aggregate demand increases. This has implications for the national employment level, the balance-of-payments, and the inflation rate.

This problem, however, is easy to exaggerate. If local authorities finance their tasks by local taxation or user charges, aggregate effects have the character of balanced budget effects the dimension of which can seldom legitimise central intervention.

However, local authorities often have access to other types of finance. In the short term local authorities can finance expenditure by liquid assets. In the longer term local authorities may finance investment expenditure by loans. Local access to these types of finance may make sense from a range of different vantage points, but at the same time it is evident that their usage may have macroeconomic effects.

### ***Redistribution***

As far as redistribution is concerned the traditional argument is that this should be the responsibility of the central government. In theory this is correct, but the traditional argument presupposes a local financial system which is seldom found in practice.

Typically, local tasks are to some degree financed by taxes. This means that redistribution takes place between local tax-payers and recipients of local service. Often this is part of the purpose of making the provision of various types of service a public responsibility. Redistribution is typically one of the central arguments why tasks such as health care and education should be a public responsibility. Allocation and redistribution are, in other words, intertwined.

Unless the central government regulates local finance, especially the balance between taxes and user charges, the degree of redistribution is likely to vary among localities. The central government thus has a legitimate interest in the types of finance which local authorities should have access to and how autonomously local authorities may use the various types of finance.

### *Allocation*

As far as allocation is concerned the traditional theoretical argument is that local authorities should be responsible for local public goods. This makes it possible to obtain a closer congruence between citizens' preferences and the provision of goods.

The reason is three-fold. First, service levels may vary among regions with different preferences. Second, citizens may take up residence in localities where tax/service packages suit their preferences. Third, optimal provision of public goods require the absence of externalities and internalities.

However, while this traditional argument is correct, it has only limited practical relevance. The problem is that the assumption that local authorities only provide local public goods is not often fulfilled. Local public goods are basic tasks such as refuse collection, sewerage, public parks, etc. In many countries, local authorities are today involved in service provision with national externalities such as education, social security and health care. This legitimises central intervention in the form of grants, legal regulation or the like.

In sum, there is a solid theoretical argument why the central government should exercise some degree of macroeconomic control of local authorities.

### **1.3. Is macroeconomic control of local authorities necessary – in practice?**

The practical relevance of the theoretical argument for macroeconomic control of local authorities outlined above depends on the size of the local government sector. The larger the size of the local government sector, the more important macroeconomic control becomes. The size of the local government sector is important in two empirically related but, analytically distinct ways:

- local authorities' share of the national economy: the larger the share, the larger the macroeconomic implications of local activities.
- local authorities' share of the public budget: the larger the share, the more difficult to instrumentalise the public budget for macroeconomic control purposes.

There is considerable variation on both dimensions among members of the Council of Europe. Table 1 provides an overview of local authorities' share of the national economy (measured as the gross domestic product, GDP) and the public budget (measured as general government expenditure, GGE).

**Table 1: Local authorities' share of the national economy and the public budget**

Country	Reference year	Local authorities' share of the gross domestic product (GDP) percentage	Local authorities' share of general government expenditure (GGE) percentage
Albania	1995	7.7	25.4
Austria	1993	12.71	20.18
Belgium	1993	4.9	10.9
Bulgaria	1999	8.8	18.8
Cyprus	1993	1.4	4.1
Czech Republic	1999	9.6	24
Croatia	1997	6.33	10.73
Denmark <sup>a</sup>	1999	19.9	29.6
Estonia	1994	7.1	17.6
Finland	1993	18	29.5
France	1998	9.8	29.35
Germany	1999	7.27	15.18
Greece	1996	0.88	4.18
Hungary	1999	13.8	18.7 <sup>b</sup>
Iceland	1994	9.1	22.3
Ireland	1994	4.9	13.8
Italy	1993	7	13
Latvia	1994	12.45	24
Lithuania	2000	6.38	31.86
Luxembourg	1993	9.92	32.3
Malta	1999	1.328	0.669
The Netherlands	1994	13.3	23.1
Norway <sup>c</sup>	1994	18.9	60
Poland	1997	12.9	25.9
Portugal	1993	4.6	9.7
Romania	1993	3.5	16.9
San Marino	1993	0.11	0.19
Slovakia	1994	4.79	11.78
Slovenia	1995	4.4	10.1
Spain	1994	4.87	12.17
Sweden	1999	23	39.2
Switzerland	1993	10.8	27.9
Turkey	1992	2.41	12.3
United Kingdom	1999	7.6	25

Source: Council of Europe

- a. Adjusted for expenditures with 100 per cent reimbursement (e.g. pensions)  
b. Share of grants and other financial transfers to local authorities out of total state expenditure.  
c. Includes counties and municipalities.

The two dimensions of the economic size of the local government sector are positively related.<sup>1</sup> This pattern is not surprising since a large local government sector is partly, but not only, the result of a transferral of tasks from the central government.

Table 1 shows that macroeconomic control of local authorities is a problem of highly varying dimensions in different countries. It thus seems evident that the practical relevance of macroeconomic control of local authorities varies considerably among the members of the Council of Europe.

<sup>1</sup> The correlation coefficient (Pearson's R) equals 0.78.

#### 1.4. Critical factors in central estimation of local expenditure and revenue

If macroeconomic control of local authorities is necessary, the question is how this goal may be pursued. Detailed and precise estimates of local expenditure and revenue are the basic prerequisites for obtaining macroeconomic control.

This section discusses in greater detail how the central government may estimate the development of the main types of general local expenditure and revenue. For macroeconomic control purposes estimations of expenditure and revenue in individual local authorities are typically not relevant. What matters for macroeconomic performance is the situation in the local government sector in general.

Consequently, this section will examine how the central government can estimate the development of general local expenditure and revenue. The focus will be on short-term estimation, i.e. how central authorities can estimate local expenditure and revenue for the coming one to two years. An overview is provided in Table 2. Closer examination is provided in the following.

**Table 2: Critical factors in central estimation of local expenditure and revenue**

<b>Critical factors in central estimation of local expenditure and revenue</b>	
<i>Estimation of local expenditure:</i>	
Transfer payments	If entitlement is fully regulated by law, estimation depends on demographic development, development in employment situation, etc. If entitlement is not fully regulated by law, local authorities' decisions on service levels must be taken into consideration.
Consumption	If access to local government services is fully regulated by law, estimation depends on demographic development, citizens' application frequencies, etc. If access is not fully regulated by law, local authorities' own decisions on service levels must be taken into consideration.
Investment	Assessment of needs for changes in present investment level
<i>Estimation of local revenue:</i>	
Taxes	Who assesses the tax base? Who sets the tax rate? Who collects the tax revenue?
Grants	Calculated on the basis of objective criteria? Dependent on local activity? Closed- or open-ended?
Charges/fees	Legal regulation of the size of charges/fees?
Loans	What types of expenditure may be financed by loans? Central government approval required?

The expenditure side of local budgets consists of three main types of expenditure: transfer payments, consumption, and investment. The relative importance of these types of expenditure varies across nations, but together they constitute the major part of local expenditure in most countries. Transfer payments constitute the various types of income transfers to individuals for which local authorities may be responsible. Examples include social security, housing benefits, and pensions. Consumption expenditure constitutes the various types of local service provision. Examples include the running of kindergartens, schools, and hospitals. Investment constitutes the capital projects of local authorities, for instance the construction of local roads.

The revenue side of local budgets consists of four main types of revenue: Taxes, grants, charges/fees, and loans. These income sources vary in relative importance among the member states of the Council of Europe, but together they constitute the major part of local finance in all member states. In the following it is examined in more detail how these expenditure and income types may be estimated by central authorities.

### *Transfer payments*

To a large extent local transfer payments are determined by factors that are not within the control of local authorities. Entitlement criteria are often specified in considerable detail in national legislation. This means that estimation of local transfers can often be done by combining entitlement criteria with socio-economic determinants.

For instance, social security benefits administered by local authorities may be estimated by combining entitlement criteria with the development in the employment situation. Likewise, housing benefits administered by local authorities may be estimated by combining entitlement criteria with demographic developments and developments in rents.

Estimation of transfer payments may be quite complex due to the nature of entitlement criteria and the often wide range of socio-economic determinants. In practice it may necessitate the cooperation of a number of central authorities such as the Social Ministry, the Labour Ministry and the Finance Ministry.

If local authorities possess any degree of autonomy in the provision of transfer payments, estimation gets more complex. Various types of local policies may influence the level of expenditure on transfer payments. For instance, local housing policies and local employment initiatives may influence transfer payments in these areas because they influence the socio-economic determinants of transfer payments. However, these types of local policies are likely to matter mostly in the longer run. In the shorter run, it is more relevant to focus on local influence on entitlement criteria. To the extent that this is the case, central authorities need information on local authorities' own decisions on service levels. Local budgets and accounts for previous years may constitute accessible indicators for local service levels which may be projected.

### *Consumption*

Consumption expenditure is made up of local services. Access to local services may be legally regulated in considerable detail. For example, primary education is often provided by local authorities, but national legislation may stipulate that municipal schools are open to all children of a certain age. To the extent that this is the case, estimation of local consumption expenditure is an exercise in combining legal stipulations with wage- and price increases and socio-economic determinants such as demographic changes.

However, local authorities are often allowed some discretion in the provision of local services. This means that local authorities' own decisions on service levels are important. Again, local budgets and accounts for previous years may constitute accessible indicators for local service levels which may be projected.

### *Investment*

Expenditure on local capital projects typically constitutes smaller amounts than current expenditure. But investment traditionally attracts more attention from the perspective of macroeconomic control because local capital projects are often financed by loans. This means that the macroeconomic implications of capital projects are larger than those of current expenditure. Further, local authorities are often allowed considerable discretion in the investment areas, e.g. the construction of local roads and the building of local service institutions.

This means that local authorities' own investment decisions are important for central estimation purposes. Local budgets and accounts for previous years, local budget estimates for coming years, or local investment plans may constitute accessible indicators for local investment levels which may be projected by using relevant wage- and price factors.

However, projection should be done with care. Investment levels are sensitive to expenditure pressures caused by previous neglect of proper maintenance of buildings and roads or demographic developments such as an increase in the proportion of elderly people causing a need for more old age institutions. Even though these types of expenditure pressure are mostly important for longer-term estimation, adjustment may have to be made in short-term estimations as well.

When estimating local investment expenditure attention should be paid to local partnerships with the private sector. For instance, local authorities may contract with private companies to build and operate local service institutions. Although decided by local authorities, these investments need not show up in local budgets and accounts because the local authority may only be contractually obliged to pay a regular current fee for a fixed period of time to the private company.

## *Taxes*

Estimating local tax revenue involves, irrespective of type of tax, the investigation of three separate questions.

The first question is the assessment of the size of the tax base. The problem here is that the local tax base typically consists of some current value (property, income, consumption, or the like) the exact size of which neither the central government nor local authorities know until some years later. This means that the tax base must somehow be assessed.

The central government may be responsible for this task. This is, for instance, the case for local income tax in Sweden where the central government stipulates that local authorities' income tax base is the local actual income tax base two years previously adjusted for the interim income development as judged by the central government. In Denmark and in France, the value of local property (the tax base for local property tax) is assessed by the central government. If the local tax base is assessed by the central government, central estimations naturally constitute no particular difficulty, apart from the coordination of assessing authorities and authorities responsible for macroeconomic management.

However, the tax base may also be assessed by local authorities themselves. This is, for instance, the case for local income tax in Norway. This makes estimation for central authorities difficult as they have to consider how local authorities make their estimates. One method is to await the budgets of local authorities. However, this will often be too late even for short-term macroeconomic control purposes. Alternatively, central authorities can make detailed estimations of their own, communicate these to local authorities, and assume that local authorities will follow them.

The second question concerns the setting of tax rates. This may be left to local decisions. This is, for instance, the case for local income tax in Sweden (although Swedish local authorities were subjected to tax limitations in the 1990s). The tax rate may also be set by the central government. This is, for instance, the case for local income tax in Norway where rates may formally be set at any rate within a centrally specified interval, but where *de facto* all local authorities use the maximum tax rate. An intermediate model is to let local authorities vary tax rates between centrally specified upper and lower bounds. This is for instance the case for Danish local property tax which may vary between 0.6 and 2.4 per cent of property values. A similar local property tax system is found in Norway.

Estimating tax rates under full local control is difficult. First, they depend on developments in expenditures. If new tasks are transferred or given to local authorities without compensation from the central government or if local authorities decide to increase service levels, tax rates may increase. Second, tax rates depend on the development of the tax base. If the tax base decreases, tax rates must go up to uphold tax revenues. Third, tax rates depend on the development in other income sources. If these change, local authorities may compensate by adjusting tax rates. For the purpose of estimating tax rates under local control, assumptions must be made concerning all these factors.

The third question concerns the collection of tax revenue. If tax revenue is collected by the central government and paid out to local authorities on the basis of the assessed tax base multiplied by the tax rate, this aspect poses no particular difficulties for estimation purposes. This is for instance the case for local income tax in Sweden and Denmark.

However, when tax revenue is collected by local authorities themselves, additional difficulties arise. In this case not only the assessed tax base, but the actual tax base matters for estimation purposes. If local income tax is collected by local authorities on a pay-as-you-earn basis, as is for instance the case in Norway, what matters for actual local tax revenue is not the assessed tax base, but the actual tax base. For estimation purposes, the central government must in this case constantly judge the extent to which the assessed tax base corresponds to the actual tax base. This may necessitate some kind of tax monitoring system throughout the budget year.

### ***Grants***

Estimating the level of grants to local authorities poses fewer difficulties than taxes since grants are to a greater extent controlled by the central government. However, grants may be dependent on decisions by local authorities in which case estimation may be quite complex.

The most complex case is open-ended activity-dependent grants. This type of grant is often a reimbursement scheme, i.e. the grant is automatically paid out by the central government if local authorities follow certain conditions, but the amount paid out depends on local decisions on activity levels.

In Norway, for instance, the central government's grant for municipal kindergartens is calculated as a certain amount per child per hour, i.e. the grant depends on activity levels in kindergartens and local decisions on coverage rates. In the Czech Republic the central government's grant for local social and health care facilities is calculated as a certain amount per bed, i.e. it is dependent on local decisions on service levels in the health area. In Poland, the central government's grant for municipal education is calculated according to a precise algorithm set by the law on local authorities' revenue and uses criteria such as teachers' wages and number of pupils; the level of this grant is therefore also partly dependent on local decisions on service levels.

Estimating the size of these activity-dependent grants must be based on the development in the relevant socio-economic factors (e.g. number of pupils), local policies, and the legal framework. Making estimations is likely to require the cooperation of various central authorities.

Other types of grants may be easier to estimate. Estimating open-ended grants always involves some uncertainty, but if they are not dependent on local decisions, estimation only depends on the legal framework. For instance, Danish local authorities' expenditure on old age pensions is fully reimbursed by the central government. Local authorities are allowed no discretion which means that the size of the grant is dependent on the number of old age pensioners only. In other cases, the legal framework may not require any formal calculation to be done. Restrictions on central government discretion may in such cases take the form of procedural requirements.

Estimating closed-ended grants only involves the uncertainty of assessing the extent to which local authorities make use of the central government's grant offer.

### *Charges/fees*

Charges are user payments for local services. "Real" charges depend on citizens' usage of the charged service. For example, charges for water may be calculated on the basis of the amount of water used. "Quasi-charges" do not depend on citizens' actual consumption, but on some other formulae. For instance, charges for water may be calculated on the basis of property size or property value.

Estimating income from charges depends primarily on the legal framework. Typically, local authorities are not allowed to set charges autonomously. Charges are often specified in national legislation as a fixed amount or as a proportion of the expenditure on the charged service. In the latter case the income from charges is primarily dependent on the expenditure used on the charged service.

Further, local authorities may have access to charges, but need not be obliged to use them. In this case, estimating income from charges must include the extent to which local authorities are likely to utilise charges.

Estimating charges is especially important in countries, such as France and Norway, where charges constitute a considerable part of local finance.

### *Loans*

Local authorities in most member countries of the Council of Europe may finance capital expenditure by loans, at least to some degree. However, the extent to which access to loans is regulated by the central government varies considerably across member countries. In some countries access to loans is unlimited, at least for certain types of capital expenditures. In other countries, all loan-making requires central government approval and restrictions are imposed on terms of loans.

Relatively precise estimations of the total amount of loans made by local authorities are critical for macroeconomic control purposes because loan-financed expenditure has the largest effects on aggregate demand. Estimations depend critically on the restrictions imposed by the central government. The fewer restrictions, the more difficult the estimations. In countries with few restrictions, estimations must be based on relatively mechanistic projections of current levels of loan-financing.

### ***Conclusion***

Estimating general local expenditure and revenue is a complex matter for the central government. Different types of expenditure and revenue require different estimation methods. Estimations require a detailed knowledge of the legal framework, of local decisions on service levels, and of various socio-economic determinants.

### **1.5. Estimation and macroeconomic control**

Precise estimations of local expenditure needs and revenue are a prerequisite for macroeconomic control of local authorities, but do not by themselves entail macroeconomic control. Instrumentalising estimates of local expenditure and revenue for macroeconomic control purposes can be done in a number of ways which must respect each nation's traditions, constitutional provisions and political culture. In general two basic approaches can be identified.

The first approach may be termed "unilateral control", i.e. control imposed by the central government on local authorities. An example of this approach is provided by Sweden in the early 1990s. The Swedish central government introduced a local tax stop in 1991, primarily as part of a major tax reform, but also in order to make local authorities contribute to solving the country's severe economic crisis and help cut down public spending. Given the importance of taxation for local finance in Sweden, the tax stop gave the central government considerable control of local finance and thus of local activity. After three years the tax stop was lifted. The Swedish central government then introduced an alternative unilateral control measure. Between 1997 and 1999, the block grants to individual local authorities were reduced in case of increases in local taxation levels.

Another example of the unilateral control approach is provided by the Norwegian "Total Revenue Scheme". This system constitutes the Norwegian central government's main instrument of macroeconomic control of local authorities. The system comprises the main income sources for local authorities, i.e. local income tax and central grants. By fixing a maximum local income tax rate (which all municipalities use) and by fixing central grants, the central government determines 80-90 per cent of local finance through this system. The "total revenue system" is adjusted according to macroeconomic needs in connection with the annual presentation of the National Budget. From the year 2000 the Norwegian central government has decided to establish a consultative procedure with the local government association on macroeconomic questions. The UK has traditionally relied on unilateral control measures, but has in recent years also adopted a less stringent and more relaxed system.

The second approach may be termed “co-operative control”, i.e. macroeconomic control achieved through cooperation with local authorities. An example of this approach is provided by Latvia which in 1996 established the Council on Control and Supervision of Local Government Loans and Guarantees. This council is responsible for securing that local fiscal activities conform to common state interests and that negative macroeconomic consequences of local government loans are averted. In the council the annual total sum of local government loans and guarantees is coordinated through negotiations between the central government and representatives of local government.

Another example of the co-operative control approach is provided by the Danish “budgetary co-operation system”. In almost every year since the early 1970s, economic agreements have been entered into between the Danish Government and the associations of counties and municipalities. The agreements are based on a common understanding of how the economic state of the whole local government sector is expected to develop over the coming fiscal year. They agreements contain recommendations on the desirable general taxation and expenditure levels in the local government sector. These levels are set according to macroeconomic needs. The agreements are recommendations, i.e. they are not legally binding for the members of the associations. But the associations assume responsibility for coordinating the members’ budgets in order to keep taxation and expenditure within the agreed limits.

## II. THE CENTRAL AUTHORITIES' ESTIMATION OF THE LOCAL AUTHORITIES' SPENDING NEEDS AND REVENUE: THE ADMINISTRATION OF GRANTS

### 2.1. Introduction

Intergovernmental grants are found in all systems. They serve a range of different purposes and are found in a variety of shapes. The practical administration of grants requires estimates of local authorities' spending needs and revenue for two purposes: the calculation of the total size of the grant and the distribution of the grant among recipient authorities.

An overview of the different purposes which intergovernmental grants may serve is provided in Table 3.

**Table 3: Overview of intergovernmental grants**

Purpose of grant	Ideal type of grant according to economic theory	Requirements of the estimation of local authorities' spending needs and revenue:	
		For the calculation of the total size of the grant	For the distribution of the grant among recipient authorities
Compensation of spillover effects and merit goods	Open-ended, matching grant	Estimate of general spending needs in specific areas	Formula for measuring activity in individual authorities
Equalisation (spending needs)	Unconditional, closed-ended grant (lump sum)	Estimate depends on local tasks: The more varied local tasks, the more difficult to assess local spending needs	Formula for estimating objective spending needs in individual authorities
Equalisation (income base)	Unconditional, closed-ended grant (lump sum)	Estimate depends on local income sources: The more varied types of income, the more difficult to assess local income base	Formula for estimating income base in individual authorities
Economic stabilisation	Unconditional, closed-ended grant (lump sum)	Estimate of cyclical dependency in local government sector	Formula for measuring cyclical dependency in individual authorities
Income support	Unconditional, closed-ended grant (lump sum)	Estimate of general gap between spending needs and income sources	Formula for the distribution of centralised tax base
Use of local authorities as agents for central authorities	Conditional grant	Estimate of general spending needs in specific areas	Formula for measuring minimum service levels in selected areas; reimbursement schemes; discretionary grants
Regional economic development	Investment grant (infrastructure)	Estimate of general need for infrastructural investment	Formula for measuring need for infrastructural investment in individual authorities

In addition to the different purposes which intergovernmental grants may serve, Table 3 also shows which type of grant is best suited to the different purposes. It should be stressed that this matching of purposes and types of grants is the ideal matching according to economic theory. In practice, the choice of type of grant must balance economic values against other values such as local self-government, democracy, and accountability.

Further, the table sums up the estimation requirements for administering the different types of grants. The table distinguishes between requirements for calculating the total size of the grant and requirements for distributing the grant among recipient authorities. This part of the table is treated in more detail in the following.

## **2.2. Different types of grants require different types of estimates**

### ***Grants for compensation of spillover effects and merit goods***

If local authorities are responsible for tasks whose benefits are not contained within their community, but some of which go to (“spill over”) the outside world, these tasks may be subsidised by the central government in order to avoid an undersupply. Alternatively, the central government could impose legal regulation on local authorities to achieve the same purpose.

If it chooses regulation by grants, the central government should ideally provide the local authorities with a grant equivalent to the value of the benefits to the outside world. The grant should be closely tied to the task it is meant to subsidise. Matching rules should require recipients to contribute some of their own resources. That is, the grant should be conditional on the task actually being solved.

Calculating the total size of this type of grant is difficult *ex ante* because it depends on local decisions. This means that the central government needs an estimate of how much local authorities are going to spend on the task. The methods, which may be used to estimate local authorities’ general expenditure, are discussed above in Section I of the report.

In order to distribute the grant among recipient authorities the central government needs a formula for measuring activity in individual local authorities. One way to do this is to establish a reimbursement scheme according to which a certain percentage of the relevant and legally specified types of local expenditure are reimbursed by the central government. This requires a uniform and relatively detailed budget and account system for local authorities. Without this, the central government may stipulate that reimbursement requests should be countersigned by an independent auditor before being submitted to the central government for reimbursement.

The same type of grant should be used if the central government wishes to encourage, but not necessarily require, specific types of local expenditure. This situation arises when the central government wants more of a public good to be provided than local authorities are willing to pay for (“merit goods”). The proper grant for this purpose would also be an open-ended matching grant closely tied to the task it is meant to stimulate.

### *Grants for equalisation (spending needs)*

Due to various factors such as demographical composition and geographical location, spending needs may vary considerably among local authorities. In order to neutralise or reduce this variation the central government may introduce equalising grants.

Equalising grants are supposed to equalise the conditions for solving local tasks. This means that grants should ideally be calculated on the basis of objective criteria. This means that local authorities cannot influence the size of their grant and that the central government avoids compensating inefficiency or authorities choosing costly ways of solving their tasks. Further, equalising grants should be distributed without any attached conditions because their aim is to give local authorities equal opportunities for providing local service.

Equalisation of spending needs need not entail any costs for the central government. If equalisation is done around average spending needs and authorities with low spending needs contribute an amount equal to the difference between their low spending needs and average spending needs (the “Robin Hood” model), no central government funds are needed.

However, central governments often choose to finance equalisation systems. This means that the central government compensates local authorities with high spending needs. Authorities with low spending needs are either not involved in the equalisation system or asked to contribute only smaller amounts. In this case the central government needs to calculate the total size of the equalising grants for its own budgetary purpose.

This calculation involves the examination of four questions. First, how are spending needs measured? If local authorities are responsible for varied and complex tasks, the measurement of spending needs may be quite complicated. However, in most equalisation systems demographic criteria (age groups) figure prominently. Table 4 provides an example of how expenditure needs may be measured in a country in which local authorities have a relatively wide range of functional responsibilities. This system may be contrasted with the equalisation of spending needs on Malta where local authorities are responsible for fewer functions and, consequently, only population size and surface area are needed as factors to measure spending needs.<sup>1</sup> This formula has just been superseded by one which is based on a more detailed evaluation of each specific competence giving a more realistic assessment of each local authority’s specific funding need.

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<sup>1</sup> It should be added that these two criteria have proven insufficient to fully measure spending needs. As a consequence, it has been necessary to introduce special funds within selected areas to compensate spending needs more adequately.

**Table 4: Calculation matrix for the equalisation of spending needs among Norwegian municipalities in 1999**

Criteria	Weight
Basic grant 1/435	0.028
Share of population 0-5 years	0.025
Share of population 6-15 years	0.309
Share of population 16-66 years	0.130
Share of population 67-79 years	0.082
Share of population 80-89 years	0.123
Share of population 90 years and over	0.045
Share of divorced and separated people 16-59 years	0.066
Share of unemployed people 16-59 years	0.023
Death rate	0.024
Share of non-married people 67 years and over	0.024
Immigrants	0.004
Average travelling time	0.037
Share of population in sparsely populated areas	0.011
Share of mentally retarded people of 16 years and over	0.066
Share of mentally retarded people under 16 years	0.003
Sum	1.000

Source: The Norwegian Ministry of Local Government and Regional Development.

Second, which local authorities are eligible for equalising grants? Eligibility may be set in relation to average spending needs. For instance, all local authorities with higher than average spending needs may be eligible.

Third, what is the level of equalisation? For instance, all differences between average spending needs and higher spending needs may be compensated, but it may also be more or less.

Fourth, do local authorities with low spending needs contribute? For instance, local authorities with the very lowest spending needs may be asked to contribute in order to increase their spending needs somewhat. Although this does not eliminate the need for central financing, it reduces the burden of the central government.

In order to distribute the grant for equalisation of spending needs among recipient authorities the central government needs to calculate all the recipient authorities' share of the different criteria chosen and summarise these on the basis of the weights attributed to each criteria.

### ***Grants for equalisation (income base)***

Local authorities' income base may vary considerably due to regional differences in citizens' income, property values and so on. In order to neutralise or reduce this variation the central government may introduce equalising grants.

The purpose of these grants is to equalise the economic conditions for solving local tasks by compensating insufficient own resources. This means that the grants should be distributed without any attached conditions.

As in the case of spending needs equalisation need not entail any costs for the central government. If equalisation is done around an average income base and local authorities with high income bases contribute an amount equal to the difference between their income base and the average income base (the “Robin Hood” model), no central government funds are needed.

However, also in this case central governments often choose to finance the equalisation system. This means that the central government compensates local authorities with low-income bases. Authorities with high-income bases are either not involved in the equalisation system or asked to contribute only smaller amounts. In this case the central government needs to calculate the total size of the equalising grants for its own budgetary purpose.

This calculation again involves the examination of four questions. First, how is the local income base measured? If local authorities have access to a range of income sources, the measurement of the income base may be quite complicated and weighting of the different income bases may be necessary. For instance, in Denmark local authorities may tax personal income as well as property values. For the purpose of equalisation these two income sources are combined into a general local tax base. In this general tax base property values are weighted according to the weight of property tax revenue in total municipal tax revenue. For the present, this weight is 6.5 per cent.

Second, which local authorities are eligible for equalising grants? Eligibility may be set in relation to the average income base. For instance, all local authorities with income bases lower than average needs may be eligible.

Third, what is the level of equalisation? For instance, all the revenue value of differences between average income bases and lower income bases may be compensated, but it may also be more or less.

Fourth, do local authorities with high income bases contribute? For instance, local authorities with the very highest income bases may be asked to contribute in order to bring their economic conditions somewhat closer to the average. Although this does not eliminate the need for central financing, it reduces the burden of the central government.

The Norwegian system may serve as an illustration of the last three questions. All Norwegian municipalities with per capita tax revenues below 106 per cent of the average receive an income grant which brings them up to approximately this level. The grant covers 92 per cent of the difference between the average level and the municipality’s own level. All municipalities with per capita tax revenues above 140 per cent of the average contribute half of their revenues above this level. The municipalities with an average income between these levels receive no compensation.

In order to distribute the grant for equalisation of income bases among recipient authorities the central government needs to calculate the revenue value of the difference between all the recipient authorities’ income base and the average income base. This value difference must then be multiplied by the equalisation level.

### *Grants for economic stabilisation*

Local authorities' expenditure and revenue are to some extent dependent on the state of the national economy. In boom periods the local income base increases and various types of local expenditure on income assistance decrease. In recessions the income base decreases whereas expenditure on income assistance increases. Different types of local income sources and local tasks are cyclically dependent to different degrees. Due to this fact, the extent of this cyclical pattern varies across nations, but is found in most countries to some extent.

Local authorities have an incentive to react to these swings in a pro-cyclical fashion ('fiscal perversity'). When the tax base decreases and expenditure increases during recessions, local authorities may react by increasing taxation levels or reducing expenditure. Likewise, when the tax base increases and expenditure drops in boom periods, local authorities may react by lowering taxation levels or increasing expenditure levels. These reactions are pro-cyclical, i.e. they aggravate the cyclical swings of the national economy.

In order to avoid these reactions, the central government may introduce grants to neutralise the effects of cyclical swings in local authorities' expenditures and revenues. During recessions grants may be increased. During boom periods grants should then be reduced. In this way the central government may use grants as a macroeconomic regulator in its relation with local authorities.

This type of grant is meant to neutralise cyclically determined changes in own resources and expenditures. This means the grant should ideally be paid out without any attached conditions.

Calculating the total size of this type of grant involves the examination the cyclical dependency of both the expenditure side and the revenue side of local budgets.

In relation to the expenditure side two questions must be examined. First, which types of local expenditure are cyclically dependent? In practice, this is likely to include only a minor portion of local expenditures. Typical examples include various types of local income assistance or employment projects.

Second, how cyclically dependent are these types of expenditure? How much do they automatically change when GDP or the employment level changes by, say, one per cent? The answer to this question may necessitate some detailed economic analyses.

In relation to the income side of local budgets, the same type of questions must be answered. First, which type of local own income sources are cyclically dependent? This is likely to be a major part since most tax bases react to cyclical swings. Second, how cyclically dependent are the tax bases? How much do they automatically change when GDP or the employment level changes by, say, one per cent?

These analyses may be complicated. But most Finance Ministries already make them for the central government in order to establish the degree of automatic budget reaction in the national budget. So the techniques are likely to be well known.

In order to distribute the grant among recipient authorities the central government needs a formula for measuring the degree of cyclical dependency of expenditure and income in individual local authorities. Once the cyclically dependent areas in local budgets have been identified, this can be done by using local budget and account systems to see how much these areas weigh in individual local authorities. This requires uniform and relatively detailed local budget and account systems.

### ***Grants for income support***

For practical reasons, such as vertical tax coordination problems, the central government may have chosen to centralise the power to tax. This deliberately leaves local authorities with insufficient own resources, but the central government then is obliged to share its revenues with local authorities.

Since revenue-sharing schemes are a compensation for insufficient own resources, these grants should ideally be unconditional.

Calculating the total size of this type of grant requires an estimation of the gap between general spending needs in the local government sector and the various income sources available to local authorities apart from the income-supporting grant. The methods, which may be used to estimate local authorities' general spending needs and revenue, are discussed above in Section I of the report.

The grant may then be distributed among local authorities according to the regional distribution of the tax base whose use has been centralised.

### ***Grants for the use of local authorities as agents for central authorities***

Local authorities may be used as agents or contractors for the central government to provide specified services. The central government may use legal regulation or economic instruments for this purpose.

If economic regulation is chosen, grants should ideally be closely tied to the service in question and conditional on the service actually being provided. Grants should cover the costs of providing the service in the quantity desired by the central government, i.e. grants should ideally be closed-ended.

Calculating the total size of the grant requires an estimate of the general costs of providing the service in question in the desired quantity. Distributing the grant among recipient authorities can be done according to a variety of formulas depending on the service in question. One possibility is to distribute the grant according to the distribution of the clients in need of the service in question. Another possibility is to reimburse certain types of expenditure up to a given level. A third possibility is to make the grant dependent on applications from local authorities.

### ***Grants for regional development***

In general, correcting uneven regional development is a task for a country's equalisation systems. But disparities may be so great that special initiatives are necessary. By providing grants for the establishment of basic infrastructure the central government may encourage development in less developed regions. The European Union also provides these types of grants.

Development grants are found in different forms, but are often investment grants of a categorical and lump sum nature. Matching rules may require recipients to contribute some of their own resources.

Calculating the total size of development grants requires an estimate of the general need for regional infrastructural development.

Distributing the grant among recipient authorities may be done according to various formulas. One possibility is to require applications from potential recipients and allocate the grant on a case-by-case basis. Another possibility is to reimburse certain types of investment expenditure up to a certain level in geographically specified local authorities.

### **2.3. Conclusion**

The practical administration of grants requires estimates of local authorities' spending needs and revenue. Different types of grants require different types of estimates. The same type of grant may require different estimates for the calculation of the total size of the grant and for the distribution of the grant among recipient authorities.

In sum, the practical administration of grants presupposes a certain capacity within the central government for making these various types of estimation.

### III. LOCAL AUTHORITIES' OWN ESTIMATION OF SPENDING NEEDS AND REVENUE: PREPARATION OF LOCAL BUDGETS

#### 3.1. Introduction

Budgeting is a core activity in all local authorities. Budgeting is the central process in which priorities on the various local services are set and general service and taxation levels are decided.

Reliable estimates of spending needs and revenue are crucial for projecting current activities into the future. Reliable estimates are also important for inspecting different budgetary scenarios. Both functions are central elements in all public budgeting.

However, making estimates for budgetary purposes is seldom a fully technical exercise. It often involves a certain degree of discretionary judgement. It is therefore important who makes the estimates. Budgetary procedures are thus also important. Since different actors have different interests in the final budget, procedures are important not only for making estimates, but also for setting priorities, deciding service and taxation levels, and for implementing budgets.

This section discusses local budgeting. Since local authorities cannot decide their budgets autonomously, but must respect certain rules specified by the central government, the section starts by describing the statutory framework of local budgeting. It then moves on to an analysis of how local authorities make budgets within these limits.

#### 3.2. The statutory framework for budgeting in local authorities

In most countries, local government acts contain rules on how local budgets must be made. These statutory rules vary from country to country. But in general the rules may imply numerical as well as procedural constraints on local budgets.

Examples of numerical constraints include:

- ***Balanced budget requirements.*** Most members of the Council of Europe allow that local authorities use loans to finance capital projects. However, in order to avoid economic irresponsibility, current spending is subjected to a balanced budget requirement in most member countries. Although the precise definition of this requirement varies, deficit budgeting of current expenditure is not generally a local option.
- ***Expenditure ceilings.*** The central government may require local authorities to respect expenditure ceilings as part of a general effort to keep public spending down. For instance, in Belgium the supervisory authority issues an annual circular which fixes the authorised percentage increase for staff and operational expenditure in local authorities.

- ***Tax limitations.*** The central government may temporarily or permanently limit local authorities' access to own resources. Limitations may imply restrictions of tax bases or of the setting of tax rates. For instance, in Sweden the central government imposed a tax stop on local authorities in the early 1990s.
- ***Budget periods.*** The local budget period is often specified by the central government. For instance, in many countries the budget period is one year. However, the statutory framework may include rules on the carry-over of funds and deficits and it may also require multi-year planning.

Examples of procedural constraints include:

- ***The role of the different local political actors in relation to the enactment of the budget.*** The statutory framework may divide competences among the local council, the committees of the councils, and the mayor. For example, the economic committee of the local council may be given a prominent position.
- ***Time limits for the enactment of the budget.*** The statutory framework may require local budgets to be proposed and enacted before certain dates.
- ***Auditing rules.*** Local authorities may be required to subject their accounts to independent auditing.
- ***Bookkeeping rules.*** For various reasons such as public planning, the making of statistics, and macroeconomic control many countries have introduced a uniform local budget and account system. This implies that all local authorities must follow the same general bookkeeping principles when making budgets as well as accounts.

In addition to statutory rules, the central government may use various means of informal influence to regulate and harmonise the making of local budgets. The central government may issue recommendations of certain budgetary techniques. It may also publish its own estimates of central factors in local budgets such as wage and price increases, the size of the local tax base, grants, the local employment situation, and so on.

### **3.3. Budgeting in local authorities**

While constrained by central government rules, local authorities are generally allowed a certain degree of autonomy in the making of their budgets in order to respect the values of local self-government and democracy.

When discussing local budgeting, it is helpful to distinguish among three phases of the local budgetary process: the administrative preparation of the budget, the political treatment and enactment of the budget, and the implementation of the budget during the budget year. This section discusses these three budgetary phases in more detail.

### ***The administrative preparation of the budget***

The most important task in the local administration's preparation of the budget is to estimate local expenditure and revenue under the condition that present service and taxation levels are upheld. The aim of this estimation is to establish the state of the local authority's economy. Does an unchanged service and taxation level lead to a financial deficit or surplus? This is the starting point for the political treatment of the local budget.

The main picture is that this estimation exercise is not subject to any detailed regulation from the central government. Local authorities are generally allowed considerable discretion in this area. This also means that central governments seldom have any precise knowledge on how local authorities make these estimations. To obtain detailed knowledge special surveys need to be conducted. More impressionistic evidence may be obtained in consultative bodies between the central government and the associations of local authorities or from teaching institutions specialising in courses in local budgeting.

When making estimations, local authorities are likely to use methods similar to those discussed above in Section 1.4 on central estimation of local expenditure and revenue. This means that budgets and accounts from previous years constitute central elements for estimating future expenditure and revenue needs.

However, a mechanistic projection of previous budgets and accounts would be misleading for this purpose. Present activity needs to be adjusted for a number of factors in order to constitute reliable estimations of future expenditure and revenue needs. This adjustment may be quite complex. In most cases it involves the following elements:

- ***Wage and price increases.*** This is the most basic adjustment in the projection of present activity levels. It aims to uphold the real value of present services. If local authorities have a varied composition of tasks, this adjustment can be quite complicated. The reason is that the different types of local expenditure are likely to be composed of items with different wage and price developments. For instance, if wage rises and price rises are not identical, it matters how appropriations are composed of these two items. Further, different categories of local employees may be part of different collective agreements which means that their wage levels do not necessarily develop uniformly.
- ***Supplementary appropriations.*** Budgetary projections are often based on the present year's budget. If supplementary appropriations of a permanent nature have been authorised since the enactment of the budget, the projection base must be adjusted accordingly.

- ***Demographic development.*** A change in the number of, say, children or elderly people is important if coverage rates for local institutions such as kindergartens and old people's homes are to be upheld. For local institutions, to which citizens have legally guaranteed access, demographic changes may constitute a more direct expenditure pressure. On the income side of local budgets, a reduction of citizens of working age may shrink tax bases.
- ***Economy and employment situation.*** Changes in the local employment situation matters for the expenditure side as well as the income side of local budgets. A worsening of the unemployment situation means more expenditure on income assistance and less income from personal income tax and corporate tax. In the longer run property values (and thus property tax) may also be affected by a change of the employment situation.
- ***Relations with the private sector.*** In most European countries, local authorities may intervene in the commercial sector: they may participate in economic ventures via private companies in which they have all or part of the stock; they may associate with private companies; they may grant guarantees. The impact of these relations with the private sector is probably the most difficult to assess, as this actually implies a form of economic risk assessment, and local authorities rarely have the know-how necessary for such estimation.
- ***Changes in statutory framework.*** Many aspects of local activity are subject to legal regulation by the central government. New or changed laws or administrative regulation may have important effects on local budgets. On the expenditure side of local budgets there may be new demands of service provision or new tasks may be imposed on local authorities. On the income side new or changed tax codes may alter the definition of tax bases, the setting of tax rates, or introduce new types of revenue for local authorities.

The above-mentioned six factors are relevant to different degrees for the estimation of different types of local expenditure and income. Table 5 sums up how relevant the six factors are for the different types of expenditure and income.

**Table 5: Important factors for the estimation of local expenditure and revenue on the basis of previous budgets and accounts**

<b>Estimating local expenditure:</b>	
Transfer Payments	<i>Wage and price increases:</i> Transfer payments are often linked to the inflation rate to secure their value.
	<i>Supplementary appropriations:</i> May have been authorised due to wrong estimates of number of recipients.
	<i>Demographic development:</i> May influence transfer payments directly if entitlement criteria are specified by the central government.
	<i>Economic and employment situation:</i> Changes affects the need for income assistance.
	<i>Relations with the private sector:</i> Within the limits of competition law, it might be necessary to improve a company's cash position by grants. The authority might also be obliged to pay the guarantees it has granted.
	<i>Changes in statutory framework:</i> Entitlement criteria may be changed by the central government.
Consumption	<i>Wage and price increases:</i> Local employees' wage levels may develop according to collective agreements or other national standards. Other current expenditure may change with inflation.
	<i>Supplementary appropriations:</i> May have been authorised due to changed decisions on service levels.
	<i>Demographic development:</i> Important if access to local institutions is legally guaranteed or to uphold coverage rates.
	<i>Economic and employment situation:</i> Only relevant for expenditure on income assisting purposes (e.g. local employment projects)
	<i>Relation with the private sector:</i> Local authorities might be obliged to face unforeseen expenses such as exceptional management auditing or court representation fees.
	<i>Changes in statutory framework:</i> New central demands may have been made of local service provision.
Investment	<i>Wage and price increases:</i> Investment expenditure changes with inflation.
	<i>Supplementary appropriations:</i> May have been authorised.
	<i>Demographic development:</i> Increased demand for local service institutions (e.g. due to demographic changes) may necessitate the building of new institutions.
	<i>Economic and employment situation:</i> May influence investment in relation to local employment projects.
	<i>Relations with the private sector:</i> Local authorities might have to make a stock increase operation.
	<i>Changes in statutory framework:</i> New central demands may have been made of local investment.
<b>Estimating local revenue:</b>	
Taxes	<i>Wage and price increases:</i> Matters directly for income tax base; other tax bases may be influenced indirectly.
	<i>Supplementary appropriations:</i> Have tax rates been altered during the budget year?
	<i>Demographic development:</i> Changes in population size or number of people of working age influence the income tax base directly. Other tax bases may be influenced indirectly.
	<i>Economic and employment situation:</i> Changes in the unemployment situation influences the income tax base directly and may influence other types of tax bases indirectly.
	<i>Relations with the private sector:</i> Not directly important.
	<i>Changes in statutory framework:</i> Are tax bases or rates subject to new/changed regulation?
Grants	<i>Wage and price increases:</i> Are grants regulated according to inflation?
	<i>Supplementary appropriations:</i> Have new grants been received during the budget year?
	<i>Demographic development:</i> May influence grants from equalisation systems.
	<i>Economic and employment situation:</i> May influence grants for income assistance or stabilisation purposes.
	<i>Relations with the private sector:</i> Not directly important.
	<i>Changes in statutory framework:</i> Distribution criteria and total size of existing grants may change. New grants may be introduced.
Charges/fees	<i>Wage and price increases:</i> Charges/fees in fixed amounts may be linked to the inflation rate.
	<i>Supplementary appropriations:</i> New charges/fees may have been authorised during the budget year.
	<i>Demographic development:</i> Not directly important.
	<i>Economic and employment situation:</i> Not directly important.
	<i>Relations with the private sector:</i> Dividends and other resources derived from economic activity may largely vary from one year to another.
	<i>Changes in statutory framework:</i> Opportunities for collecting charges/fees may have been changed.
Loans	<i>Wage and price increases:</i> May be important for interest rates.
	<i>Supplementary appropriations:</i> New loans may be raised during the budget year; repayments may have been changed during the budget year.
	<i>Demographic development:</i> Not directly important.
	<i>Economic and employment situation:</i> The economic situation may influence the interest rates.
	<i>Relations with the private sector:</i> A local authority's loan capacity may be influenced by the revenue level it derives from economic activities.
	<i>Changes in statutory framework:</i> Centrally specified conditions for raising loans may have been changed.

An example of how a local authority estimates expenditure and revenue is provided in Table 6.

**Table 6: Estimating expenditure and revenue in the municipality of Bergen, Norway**

<p><b><i>Estimating expenditures</i></b></p> <p>Bergen municipality's budgeting of expenses is based on previous years' appropriations to the various service categories. The appropriations are then adjusted based on the following criteria:</p> <ul style="list-style-type: none"> <li>Expected inflation and wage-growth</li> <li>Goals for cost effectiveness in the specific service area</li> <li>Planned and/or expected change in activity levels</li> </ul> <p>Changes in activity levels lead to changes in necessary expenses as well as changes in the annual appropriations on the municipal budget. Activity changes may be necessary due to e.g. changes in the population composition. To be able to consider such changes, municipalities use official statistics as a basis to estimate future activity levels. In addition, changes in activity levels may be caused by politicians' wish to improve certain service areas.</p> <p><b><i>Estimating revenue</i></b></p> <p><b>Own taxes:</b> The budgeted revenues for the previous year and the National Budget's growth estimate compose the basis for budgeting income tax and property tax revenue. The National Budget's growth estimate is adjusted for the development in tax basis based on possible changes in local employment compared to the national average and possibly other factors. Budgeted amounts from the previous year, adjusted for changes in property rates, is used to budget revenues from property tax.</p> <p><b>General grant:</b> Bergen municipality uses the amount apportioned to the municipality according to the figures in the National Budget.</p> <p><b>Earmarked grant:</b> Budgeting of earmarked grants are based on governmental signals. When amounts are granted per unit or individual, the budgeted amount will be a product of rates and volume of the service. When other appropriations-criteria are used, the amount appropriated by the government is entered, or an estimate based on governmental signals is computed if the appropriation to municipalities is not known in the National Budget.</p> <p><b>Charges and fees:</b> The budgeted revenue is a product of price per unit and volume. For services that by law are expected to be completely financed by user fees, the budgeted expenses will set the budgeted revenues. The price per unit is adjusted for inflation on all other services.</p> <p><b>Other revenues:</b> This revenue category is composed of several items. The largest items are refunds from the National Insurance Programme and transfers from municipal corporations. Estimates of refunds of sickness benefits are based on statistics over sick leave. Transfers from municipal corporations are budgeted based on the corporation's last known fiscal year financial results.</p>
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Source: The Norwegian Ministry of Local Government and Regional Development.

Note: The municipality of Bergen has 225 400 inhabitants.

The estimation of local expenditure and revenue, conducted under the condition that present service and taxation levels are upheld, results in a general financial deficit or surplus. A deficit means that income levels must be increased or expenditure levels reduced since local authorities in most countries are subjected to some kind of balanced budget requirement.

Apart from technically estimating service and taxation levels, the local administration may be asked to recommend measures to address a financial deficit as part of the administrative preparation of the budget.

Possible ways of reducing expenditure levels may be investigated by administrative working groups. Different areas in the local budget may be subjected to close scrutiny in order to uncover ways of increasing efficiency in service provision or reducing service levels without harmful effects. Conducting these analyses may require the cooperation of different branches of the local administration.

Likewise, possible ways of increasing income may be investigated by special administrative working groups. This may also require the cooperation of different branches of the local administration in order to investigate questions such as the full exploitation of grant systems or the effects of an increase in local tax rates.

Since administrative budget preparation is likely to involve a certain degree of discretionary judgement and since various administrative actors do not have identical interests in the budget, it may also matter how budgetary procedures are arranged at the administrative level. The division of tasks between central economic agencies and sectoral spending agencies may be important for budgetary outcomes. Since the arrangement of the administrative process is basically a political responsibility, this question will be treated in more detail below.

### ***The political treatment and enactment of the budget***

Within the limits specified by the central government, politicians in local authorities can arrange the budgetary process in various ways.

First, politicians may utilise various instruments for budgetary purposes. Examples include fiscal targets (i.e. limitations on budgeting in terms of fiscal aggregates such as tax levels, expenditure ceilings, or growth rates) and budget conferences (i.e. special meetings for local politicians on budgetary questions such as the setting of difficult priorities).

Second, politicians may arrange budget procedures in various ways. Procedures are important because they determine the relative influence which different actors wield. It is useful to think of the budget process as a conflict between, on the one hand, the collective interest of the actors as a group and, on the second hand, the individual interests of the particular actors.

The basic source of this conflict is the fact the benefactors of local activities are often a smaller group than those paying to finance the activities. Finance is often provided by the general taxpayer whereas activities are targeted towards narrower groups such as day care for children or the elderly.

This incongruence means that the net benefit of an increase in a given public activity is almost always larger from the point of view of the benefactors than from the point of view of the general public. The benefit of a public activity often approximates a private good, whereas the corresponding taxation approximates a (negative) public good.

Collectively, as a group, the participants in the budget process seek to decide the optimal volume of local spending and taxation. Individually, however, participants respond to political incentives and wish to maximise the net benefits of their constituencies.

The individual interest of participants is likely to be supported by administrative actors and other actors such as interest groups who have a powerful incentive to try and influence the budget process. The collective interest, however, is not likely to be supported to the same degree by other actors since only the weakly organised general taxpayer benefits.

If all participants in the budget process decided only according to their individual interests, budgeting would lead to excessive spending in the sense that the general benefit of the last increment in local expenditures would fall short of the general costs of financing it. The reason is that the participants, who push for this increment, focus on the full value of the increment for their constituency, but consider only part of the resulting increase in the tax burden because this is spread out among all local taxpayers.

The way politicians arrange budget procedures is important for the balance achieved between the collective and individual interests of the budgetary actors. Procedures can promote the collective interest in various ways such as:

- by giving those actors whose individual interests coincide the most with the collective interest a dominant position in the process. This is likely to be cross-sectoral actors such as economic agencies and the economic committee of the local council;
- by restricting choices for other participants;
- by setting incentives or rules for making choices;
- by structuring decision-making processes, interactions and flows of information among the participants.

Budget procedures may thus vary on a continuum from highly centralised procedures to highly decentralised procedures.

Centralised budget procedures are characterised by a prominent position for economic agencies at the administrative level and economic committees at the political level. Decentralised budget procedures are characterised by a prominent position of sectoral agencies and institutions at the administrative level and sectoral committees at the political level. Interest groups may also be invited to comment on budget proposals when using decentralised procedures.

Examples of how local budget procedures may vary are provided in Table 7 which shows elements of the administrative budget preparation and involvement of political actors in the budget process in Danish local authorities.

**Table 7: Aspects of budget procedures in Danish local authorities. 1998**

<b>Administrative budget preparation in Danish municipalities (N252)</b>											Percentage
Budget prepared by the economic administration											41
Budget prepared by the economic administration in co-operation with the sector administrations											44
Budget prepared by the sector administrations											15
Sum											100
<b>Involve ment of local political institutions in the budget process (N=255) *</b>											
	Jan. 98	Feb. 98	Mar. 98	Apr. 98	May 98	June 98	July. 98	Aug 98	Sep. 98	Oct. 98	
Local Council	6	18	30	30	38	35	1	157	234	247	
Economic Committee	23	5	85	82	82	138	29	236	231	157	
Standing sectoral committees	2	5	21	49	121	153	29	173	109	28	

\* The figures in this part of the table show the number of municipalities in which the budget was on the agenda of the meetings of the local political institutions in the months up to the enactment of the 1999 budget in October 1998.

Source: J. Blom-Hansen. *Questionnaire to economic managers in Danish municipalities*. Aarhus. 1999.

In sum, budget procedures are not neutral for budgetary decisions. Choosing budget procedures is important and should be the result of a careful political decision.

### ***The implementation of the budget during the budget year***

Once the local budget has been enacted, it must be implemented. Different rules may guide the implementation process. The rules may allow different degrees of managerial flexibility for the local authority's administration.

Rigid rules may lead to inoptimal budgetary behaviour. For instance, if unused funds cannot be carried over to the next budget year, the administration has no incentive to economise and not use all appropriated means.

A certain degree of budget flexibility may encourage the administration to economise on appropriated monies. Flexibility may be increased by decentralising the competence over the use of appropriations. Flexibility may be increased by adjusting the following sets of budget rules:

- ***Rules for the carry-over of unused funds.*** These rules may give budgetary actors an incentive to save appropriated means for future use instead of spending them on not strictly necessary purposes at the end of the budget year in order not to lose the means.

- **Rules for transferring funds across budgetary items.** Traditionally, central agencies have specified appropriations in considerable detail. But the optimal composition of a given appropriation is only fully known to the appropriation holder. If sectoral agencies and institutions are given a certain leeway for choosing exactly how to spend appropriated means within the budget year, they have an incentive to spend efficiently in order to get the most for the appropriated means.
- **Rules for the use of supplementary revenue.** Appropriations have traditionally been measured in gross terms. That is, sectoral agencies and institutions have had separate expenditure and income appropriations. If individual agencies were somehow able to generate supplementary revenue during the budget year, this would not benefit the individual agencies, but go to central coffers. If appropriations are measured in net terms, agencies and institutions may use supplementary revenue during the budget year for own purposes. They thus have an incentive to utilise opportunities for generating supplementary revenue.

Adjusting internal budgetary rules should be done with care and introduced cautiously. Potential problems of congruence with statutory rules should be scrutinised. For instance, rules for the carry-over of funds across budget periods must respect statutory requirements to balance the budget.

As experience is gathered, adjustments may be extended. For instance, rules for transferring funds across budgetary items should pay special attention to transferrals of general expenditure into wage expenditure or capital expenditure into current expenditure. Rules for supplementary revenue may also limit the amount which may be spent on the basis of this income source. Rules for the carry-over of funds should not be introduced without limitations. Often only an amount equivalent to a certain percentage of the appropriation may be carried over.

An example of rules for implementing local budgets is provided in Table 8 which shows how budget rules for hospitals are specified in the fourteen Danish counties.

**Table 8: Budget rules for hospitals in the fourteen Danish counties**

County	Transferring funds across budgetary items allowed?	Carry-over of savings allowed?	Carry-over of deficits allowed?	Establishment and abolition of job positions allowed?	Dismissing of personnel allowed?	Own purchasing department?	Large purchases allowed?
Copenhagen	Partly	Yes	Yes	Partly	Partly	No	Yes
Frederiksborg	No	No	No	No	Partly	No	Partly
Roskilde	Partly	No	No	No	Partly	No	Yes
Vestsjælland	Partly	Yes	Yes	Yes	-	No	No
Storstrøm	Partly	Yes	No	Partly	Partly	No	Partly
Bornholm	Partly	No	No	No	No	No	Yes
Fyn	Partly	No	No	Partly	Yes	Yes	Yes
Sønderjylland	Partly	Yes	Yes	-	Yes	No	Partly
Ribe	Partly	No	No	Partly	Yes	No	Partly
Vejle	Partly	No	No	Partly	Partly	-	No
Ringkøbing	Partly	No	No	Partly	Yes	No	Partly
Aarhus	Yes	No	No	Partly	Yes	Yes	Yes
Viborg	Partly	No	No	Partly	Partly	Yes	Yes
Nordjylland	Partly	No	No	Partly	Partly	No	Yes

Source: J. B. Damgaard & T. Pallesen, "Kommunalt selvstyre og organisering", pp. 122-146 in J. Blom-Hansen et al., *Offentligt og effektivt?* Copenhagen: Gyldendal. 1998.

Decentralisation of budgetary competence may lead to a more efficient use of appropriations, but also to a loss of control for politicians and central agencies. This may be counteracted by an increased focus on the output of sectoral agencies and underlying institutions.

Output may be measured by indicators of the performance of agencies and institutions. In performance contracts local agencies and institutions may commit themselves to concrete targets in exchange for agreed-to resources.

It is essential that local authorities use efficient monitoring systems for their economic activities, designed according to systems used by private companies. Economic developments are indeed too swift to allow authorities to properly assess the results of their participation in economic activities by traditional budgetary rules and procedures.

An example of performance indicators for a local authority's school department is provided in Table 9. The table shows three examples of performance indicators and the targeted score in 2000. Meeting the performance indicators for the budget year is a condition for the utilisation of the school department's appropriation.

**Table 9: Selected performance indicators for the school department in the municipality of Fredericia, Denmark, budget 2000**

<i>Pupils' reading skills:</i> Tests conducted in the 3rd grade should demonstrate a reduction of pupils with low reading skills as compared to 1997, 1998 and 1999.
<i>Parental satisfaction:</i> A user survey in year 2000 should demonstrate an increasing parental satisfaction as compared to surveys in 1996 and 1998.
<i>Effect of 10th grade</i> (last and optional grade in Danish public schools). At least 90 per cent of pupils should choose secondary education after completion of the 10th grade.

Source: *Budget 2000 samt budgetoverslag for 2001-2003. Del 2: Bemærkninger.* Fredericia Kommune. 1999.

Note: The municipality of Fredericia has 47 800 inhabitants.

### 3.4. Conclusion

Budgeting in local authorities is highly technical and highly political at the same time. Estimating expenditure and revenue is a complex technical task which makes considerable demands of the administrative preparation of the budget.

But technique and discretionary judgement are intertwined, and different actors have different interests. This makes procedures important. By designing procedures, politicians can influence the weight given to different budgetary claims.



#### IV. CONCLUSION AND SUGGESTED GUIDELINES

##### 4.1. Guidelines on the estimation by central authorities of local authorities' spending needs and revenue: macroeconomic concerns

*Macro-economic control measures should take into account the importance of local authorities' financial autonomy*

Central government needs to consider the effect of local authorities' activity on the national economy. In implementing a coherent national economic policy, central authorities need to control local authorities' aggregate expenditure. This need may vary from country to country by the degree of importance of local authorities in the national economy, their share of the public budget and whether there is a clear national macro-economic priority.

Macroeconomic control should be balanced against values such as local-self-government, decentralisation, local accountability, and democracy.

Control measures are generally represented by restrictions imposed on local authorities' financial freedom, budget procedure rules and supervision mechanisms. Moreover, an important control mechanism is the overall amount of public funds transferred to local and regional authorities. This amount should take account not only of the macroeconomic targets, but also of the local authorities' actual spending needs and potential resources.

*Control mechanisms should be set in consultation with the local authorities*

Central governments should establish consultative bodies in which control measures can be discussed with representatives of local authorities. As a minimum, central governments should inform local authorities on the control mechanisms and take account of their opinion.

Estimating local spending needs and revenue for macroeconomic control purposes is difficult, but may be made more accurate if discussed with representatives of local authorities. If control measures are discussed with representatives of local authorities, a smoother implementation process may be achieved.

#### **4.2. Guidelines on the estimation by central authorities of local authorities' spending needs and revenue: the administration of grants**

##### *The administration of grants requires resources at the central government level*

Intergovernmental grants may serve a range of purposes for the central government. But calculating the correct size of grants and establishing proper formulae for distributing grants are tasks which demand considerable resources. Local authorities' own resources should be weighted against the size of the grant. If grants are used to any great extent, central governments should carefully consider how to arrange their proper administration. The cooperation of several agencies may be necessary for the establishment and maintenance of necessary statistics, the calculation and distribution of grants, and the practical disbursement of grants. Special coordinating units responsible for the administration of intergovernmental grants may be necessary.

##### *The formulae for calculating and distributing grants should be transparent, stable, fair and objective*

General grants should normally be administered by the use of formulae. Formulae should be transparent in order to be widely understood and, further, relatively stable in order to allow a reasonable degree of predictability for local authorities. At the same time, formulae should be as fair as possible. Finally, care should be taken that individual local authorities cannot influence the amount of general grant they receive, unless this is the explicit purpose of the grant system. This means that general grants should normally be calculated and distributed according to objective indicators. The design of general grant systems should pay respect to these considerations, although difficult trade-offs are likely to be involved.

#### **4.3. Guidelines on local authorities' own estimation of spending needs and revenue: preparation of local budgets**

##### *Budgetary rules are important but they must leave room for manoeuvre for local authorities*

Budgeting is a core activity for all public authorities. In respect of local self-government, binding rules set by the central government should be limited to what correct application of local democracy, macroeconomic control, public planning, and statistical purposes necessitate.

Budget procedures are not neutral for budget decisions. Procedural questions are basically political questions and should be treated as such by local authorities. They should be actively debated by the local council and periodically evaluated.

***Politicians and administrators in local authorities should have opportunities for budget training***

Given the importance of budgeting, local politicians and administrators should have opportunities for receiving training in the making of budgets. The creation of such opportunities may take several forms such as in-house seminars in individual local authorities, formal courses at training institutions, or conferences arranged for this purpose. The creation of these opportunities should be encouraged by the national government. The associations of local authorities may also play a role in this respect.

***Rules for implementing local budgets should be formulated in order to maximise efficient budgetary behaviour***

Budget rules are incentives for budgetary behaviour. If properly specified, budget rules may induce efficient use of limited resources. Local authorities should be able to further develop budget rules in order to adapt them to their specific situation.

***The impact of relations with the private sector must be carefully assessed***

From the point of view of resources, those derived from the participation in economic activities may vary greatly from one year to another. From the point of view of expenditure, the payment of guarantees granted by a local authority to a company may destabilise its finance. Moreover, local authorities may be obliged to improve the cash position of a company partly owned by them, when the company has a strategic importance and faces financial difficulties; this may be done either by grants or by capital increase. It is therefore necessary to:

- i. carefully assess the results of the relations between local and regional authorities and the private sector by following assessment rules and procedures used by the private sector and
- ii. have regard to competition and other legal requirements.



## **CASE STUDIES**



## ALBANIA

The methods used for estimating the spending needs and income of local authorities belonging to the two tiers of local authorities, i.e. municipalities, communes, and regional councils in Albania, are the same as those used when preparing the state budget. They are based on an institutional act relating to the state budget, on the law governing the current year's budget, and on other decisions and instructions supporting those laws.

Every year, the Ministry of Finance issues an instruction for the following year's budget. This sets down compulsory rules and procedures to be implemented by each category of budgetary institution, including local authorities, which receive income from the state budget.

Every year when planning the budget, central government takes into account the growth in inflation and changes in the price index.

Currently the budget (including estimating spending needs and income) is planned using the "line-item" system, or the budgetary system by which costs are estimated according to their economic nature and by "incremental budgeting", based on results from the previous year, but modifying these according to increased inflation and changes in the price index.

When estimating staff costs and social insurance payments, the evaluation is based on the actual number of employees, their respective salaries according to their positions, wage increments, working hours and difficulties. Any fiscal disparities will be modified according to the wage index in the following year. Expenditure on social and health insurance is evaluated by taking into account wages and the selected social and health insurance.

The methods that are used to estimate total income are implemented according to instructions given by the Ministry of Finance and the Ministry of Local Government. The budgetary plan can be modified and there is always a reserve fund available in case any mistakes occur when planning the budget, or any unpredictable situations arise.

For the time being, other budgetary systems such as programme budgeting, performance budgeting (selecting key objectives) and zero-based budgeting cannot be used in Albania. This is because those systems require time and necessitate considerable resources; therefore they are used in more developed countries for analysing budgets over a period of time, usually blocks of three to five years.

In Albania in 1999 a new method for providing local authorities with an operative budget in the form of a grant was implemented. This grant is the result of the difference between local authority income and expenditure. It is awarded to local authorities by central government in the form of a donation. The grant is to be used to fund activities in conformity with certain policies which have been set down by the particular council. It is not possible to use it for other activities without paying interest on it.

Although the state budget has an important place in the composition of local authorities' total budgets, the most important way of estimating income is according to the resources of the organs of local authorities, because this allows for the establishment of their regional economic policies. The percentage of income derived from local authorities' own resources varies from one local authority to another; this is because the way in which resources are "exploited" differs between authorities. Equally, local authorities' financial resources vary depending on the specific situation in each authority.

In the municipality of Tirana local authority own income accounts for 18.2 per cent of the total budget, in the municipality of Durres it accounts for 11.5 per cent, in Pogradec it accounts for 3.9 per cent, and in the communes with low socio-economic levels of development, the state transfers make up 100 per cent of the local budget. Local budgets' own income consists of:

- local taxes and levies approved by the Albanian Parliament;
- temporary taxes (these initiatives are decided upon by the local authority);
- other non fiscal income that belongs by law to the local government.

Income from local authorities' own resources allows local authorities to manage their finances properly for the benefit of the community on whose behalf they perform their activities. In order to improve management, it is necessary to build on those resources and to accurately forecast future expenditure. For the levies and taxes prescribed by law, planning is easy because the ratio of tax has been prescribed by law. In order to calculate temporary taxes and other sources of income that local authorities receive from the different services they perform in the community, calculations are carried out according to the number of taxes imposed by the appropriate council, the number of people who are taxed and the number of services performed by the local government.

The use of these estimation methods is the same for all local authorities.

The central authorities, in this case the Ministry of Finance, exercise considerable discretion in the application of the results of accounting formulae. This ministry also gives instructions as to how these formulae can be implemented.

Although estimation methods for expenditure and income are constantly improving there is a difference between local authority spending needs for implementing activities which will benefit the community where the local authority operates, and the income it actually has, from its own income or the grants it receives from central government. For 1999, there are some municipalities and communes that are still lacking funds to cover 12-20 per cent of their activities. An important role is also played by the failure of local authorities to raise the necessary income.

To compensate for those differences the Ministry of Local Government and the Ministry of Finance transfer funds and provide supplementary grants.

Estimation methods for expenditure and income have changed over this period, as methods of calculation allow for greater local authority independence. Modifications made over this period are valuable and transparent with regard to local organs.

In comparison with the attention paid to forecasting income, local authorities pay less attention to forecasting expenditure. Estimating expenditure is a very complex process. In general, there are some aspects about which local authorities can be more certain, such as:

- financial quotations approved for budgetary profits;
- payments for contracts;
- the cost of debts.

Despite this, when estimating expenditure an analytical review should be carried out of all the activities and services. Local authorities should consider:

- services' needs, levels of activity, policies and procedures;
- demographic changes;
- increases in costs owing to inflation;
- the extent to which objectives are met for each activity.
- the way in which services are affected by economic changes in the health service, social profits and unemployment benefit.

All these factors as well as other ones are analysed by local authorities using measurable indicators. Every item of cost is considered.

The classification of expenditure according to each item indicates the nature of the goods and that of the services purchased. Items of expenditure are sub-divided into the budgetary divisions that are called articles. The following units of articles are most often included in budgets:

- wages and other profits;
- social security contributions for local civil servants;
- contractual services;
- materials and other furniture;
- machinery and equipment;
- financial obligations.

These categories are themselves sub-divided, and there are sometimes further sub-divisions within these. The aim of this system is to supervise resources that are required by every level of government.

Institutions and budgetary enterprises that perform paid services, despite their requirements being allowed for in the budget also make provisional incomes for the next year. This is a very complex process and is based on a series of economic suppositions and methods.

Municipalities with populations ranging from 30 000 to 80 000 people, and communes with more than 10 000 inhabitants are more at risk from the danger of assessment mistakes than other local authorities.

Local administrative authorities apply uniform methods for estimating expenditure and income in the light of their annual budget preparation, according to the laws, government decisions, and instructions prepared for this purpose.



## **BELGIUM**

### **I. Federal government grants**

The federal government does not award grants to municipalities, with the exception of a special grant to the city of Brussels on account of its status as capital of the kingdom. The basic amount of the grant, which was set at BEF 2.56 million for 1989, is adjusted annually to the consumer price index. In 1998, the amount of this grant was BEF 3.16 million.

The grant is paid in quarterly instalments, with an adjustment the following year when the definitive amount of the grant is known. Since the adjustment coefficient for one year is not known until the following year, the first three quarterly instalments have, since 1994, been limited to one quarter of the previous year's final grant, with the fourth being reassessed when the budget is reviewed.

In some years, the sum of the instalments is higher than the definitive amount of the grant (as a result of low inflation, poor estimates, etc). In that event, the excess is deducted from the grant for the following year, as occurred in 1991, 1992, 1994 and 1997.

The federal government also awards specific grants, such as:

- a contribution towards the renovation of Baudouin stadium in preparation for Euro 2000;
- a contribution to assist the running of municipal police forces.

The Belgian Municipalities Act has compelled municipalities to balance their budgets since the 1988 financial year.

### **II. Transfers from the Brussels capital region to the municipalities**

The Brussels capital region provides three types of financial support to its municipalities:

- the general grant to municipalities; it was created by an order adopted by the Brussels Capital regional government in 1998; this is one of the most substantial items of the regional expenditure budget: in the initial budget for 1999, the grant was allocated an appropriation of BEF 7 597 500 000, representing 11 per cent of the Brussels capital region's initial expenditure budget for 1999;
- the Brussels Regional Refinancing Fund for Municipal Accounts;
- subsidies and other grants.

## **A. General grant to the Brussels municipalities**

Before the general grant is divided among the nineteen municipalities of the Brussels conurbation, 5 per cent of it is deducted and allocated to the Joint Community Commission [the body representing the French and Flemish Communities in the Brussels capital region]. The Commission distributes this sum among the nineteen municipalities according to its own criteria. The balance is split into three packages:

- basic grant, 8 per cent
- revenue-based grant, 42 per cent
- expenditure-based grant, 50 per cent

As a general rule, the grants must be allocated objectively. For that reason the relevant order stipulates not only the criteria for allocation but also the reference years and sources of the funding. The reference year is normally the preceding year, and the sources are set out in Article 20 of the order.

### **1. Allocation of the basic grant**

- 80 per cent of the basic grant is allocated according to population numbers;
- 20 per cent is allocated according to total land area.

### **2. Allocation of the revenue-based grant**

The revenue-based grant is allocated in two parts, which account respectively for two thirds and one third of the package.

The first part (two-thirds of the package) is allocated among those municipalities where the average per capita revenue (calculated for the group of municipalities) from the municipal tax levied on top of personal income tax (IPP) is less than a reference amount equivalent to 150 per cent of the corresponding figure for all the municipalities.

The share for each municipality is calculated according to the difference between its average per capita revenue from this source and the reference amount, multiplied by the number of inhabitants.

The second part (the remaining third) is shared among those municipalities where the average per capita revenue (calculated for the group of municipalities) from the municipal supplement levied with property tax (PRI) is less than a reference amount equal to 150 per cent of the corresponding figure for all the municipalities.

The basis for calculating the allocation is the difference between each municipality's average per capita revenue from this source and the reference amount.

### **3. Allocation of the expenditure-based grant**

The expenditure-based grant is divided into five parts each of which is shared among the municipalities according to a specific criterion.

The first part (10 per cent of the package) is allocated as follows:

- 50 per cent according to levels of enrolment in nursery, primary and secondary schools and non-university higher education run by the municipalities;
- 25 per cent according to levels of enrolment in community education and part-time arts education run by the municipalities;
- 12.5 per cent according to levels of enrolment in nursery, primary and secondary schools and non-university higher education run by other authorities within the municipality;
- 12.5 per cent according to the capacity of the municipal day nurseries.

The second part (30 per cent of the package) is allocated among those municipalities whose population density, calculated as the number of persons per hectare, is above the regional average. Each municipality's share is proportionate to the ratio between its population density and the average, adjusted by a weighting factor.

The third part of the package (20 per cent) is allocated according to the numbers of people unemployed for more than a year.

The fourth part (also 20 per cent) is shared according to the numbers of persons in receipt of minimum income security benefit and statutory benefits from local social insurance funds.

The remaining 20 per cent of the package (see Article 15) is allocated according to the land area of each municipality earmarked for additional housing development under the regional development plan.

### **4. Scaling and guaranteed levels of grant**

The threshold system of categorising the municipalities that produced sudden hikes and cuts in grant levels has been replaced since 1998 by scaling, under which, in principle, no municipalities are excluded: this is one of the methods used to ensure a degree of stability in each municipality's level of allocation. The scaling system will operate until 2002.

In addition, no municipality may receive less than BEF 2400 (€59.5) per capita.

### **5. Conurbation levy**

The order continues to stipulate that 3 per cent of the municipalities' allocations from the general grant shall be levied to finance expenditure at conurbation level.

Although there is no longer a conurbation authority, its responsibilities having been taken over by the Brussels capital region, the regional council and the government decided to maintain the levy as a reflection of the fact that the functions carried out at conurbation level (in particular public cleansing, fire prevention and control and the emergency medical service) originated as municipal tasks and that, logically, the municipalities should continue to help pay for them.

## 6. *Implementation of the order*

The Government is required to allocate the general grant by 1 November each year so that the balance of each municipality's share may be paid by 31 December.

### Grants to municipalities of Brussels capital region

Year	General grant	Special social welfare fund	City of Brussels fund	
			Regional fund	National fund
1989	4 042 282 794	0	914 856 103	2 565 400 000
1990	4 114 039 053	0	827 688 546	2 653 900 000
1991	5 136 907 217	0	855 618 409	2 739 100 000
1992	5 099 107 217	299 498 049	735 219 233	2 805 700 000
1993	6 319 304 997 <sup>a</sup>	332 595 000	150 000 000 <sup>b</sup>	2 882 900 000
1994	6 384 000 000 <sup>a</sup>	336 000 000	150 000 000 <sup>b</sup>	2 951 500 000
1995	6 511 680 000 <sup>a</sup>	342 720 000	153 000 000 <sup>b</sup>	2 994 800 000
1996	6 614 513 200 <sup>a</sup>	140 000 000 <sup>b</sup>	155 386 800 <sup>b</sup>	3 056 500 000
1997	6 918 056 500 <sup>a</sup>	356 213 500	159 030 000 <sup>b</sup>	3 106 300 000
1998	7 076 550 000 <sup>a</sup>	372 450 000	0	3 157 000 000

a. Including Brussels

b. Supplementary fund

## B. **Brussels Regional Refinancing Fund for municipal accounts**

This fund is an exceptional measure to support municipalities that are in financial difficulty and/or are unable to repay their past debts in full. Not all municipalities are supported by the fund. Support is provided on the basis of an agreement.

The worsening financial situation in municipalities compels the national government, followed by the regional government, to raise loans for the benefit of the municipalities concerned.

### 1. *Financing*

The fund is financed by loans and receives an annual grant (set at BEF 2.3 billion in 1995).

In repaying the Hatry loans (municipal loans raised in 1983 and 1984), municipalities are required to contribute 60 per cent of the capital due, the balance being covered by the fund.

### 2. *Operational arrangements*

The fund may:

- assume municipalities' liabilities (repaying the balance of the Hatry loans);
- lend money;
- issue securities (an important function in tendering procedures).

Its assistance is subject to the signing of an agreement laying down each party's obligations.

Municipalities must abide by the following general conditions:

- submit a financial plan in support of their application for assistance, guaranteeing a balanced budget;
- use the loans granted by the fund or obtained through securities issued by the fund exclusively for the purpose for which they were granted;
- undertake to repay the loans that have been granted if the executive rules that the municipalities are failing to honour their commitments.

Each agreement authorises deduction of repayments to the fund from the municipalities' grant. The fund also appoints a regional inspector to monitor the municipalities' compliance with the obligations they have entered into. The executive can also suspend or alter the rate of the fund's payments.

### **C. Subsidies and other grants**

The region awards subsidies to municipalities in areas within its field of competence (such as security, public cleanliness, *contrats de quartier* (neighbourhood rehabilitation projects), urban renewal, housing and urban development).

#### **1. Subsidies allocated to all municipalities according to a scale**

The legal basis for these subsidies is the 1998 order on the allocation of subsidies to encourage investment in open spaces, buildings and sanitation within the territory of the Brussels capital region, in the public interest.

The three-year investment grant is distributed among all the municipalities in proportion to their share of the general grant to municipalities (Part A) for the year preceding the start of each three-year period.

#### **2. Subsidies granted to certain municipalities**

There are no general criteria for granting these subsidies; they vary according to the purpose of the agreement. The most frequently used criteria are: population, population density, surface area, kilometres of roads and priority renovation areas.

#### **3. Subsidies not specifically intended for municipalities**

##### **a. Monuments and sites**

Appropriations earmarked for monument and site conservation projects are chiefly intended to subsidise maintenance and repair work on listed buildings, some of which are the property of the local authorities.

In 1999, local authorities were allocated BEF 241 400 000 in authorised appropriations and BEF 177 600 000 in commitment appropriations, out of total appropriations of BEF 350 500 000 and BEF 233 800 000 respectively.

*b. Spatial planning*

These subsidies are intended for buildings, some of which are the property of local authorities, as part of the general spatial planning budget. The appropriations earmarked for spatial planning in the initial 1999 regional budget were as follows:

- BEF 669 700 000 (uncommitted appropriations);
- BEF 972 000 000 (authorised appropriations);
- BEF 687 500 000 (commitment appropriations);
- BEF 148 200 000 (variable authorised appropriations);
- BEF 82 300 000 (variable commitment appropriations).

### **III. Grants and methods of estimation in the Flemish community**

#### **A. Use of estimation methods in the preparation of the Flemish Community budget**

In the Flemish Community budget, provision is made for general and specific grants for local authorities. These grants are calculated using methods laid down by decree or order. Authorities therefore have no margin of discretion in applying criteria or calculation methods.

The main general grants are:

- the Municipalities Fund;
- the Capital Investment Fund;
- the Social Impulse Fund.

The main specific grant is for the upkeep and improvement of the public sewerage system.

#### **B. Use of estimation methods for apportioning financial support among local authorities**

The methods used to estimate local authorities' revenue for the purpose of apportioning general and specific grants are laid down by decree.

For more detailed information on methods for calculating the Municipalities Fund and the Investment Fund, see the publication "Limitations of local taxation, financial equalisation and methods for calculating general grants", pages 67 and 68.

With regard to the Social Impulse Fund, the sum to be apportioned is set annually as a fixed amount. The specific grant for sewerage work amounts to 50 per cent of expenditure.

**C. Use of estimation methods in the preparation of local authorities' annual budgets****1. Expenditure**

Municipalities estimate their expenditure on the basis of data supplied by the various local government departments.

Each year, the supervisory authority, in a circular issuing instructions for the preparation of municipal budgets, fixes the authorised percentage increase for staff and operational expenditure, taking account of changes in the cost of living.

The level of expenditure on debt repayment depends on the investments that are envisaged.

**2. Revenue**

Municipalities estimate their revenue on the basis of the taxes and fees paid to them and the prices charged for the provision of certain services.

The municipalities are informed by the supervisory authority of the proportion they have been allocated from each of the funds.



## BULGARIA

### Introduction

In Bulgaria the three levels of administrative organisation are central government, the regions and the municipalities.

The regions (*oblasti*) (of which there were nine prior to 1999 and which now number twenty-eight) are responsible for implementing regional policy and state policy. The governors, as representatives of the state in the regions (appointed by the Cabinet), are responsible for protecting the nation's interests, harmonising national and local interests, supervising administrative matters and ensuring compliance with the law in their regions.

The basic local administrative entities are the municipalities (*obchtini*) (of which there are currently 262). This is the level at which local self-government takes place. The municipalities are sub-divided into boroughs or districts (Greater Sofia, for example, has twenty-four). The organ of local self-government is the municipal council, and the executive authority is the mayor. Councillors and mayors are elected by the municipal population by direct universal suffrage for a four-year term.

Over the past ten years public financing, which is at the heart of relations between central and local government, has changed considerably with the adoption of a number of new laws: the Constitution of the Republic of Bulgaria, the law on local self-government and local authorities, the local taxation law, the State Budget Adjustment Act, the Municipal Budgets Act, etc.

Each year the National Assembly approves a State Budget Act. The section on the municipalities specifies only the amount of the financial transfer from central government. Municipal budgets therefore no longer come under approval of the State Budget Act.

The local authority budget process is governed by the new Municipal Budgets Act passed in 1998, which lays down the rules and standards to be observed by local authorities in budget preparation. It lays down the procedures for the various stages local budgets must go through (preparation, adoption, execution, annual presentation of accounts), together with the powers and responsibilities of local authorities in the matter. It provided the legal framework for reform of local-authority finance, consisting in giving local authorities greater powers to apportion the resources at their disposal and in striking a balance between greater financial autonomy at the local level and structural reorganisation of the public services and the economy in general. The act is consistent with the principles of the European Charter of Local Self-Government.

Although local authorities already enjoy a larger measure of financial autonomy, they still depend to a certain extent on funds transferred from central government and are accordingly subject to supervision in this respect.

In some cases, for example, when revenue at central government level is less than expected, the sums allocated to the municipalities are also reduced, leading to a corresponding decrease in local authority receipts.

The methods used to estimate local-authority spending and income requirements for the purposes of the annual state budget are similar to those used to calculate revenue and expenditure in preparing the consolidated state budget.

They take into account the main macroeconomic indicators for the financial year: gross domestic product (GDP), inflation, base lending rate, exchange rate, income policy and so on.

The purpose of the complex reforms being implemented in almost every field is to prepare for Bulgarian membership of the European Union. In the specific context of the present study, the aim of the reforms is to take the macroeconomic indicators for the relevant financial year into account in the preparation of the state budget and particularly its section on municipal finance.

## **A. Methods used to estimate local authority spending needs**

### **I. Methods used for the purposes of the state budget**

The first step is to estimate those items of expenditure which will remain constant during the financial year, in particular direct municipal responsibilities such as staff salaries, insurance contributions and operating costs, taking macroeconomic indicators into account.

An estimate is then made for all the new obligations incumbent on municipalities as a result of new laws and/or orders adopted by the National Assembly, and this is added to the projected expenditure.

The calculation methods fall into two categories: mandatory (mathematical) and optional (expert appraisal).

Mathematical methods are used to calculate the cost of the salaries and social contributions paid by local authorities and their public establishments. Here, the number of staff is multiplied by the mean salaries of different categories of staff and appropriate provision is made in the government order on salaries in the public service sector.

Experts are used when there is no legislation or regulation to serve as a reference, or when a new power is due to be transferred to the municipalities and the transfer will take place when the State Budget Act is in preparation.

Generally speaking the former (mandatory or mathematical) calculation method, generally used by virtue of an existing legal instrument, is easier to apply and defend than the second method (expert appraisal), where overestimates or underestimates are possible. Where there is high inflation, however, both methods give unsatisfactory results.

## **II. Methods used to calculate sums for distribution to local authorities**

The difference between local authorities' own income and their projected expenditure for a given financial year is the amount required in order for the local authorities to function correctly. Article 141(3) of the Bulgarian Constitution states: "The state shall help the municipalities to function properly by budgetary or other means."

The appropriations to the municipalities (once their needs have been estimated for the purposes of the consolidated state budget) are shared out among the municipalities on the basis of a "method for determining the budgetary relations between the municipalities and the Republic" which is approved every year when the state budget is adopted. The method is governed by the Municipal Budgets Act (Article 35) and the law on local self-government and local authorities (Article 52), and its purpose is to lay down objective criteria of resource distribution.

The method used to calculate financial transfers between municipalities and the state for 1999 was based on the following formula:

$$- \quad C = C1 + C2 + C3 + C4 + C5 + C6 + C7$$

where:

- C is the transfers from the state budget minus payments into the state budget;
- C1 is 50 per cent of that amount, fixed on 31 August in the annual plan of central government appropriations to the municipalities under the State Budget Adjustment Act for the previous financial year;
- C2 is the total sum transferred by the state and shared out among the municipalities on the basis of objective criteria.

The size of the appropriation which each municipality receives is determined by applying weighted objective criteria to the sum available for distribution.

Objective criteria	Weighting
Number of patients registered with regional hospital	14.2
Number of patients registered with municipal hospital	6.8
Number of patients registered with maternity and gynaecological hospital	0.6
Number of patients registered with oncology dispensary	1.2
Number of patients registered with tuberculosis dispensary	0.3
Places in maternity and children's home	1.2
Number of veterans	5.0
Places in welfare homes	6.9
Number of people receiving social assistance in their homes	0.5
Number of people assisted under the Welfare Act	8.1
Number of children whose parents are unemployed	1.8
Number of single, unemployed mothers receiving assistance under the Births Promotion Act	8.8
Number of funerals	0.8
Number of reading and cultural centres	0.7
Number of museums, art galleries and libraries of regional significance	0.3
Number of pupils in secondary schools	6.6
Number of classes in secondary schools	7.9
Number of pupils in boarding schools	0.1
Number of children in day-care establishments and kindergartens	3.0
Number of groups of children in day-care establishments and kindergartens	3.1
Number of public tutors	0.1
Population	10.3
Number of people in services	1.7
Number of geographical sub-divisions in the municipality	4.7
Area of the municipality in square kilometres	3.2
Number of housing units in the municipality	2.1

The sum allocated to each municipality is calculated by relating its scores for the objective criteria at local level to the weightings for the same criteria at national level.

- C3 is the income-ceiling adjustment (ICA)

The following formula is used:

$$ICA = (PI - UIL) * P$$

where:

- PI is predicted income, i.e. the ratio, for the financial year, of the municipality's general allocation from the state plus its own income to the population of the municipality based on figures supplied by the registry office.
- UIL is the upper income limit.
- LIL is the lower income limit.

Municipalities are broken down into five groups according to their population (Sofia forming a category of its own). Upper and lower income limits for each of these groups are as follows (in Bulgarian levs):

<b>Municipality groups by population</b>	<b>LIL</b>	<b>UIL</b>
Municipality of Sofia	204 035	204 035
Chief towns	132 115	176 141
Fewer than 5 000 inhabitants	103 285	177 427
From 5 000 to 50 000 inhabitants	95 380	176 546
From 50 000 to 100 000 inhabitants	112 130	143 864

- P is the population of the municipality
- C4 is the equalisation factor used to make a further adjustment of central budget appropriations to the municipalities.

This factor is applied to those municipalities whose planned budget for the financial year is below or above the growth limit calculated non-algebraically (the median method).

- C5 is the cost of contributions under the Health Insurance Act.
- C6 is the special allocation from the state budget to cover 50 per cent of the welfare benefits available under the Welfare Act and the Births Promotion Act.
- C7 is the special allocation to the municipalities to finance performance of certain functions on behalf of the state (such as investment in infrastructure).

The state budget can transfer additional funds to the municipalities (in the form of special appropriations) in the event of major natural disaster (earthquakes or floods, for example) or technological disaster.

The size of the allocations and subsidies paid to each municipality and the sum each municipality must pay into the state budget are made public in the annual State Budget Act.

The method used to determine the state's contributions to municipal finances raises certain administrative problems because of its complexity, based as it is on a broad spectrum of budgetary indicators, including equalisation factors (C3 and C4).

In present circumstances (falling inflation, improved tax collection and an increase in municipalities' own income) the apportionment of funds among municipalities bore the following factors in mind:

- per capita income in each group of municipalities;
- the increase in the provisional budget for 1999 compared with 1998 (rather than the increase in the appropriation, as previously).

Having prepared the draft budget for 1999, the Ministry of Finance organised meetings with the municipalities in each region to discuss the initial apportionment between municipalities. Following these meetings, some adjustments had to be made to the own income projections and the objective criteria for some municipalities, with corresponding changes in the municipal appropriations section of the budget.

Broadly speaking, the number of criteria and their relative constancy depend on:

- a. their statistical approval;
- b. their pertinence to a majority of municipalities;
- c. their social importance;
- d. political stability;
- e. the feasibility of reforms.

### **III. Additional information concerning the estimation methods described in I and II above**

The shortcomings of each estimation method become partly apparent in the course of the financial year and fully apparent at the close of the year in the discrepancy between projected spending and real spending. Only after the adverse consequences of the discrepancy have been analysed can a decision be taken to correct any aspect of established methods. For example, weaknesses in the method of calculating social payments led to social unrest in 1998, so this was corrected in 1999 with a new “special appropriation”.

The state budget must also make allowance for malfunctions due to the economic reorganisation taking place. Where necessary the central budget can be used to help municipalities in serious economic difficulties.

### **IV. Estimation of spending needs in preparation of annual local authority budgets**

In the current, relatively stable economic context, spending needs have become easier for local authorities to forecast when preparing their annual budgets.

On the spending side local authorities must make adequate provision for:

- health care, social work, education, culture, sport and tourism;
- public works;
- municipal heritage maintenance and management;
- acquisition of durable and non-durable assets;
- environmental protection;
- implementation of international projects in which the municipality is involved, etc.

Municipalities are not responsible for financing activities for which no provision was made in their annual budgets.

The broad principles that guide municipalities in preparing their budgets are compliance with the law, public utility, efficiency, efficacy, transparency and the interests of the local population.

The National Association of Municipalities of the Republic of Bulgaria is consulted on questions relating to local authority budgets before the state budget is submitted to the Cabinet and the National Assembly.

## **B. Methods used to estimate local authority income**

### **I. Methods used for the purposes of the state budget**

The receipts side of local authority budgets is composed of own income plus resources allocated by the state, which include appropriations (general and special) and subsidies. The sources of own income are:

#### **1. Local taxes (statutory):**

- **property tax:** the rate is 0.15 per cent of property's estimated value. The tax is collected by the local branch of the central tax authority and treated as municipal revenue. Some buildings are exempt from property tax: public (state and municipal) buildings, buildings of diplomatic delegations, reading and cultural centres, museums and art galleries, Bulgarian Red Cross buildings, independent higher-education establishments, agricultural buildings and churches.
- **inheritance tax:** this is payable by Bulgarian and foreign nationals who, by law or by legacy, inherit property located inside or outside Bulgaria. The property (when not exempt from taxation) is valued in the national currency (the Bulgarian lev); foreign currency and precious metals are re-valued using the official exchange rate; stocks and shares are valued at their market value; vehicles are valued according to their insurance value and all other items according to their market value. Property bequeathed to the state, a municipality, the Bulgarian Red Cross or reading and cultural centres and the property of those who die for the Republic of Bulgaria in the course of duty or who perish in natural or technological disasters are exempt from the tax.

- **donation tax:** this tax is levied on property acquired as a gift. The rate is based on the value of the property in national currency at the time of the gift and varies from case to case (depending on whether the gift was between family members, for example). The tax is not levied on property gifted to the state, a municipality, Bulgarian public health, educational, cultural or scientific organisations; welfare centres and maternity and child care centres; the Bulgarian Red Cross; reading and cultural centres; national organisations for the disabled. Also exempt are donations to humanitarian cases, to emergency funds in the event of natural disasters and towards protection or rescue of the historic and cultural heritage.
- **vehicle tax:** this is paid by all vehicle owners. It is collected by the tax authorities of the owner's usual place of residence. It is payable on all registered vehicles which use the national road network, boats registered at Bulgarian ports, aircraft owned by Bulgarian nationals or legal entities, etc.

**2. Local service charges:**

- household refuse disposal;
- use of markets and fairs;
- use of nurseries;
- use of tourism facilities;
- operation of quarries;
- use of administrative and technical services, etc.

**3. Licensing fees**

**4. Fines and penalties:**

- collected on the basis of local by-laws.

**5. Rents**

The sums transferred to the municipalities by the state are laid down by act of law.

Property tax is collected by local branches of the central tax authorities and local service charges by the local authorities themselves.

## **II. Methods used to estimate receipts for the purpose of allocating funding to local authorities**

The sums paid by the state to the municipalities play an important part in the running of local authorities and in public finance in general.

Examples are:

- the general allocation (based on the system of weighted objective criteria);
- special allocations;
- subsidies (sums allocated to municipalities on certain conditions).

Where necessary, the state makes other contributions to the municipalities from the national budget.

One of the major challenges of tax policy at the local level consists in developing a system of measures to cope with serious unforeseen malfunctions occurring in financial flows for various reasons and making it impossible for municipalities to fulfil their budget commitments because their income is lower than expected. As a stopgap measure the state may grant loans at zero interest, which must be repaid by the end of the financial year (which, in Bulgaria, coincides with the calendar year).

These, in outline, are the different types of financial input from the state to local authority finances.

## **III. Additional information concerning the estimation methods described in I and II above**

Central financing of local authorities may be analysed in terms of the following aims:

- sharing by the different levels of government of responsibilities (or obligations) and therefore also of the resources for discharging them;
- setting up an equalisation fund to offset differences in local authorities' ability to increase their revenue. The fund would guarantee that essential expenditure was covered, strengthen solidarity with the less well-off municipalities, redistribute wealth equitably amongst taxpayers and ensure that a minimum level of services was provided nationwide.

At present equalisation is achieved via the general allocation to the municipalities in keeping with the priorities laid down in the annual State Budget Act (public welfare, health and educational provision, free medication for certain categories of illness, etc).

#### IV. Estimation of receipts in the preparation of annual local authority budgets

All receipts in annual local authority budgets, with the exception of special allocations and subsidies from the government, are for municipalities to use as they see fit to cover all the planned expenditure in the annual municipal budget adopted by the municipal council.

Municipal spending policy has managed to overcome the inertia of the old approaches and is already bearing fruit in the setting up of a modern budgetary system. After a period of substantial decline in spending, Bulgaria's municipalities have done their utmost to rationalise their spending arrangements and set their priorities in line with the current situation and the prospects for economic development.

The plan is now to have municipalities draw up their budget projections triennially and frame local development strategies that must tie in with the government's programme budget, the "Medium-term macroeconomic framework".

#### V. Financial data concerning different types of municipalities, as used – in accordance with the method for determining budgetary relations between municipalities and central government – in the preparation of municipal budgets for 1999

##### 1. Municipality of Sofia (population: 1 288 575) Group one municipality (in millions of Bulgarian levs)

Year		1997		1998		
Type		Estimated	Actual	Projected	Estimated	Actual
Expenditure	Mandatory	59 096.1	60 679.1	88 311.8	97 465.9	96 576.3
	Optional	25 646.2	28 487.3	35 374.7	42 892.9	48 340.5
	Investment	24 656.7	23 762.9	55 197.8	82 142.1	81 780.9
	Operational	50 848.5	61 434.6	123 005.8	140 238.9	123 627.7
	Total	160 247.5	174 363.9	301 890.1	362 739.8	350 325.4
Receipts	Own taxes	38 981.6	46 893.9	89 599.5	110 356.4	112 301.7
	Shared taxes	64 109.9	76 636.5	99 254.3	106 008.0	112 583.9
	Licence and users' fees	9 037.6	11 040.9	13 451.0	19 424.9	21 215.9
	Grants	16 592.8	16 592.8	24 651.1	32 839.3	32 839.3
	Subsidies	19 250.0	18 800.0	19 500.0	47 188.6	47 188.6
	Other receipts	12 275.6	9 767.9	55 434.2	46 922.6	24 196.0
	Total	160 247.5	179 732.0	301 890.1	362 739.8	350 325.4

**2. Municipality of Ruse (population 199 740) Group two municipality**  
(in millions of Bulgarian levs)

Year		1997		1998		
Type		Estimated	Actual	Projected	Estimated	Actual
Expenditure	Mandatory	10 364.2	10 364.2	15 849.5	17 713.4	16 532.3
	Optional	76.6	76.6	366.8	323.6	323.2
	Investment	2 027.3	2 027.3	6 400.0	7 472.3	4 820.6
	Operational	10 242.7	10 242.7	18 609.4	19 598.1	16 547.5
	Total	22 710.8	22 710.8	41 225.7	45 107.4	38 223.6
Receipts	Own taxes	6 081.6	6 081.6	13 920.1	13 929.1	11 054.0
	Shared taxes	7 493.8	7 493.8	14 303.8	14 316.0	10 393.1
	Licence and users' fees	1 766.2	1 766.2	2 908.4	2 917.3	3 161.3
	Grants	5 416.7	5 416.7	7 407.5	9 380.2	9 380.2
	Subsidies	484.0	484.0	529.9	699.9	699.9
	Other receipts	1 614.2	1 614.2	2 156.0	3 864.9	3 639.6
	Total	22 856.5	22 856.5	41 225.7	45 107.4	38 328.1

**3. Municipality of Petrich (population. 58 993) Group three municipality**  
(in millions of Bulgarian levs)

Year		1997		1998		
Type		Estimated	Actual	Projected	Estimated	Actual
Expenditure	Mandatory	10 364.2	10 364.2	15 849.5	17 713.4	16 532.3
	Optional	76.6	76.6	366.8	323.6	323.2
	Investment	2 027.3	2 027.3	6 400.0	7 472.3	4 820.6
	Operational	10 242.7	10 242.7	18 609.4	19 598.1	16 547.5
	Total	22 710.8	22 710.8	41 225.7	45 107.4	38 223.6
Receipts	Own taxes	6 081.6	6 081.6	13 920.1	13 929.1	11 054.0
	Shared taxes	7 493.8	7 493.8	14 303.8	14 316.0	10 393.1
	Licence and users' fees	1 766.2	1 766.2	2 908.4	2 917.3	3 161.3
	Grants	5 416.7	5 416.7	7 407.5	9 380.2	9 380.2
	Subsidies	4 84.0	484.0	529.9	699.9	699.9
	Other receipts	1 614.2	1 614.2	2 156.0	3 864.9	3 639.6
	Total	22 856.5	22 856.5	41 225.7	45 107.4	38 328.1

**4. Municipality of Miziya (population 10 371) Group four municipality**  
(in millions of Bulgarian levs)

Year		1997		1998		
Type		Estimated	Actual	Projected	Estimated	Actual
Expenditure	Mandatory	634.6	634.6	982.9	974.2	974.2
	Optional	17.5	17.5	252.6	176.7	176.7
	Investment	71.1	71.1	128.0	180.9	180.9
	Operational	251.9	251.9	286.5	296.0	296.0
	Total	975.1	975.1	1 650.0	1 627.8	1 627.8
Receipts	Own taxes	66.2	66.2	212.7	94.6	94.6
	Shared taxes	58.3	58.3	85.0	87.0	87.0
	Licence and users' fees	36.1	36.1	136.8	43.9	43.9
	Grants	721.3	721.3	1 065.8	1 255.5	1 255.5
	Subsidies	70.0	70.0	77.0	126.1	126.1
	Other receipts	23.2	23.2	72.7	20.7	20.7
	Total	975.1	975.1	1 650.0	1 627.8	1 627.8

**5. Municipality of Borino (population 4 591) Group five municipality**  
(in millions of Bulgarian levs)

Year		1997		1998		
Type		Estimated	Actual	Projected	Estimated	Actual
Expenditure	Mandatory	380.7	370.7	522.7	577.0	535.3
	Optional	7.4	7.2	5.5	7.6	8.0
	Investment	1.7	1.7	55.0	71.3	71.3
	Operational	170.3	126.7	194.7	201.7	166.8
	Total	560.1	506.3	778.9	857.6	781.4
Receipts	Own taxes	18.3	22.6	38.7	38.7	50.2
	Shared taxes	35.0	65.0	80.0	80.0	72.0
	Licence and users' fees	9.9	12.9	17.1	17.1	25.7
	Grants	406.7	406.7	513.1	562.2	562.2
	Subsidies	1.7	1.7	55.0	84.6	84.6
	Other receipts	88.5	7.9	75.0	75.0	19.3
	Total	560.1	516.8	778.9	857.6	814.0

## 6. Breakdown of the state budget

Types of budget (millions of levs)	1995	1996	1997
<b>Public sector</b>			
Receipts (including transfers)	353 774	646 243	6 304 887
Expenditure	403 775	929 096	6 487 378
Deficit	-50 001	-282 853	-182 491
<b>Central government 2.</b>			
Receipts (including transfers)	199 291	352 718	3 237 722
Expenditure	256 506	542 608	3 560 797
Deficit	-57 215	-189 890	-323 075
<b>Regions and municipalities 3.</b>			
Receipts (including transfers)	67 264	110 817	1 010 604
Expenditure	67 152	110 721	999 268
Deficit	112	96	11 336
<b>Social security and other extra-budgetary funds 4.</b>			
Receipts (including transfers)	138 039	249 907	2 424 363
Expenditure	1 309 371	3 429 661	22 951 151
Deficit	71 021	-930 591	1 292 481

Note: Receipts do not include those generated by privatisation

Types of budget (as a percentage of GDP)	1995	1996	1997
<b>Public sector</b>			
Receipts (including transfers)	40.2	37.0	36.9
Expenditure	45.9	53.1	37.9
Deficit	-5.7	-16.2	-1.1
<b>Central government</b>			
Receipts (including transfers)	22.6	20.2	18.9
Expenditure	29.1	31.0	20.8
Deficit	-6.5	-10.9	-1.9
<b>Regions and municipalities</b>			
Receipts (including transfers)	7.6	6.3	5.9
Expenditure	7.6	6.3	5.8
Deficit	0.0	0.0	0.1
<b>Social security and other extra-budgetary funds</b>			
Receipts (including transfers)	15.7	14.3	14.2
Expenditure	14.9	19.6	13.4
Deficit	0.8	-5.3	0.8
<b>Gross domestic product</b>	<b>880 322.0</b>	<b>1 748 701.0</b>	<b>17 103 433.0</b>

Transfers (in millions of levs)	1995		1996		1997	
	Allowances	Payments	Allowances	Payments	Allowances	Payments
2. Central government	390	50 430	1 521	65 678	9 354	358 448
3. Regions and municipalities	28 808	226	37 534	593	358 448	9 354
4. Social security and other extra-budgetary funds	21 622	164	28 144	928		
Total	50 820	50 820	67 199	67 199	367 802	367 802

### 7. *Distribution of expenditure under the state budget*

	Central government	Local authorities
<b>Education</b>	Universities	Primary and secondary schools Technical colleges Nurseries Kindergartens
<b>Health</b>	Hospitals run by institutes Specialised hospitals (cardiology, oncology, etc.)	Hospitals of regional significance Polyclinics
<b>Roads</b>	Motorway and trunk road maintenance	Minor road maintenance
<b>Transport</b>	Air transport Rail transport	Urban transport Inter-city public transport
<b>Municipal services</b>	Electricity and central heating	Mains water Central heating Street cleaning
<b>Housing construction</b>		Construction and maintenance of municipal housing
<b>Environment</b>	Protection of the environment at national level	Protection of the environment at regional and local level
<b>Defence</b>	Full responsibility	-
<b>Judicial authorities</b>	Full responsibility	-

## DENMARK

### Preamble

Spending needs can be assessed in two different ways:

- as estimated expenditure for a certain period, to be used for some budgetary purpose;
- as standardised expenditure, i.e. calculated expenditure for a municipality using standard expenditure figures per capita combined with the per capita figures of the municipality. That is, the expenditure of a standard municipality also taking into account the municipality's population figures (and other factors). The purpose of these calculations is most often to equalise spending needs.

In what follows, the first method of assessment will be taken as a point of reference. With this as a starting point three situations in which local authorities' spending and revenue is estimated will be expounded:

- the budgetary co-operation system (a system under which voluntary agreements are made between the state and all the local authorities);
- the preparation of the national budget;
- the preparation of local authorities' budgets.

They vary in terms of purpose and scope. Finally three case studies based on local authority findings will be presented.

### I. The budgetary co-operation system

In Denmark, local authorities have been given extensive responsibilities and a high degree of autonomy. As a consequence of this policy of decentralisation local authorities manage resources amounting to approximately 30 per cent of the national GNP.<sup>1</sup> At the same time local authorities have the right to levy taxes and are free to set the municipal tax rate. Central government therefore has a genuine interest in involving local authorities in the planning of general economic policy. A cornerstone of this involvement is the so-called budgetary co-operation system under which voluntary agreements are made between central government and local authorities' organisations, which cover all municipalities.<sup>2</sup> Macroeconomic management and co-ordination are major objectives of the budgetary co-operation system. In other words the budgetary co-operation system provides the economic framework for local authorities as a whole.

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1 The local authorities comprise fourteen counties and 275 municipalities. These figures include the unitary authorities of the cities of Copenhagen and Frederiksberg.

2 The key negotiation partners consist of the government, represented by the Ministers of Finance, Economy and the Interior, on the one hand and the local government partners, by the National Association of Local Authorities in Denmark, the Association of County Councils in Denmark and the authorities of Copenhagen and Frederiksberg, on the other.

The basis for the negotiation is a description and common understanding of how the economic state of the whole local authority sector is expected to develop over the coming fiscal year. Based on this, the partners involved agree on certain general economic conditions and means for the local sector. Often an agreement may require central government to introduce legislation initiatives before parliament.

In recent years agreements on economic means have been influenced by the desire to ensure moderate growth in public expenditure. For 1999 for instance, it has been agreed that total local taxes should not increase. Moreover it has also been agreed for counties as well as municipalities that net operating costs for services will be limited to a one per cent growth rate per year over the 1999-2002 period. Further, as regards counties, the 1999 agreements also include statements about higher priority being given to the health sector. For municipalities the focus has been on day care for young children and a reduced use of resources per pupil in state schools.

Technical calculations are used to describe the state of the economy for all local authorities and to provide an overview. The key question to be posed in relation to estimating expenditure/revenue is how the state of the economy for local authorities will be in the coming year – assuming a stable tax rate and level of activity.

The latest available budgets and accounts combined with macroeconomic prognoses are used as a basis for estimating expenditure and revenue. Estimations are divided into several autonomous categories. The estimation method for each of these categories of aggregated items depends on the nature of the category and is described below.

### ***1. Net operating costs***

As regards estimating operating costs, the method includes, as mentioned above, an estimation of how operating costs will develop assuming that there is a stable level in the activities of services. This means taking into account estimates of how possible demographic change will affect the economy of the local sector. In recent years the number of young children has increased. This has had a direct effect on operating costs. If changes in the distribution and/or magnitude of public tasks have taken place these are taken into account as well. In 1998 for instance it was decided that the task of food control should be transferred from the municipalities to the state. In 1998 however, it was decided that responsibility for the integration of refugees and the provision of Danish lessons should be given to the municipalities. These two examples of changes in the distribution of tasks both affected the “estimates” in opposite ways.

The next step is to assess how the anticipated changes in price and wage levels will affect cost levels. The Ministry of Economic Affairs estimates relevant price and wage indexes for this extrapolation. The ministry uses central economic projections derived from macroeconomic models. The state of the domestic market and markets elsewhere is taken into account in the estimation. The result of collective bargaining by the labour markets is an important consideration when estimating wage increases. Depending on the relative amount of local authority spending, the different estimates of price and wage indexes are weighted together.

## **2. *Net capital investment costs***

Investment costs are estimated in a similar way to operating costs. There are differences but these are mainly related to the weight that different indexes are given when the initial cost is to be extrapolated, e.g. investment costs are less dependent on wage increases than operating costs are.

## **3. *Value added tax***

The VAT estimate is based on estimates of trends in operating and construction costs.

## **4. *Total net expenditure***

The estimates listed under items 1-3 together constitute the local authorities' total net expenditure.

## **5. *Net interest***

Net interest is the result of separate estimates of interest costs and interest revenue respectively. The cost estimate is based on the expected interest rate, loan repayment profile and the issue of new loans. The revenue is based on the expected interest and the average liquidity balance. As with the paragraphs above the expected interest rate is based on central macroeconomic estimates.

## **6. *Income tax***

When estimating income tax the main objective is to forecast the number of taxpayers and their average income for taxation for the following year. The estimate hinges again on the prognoses for general economic development and in particular the unemployment rate. Therefore, calculations incorporate economic projections based on macroeconomic models.

## **7. *Company tax***

The method for estimating company tax is very similar to the method for estimating income tax, but of course it focuses on estimates of company profits.

## **8. *Land tax***

The land tax estimate is based on estimates of the property value of premises. Every year Central Customs and Tax Administration publish the property value of premises. In order to have the latest – and therefore the most realistic – estimates the Central Customs and Tax Administration carries out specific estimates for the negotiations.

## **9. *General grants***

General grants are, following the law, adjusted according to:

- the price and wage index;
- the Total Balance Principle;
- the Budget Guarantee Scheme.

The aim of the above-mentioned arrangements or tools is to preserve the real value of the grants. It follows that these are incorporated into calculations when estimating the state of the local authorities' economy.

The price and wage index is also based on estimates from the Ministry of Economics. The total balance principle regulates general grants according to new functions. If parliament has passed a statute assigning new functions to local authorities, local authorities are compensated for the estimated expenditure rise created by the new statute. If the opposite happens general grants are reduced. The budget guarantee scheme compensates local authorities for changes in certain tasks that are sensitive to the business cycle, e.g. expenditure on family welfare programmes.

#### **10. *Specific grants***

Reimbursements from the state are another item to be considered in an assessment of local authorities' economies. Approximately 20 per cent of social and health spending is used for income transfers, and these are partly reimbursed by the state. The state, for instance, reimburses 50 per cent of local authority spending on unemployment benefit, other cash handouts and pensions for early retirement on health grounds. The way in which this expenditure level changes depends on the employment situation. So the estimation method for these reimbursements is based on central macroeconomic estimates of the employment situation. Other important reimbursements are rent subsidies – 50 per cent – and rent allowance to old-age pensioners – 75 per cent.

#### **11. *Total income***

The estimates mentioned under points 5.-10., when added together, make up local authorities' total net revenue.

#### **12. *Net result (11-4)***

The net result is estimated as what is left when net expenditure is subtracted from total income.

#### **13. *New loans***

Central government's anticipated loan policy is important for estimating new loans.

#### **14. *Loan repayments***

The total debt and loan repayment profiles are both taken into account from the outset when estimating the net repayment of loans.

#### **15. *Financial surplus or deficit***

If calculations forecast a total local authority deficit, there are basically five possibilities or solutions to be decided on: a tax increase, increases in fees and charges, retrenchments, an increase in grants from the state or an increase in the loan balance.

## **II. Estimation methods in the preparation of the national budget**

Local authorities' revenue and spending estimates are also taken into account in the preparation of the national budget (the "Law of Finance"), particularly in situations where the relevant ministry reimburses a specific percentage of local authorities spending – often spending on income transfers, which are generally sensitive to the business cycle. In order to estimate this kind of reimbursement, it is of course necessary to estimate municipal spending on the specific items concerned.

In this section estimation methods for assessing particular items in the social sector will be described. The estimation methods used are similar to those used for the budgetary co-operation system, but are often based on more detailed data. Estimates are based on several different components, as will now be illustrated.

Rent subsidies to low income groups and rent allowances to old-age pensioners are the responsibility of the Ministry of Housing and Urban Affairs. The municipalities make the payments to their citizens but the state reimburses 50 and 75 per cent of the payments respectively.

The key question in these assessments is how many citizens during the following year will be entitled to receive subsidies or allowances and how much allowance or subsidy they will receive. It follows that the allowance estimate depends on the expected number of old-age pensioners and the death rate. Statistics Denmark supplies relevant prognoses for this. The actual disbursement, however, and therefore also the estimate, depend on a number of socio-economic parameters, i.e. old-age pensioners' household income, the composition of this, how much they receive and what additional fees they have to pay. Finally the estimate takes into account the fact that contributions vary according to whether the pensioners are tenants, owners or members of a co-operative society.

The estimation method for rent subsidies for low-income groups is similar to that for rent allowance, although this estimate is more technical because the actual number of people with low incomes is affected by the business cycle. For example, the estimated total of rent subsidies in the 1999 national budget took into account an expected drop of 10 000, in the number of unemployed people, as well as other factors. The expected fall in unemployment was based on the general macroeconomic models mentioned in the paragraph above on estimating net operating costs.

Financial assistance for family welfare programmes, and pensions for those who have taken early retirement on health grounds, are important parts of social sector expenditure. The Ministry of Social Affairs is responsible for estimating expenditure on benefits and pensions. The ministry estimates spending for the following year in two stages. The first stage is to get an overview of current spending, based on the latest available accounts and budgets. Information about municipalities' current requests for reimbursements is also taken into account. Furthermore, separate statistics on the numbers of clients and disbursements are used. The next stage involves the extrapolation of the number of citizens affected and the budgeting itself. The ministry takes into consideration changes in legislation. If, for example, the unemployment benefit statute (which is the responsibility of the Ministry of Labour) is changed, it might affect the numbers of citizens living off benefits. Changes in rates are also taken into account. Finally estimates of developments in the state of the labour market are used. In the 1999 national budget, estimated spending on benefits came to DKK 7 694 million. The state refunds 50 per cent of municipal spending on benefits.

### **III. Estimation methods in the preparation of local authorities' budgets**

The methods used and the general way in which the local budget is prepared reflect the considerable autonomy of Danish local authorities. In general, local authorities choose estimation methods of their own without government interference.

However, there are certain rules and procedures which must be observed when making up the budget:

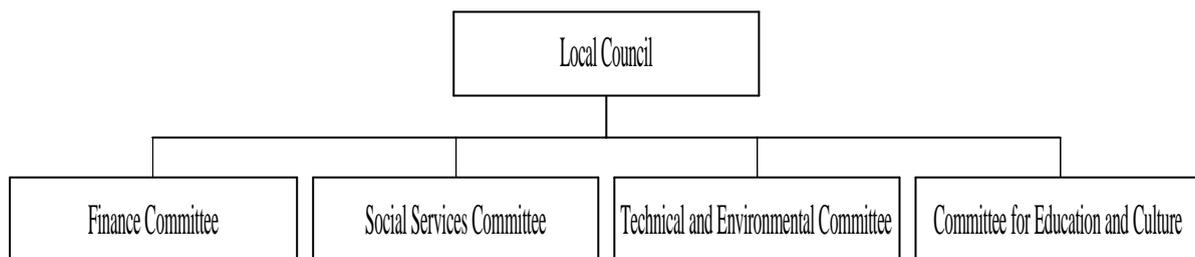
- the finance committee's budget proposals should be given at least two readings. The second time – which must be no later than 15 October – the budget proposal for the next year is adopted. At the same time a 3-year estimate of expenditure and revenue is also adopted;
- the perennial budget should cover all revenue and expenditure, be balanced every year and it should correspond to the "gross amount book-keeping principle" (all types of expenditure and income are to be shown separately);
- in connection with the adopted budget a municipal staff survey should be conducted amongst full-time employees.

These specific rules and procedures ensure that local budgets comprise three main constituents:

- the authorised budget (and accounting) system, where expenses and income are endowed with fixed/clear objectives;
- standardised overviews of the budget figures;
- more developed observations, where assumptions and the content of the budget are reviewed. General observations could be, for example, key figures relating to estimates of levels of service and price and wage levels. Specific observations are related to applications for grants.

In order to help clarify the budgetary methods described there now follows a general description of the organisation of Danish local authorities. The ordinary government system laid down by the Local Government Act is a committee structure, see Figure 1. The Local Government Act states that the council must set up a finance committee and at least one other permanent or “standing” committee. The finance committee is responsible for the finances of the local authority, for co-ordinating planning and administration. Moreover, the finance committee is to be consulted in all matters pertaining to economic and administrative affairs before they are put before the council.

**Figure 1: A representative example of the organisation of local authority committees**



Note: The committee structure varies depending on the local authority. Local authorities in larger cities (Copenhagen, Aarhus, Frederiksberg, Odense and Aalborg) have a different organisational structure.

Typical budgetary methods used by the local authorities include a mixture of marginal, frame, norm and block budgeting. A description of the principles of each now follows.

### ***Marginal budgeting***

The marginal budgeting method concentrates on activity changes in relation to the current year's budget. The administrative authorities are responsible for setting down the overall economic framework for individual sectors of expenditure. Often budgetary lines are allocated to specific institutions in the municipality – normally the institutions have a relatively high degree of freedom to manage their own budgetary lines. The finance committee then receives these in order to work out the entire budget.

### ***Frame budgeting***

The main principle behind the frame budgeting method is that economic items to be included in the budgetary proposals for specific sectors are set down by the finance committee in the initial budget preparation phase. Following this the administration of the individual sector makes its own detailed budget plan.

### ***Norm budgeting***

The norm budgeting method is conducted on the basis of certain normative figures. For the school sector a normative figure could be the estimated average cost of education per pupil (the normative value is then simply multiplied by the number of pupils). The normative value includes for example average expenditure on maintenance, education and cleaning.

### ***Block budgeting***

The characteristics of this method are that individual areas or sectors are divided into blocks of basic or minimum activities. Further blocks of higher activities or service levels supplement the basic blocks. The basic idea is that politicians choose services with corresponding expenditures – the expenditure reflects the service level of the chosen block.

Local authority budgets are generally established according to two main conditions: on the one hand, estimated developments in demographic, economic and other variables that influence spending and revenue (these estimates are usually the responsibility of the municipal or county administrative authorities), and on the other hand, policy objectives, the level of service, e.g. maximum waiting time for surgery in hospitals or a place for a child in a kindergarten. The politicians of course lay down these objectives. Administration solves the question of “what can we afford?” and the politicians “what do we want?”.

### ***Examples of the budgetary process over the course of a year***

There now follows an example of how a Danish municipality can organise the budgetary process. At the same time examples of methods used by the municipalities of Alleroed and Langeskov will also be described<sup>1</sup>.

In Section IV, financial data on the different sized municipalities of Alleroed, Langeskov and Aarhus will be presented. The municipality of Langeskov has 6 198 inhabitants and is the smallest of the three. It is situated on the island of Funen. The municipality of Alleroed has 22 911 inhabitants and is situated in the northern part of the Copenhagen metropolitan area. Finally Aarhus has 283 673 inhabitants, and is the largest of the three. It is situated in Jutland and is the second largest city in Denmark.

#### *January*

A population forecast is made. The close correlation between population and spending/revenue makes this essential – especially as changes in the number of elderly people and young children have attracted so much attention. The main source for this is Statistics Denmark, which supplies demographic data at municipal level. But the administration may find it necessary to adjust Statistics Denmark’s estimate: For example if the municipality’s policy is to increase residential development this will generally influence the local demographic composition and its development. Both Alleroed and Langeskov adjusted their original prognoses to match local conditions.

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<sup>1</sup> The municipalities of Alleroed and Langeskov were interviewed for this purpose on 29 June and 6 July 1999 respectively.

*February*

Central government as well as local authority organisations publishes changes in prices, wages and incomes. Further examples are the growth rates of central economic variables such as employment, the gross national product and public consumption. The “fiscal impact” allows the municipalities to assess the expected effect of fiscal policy on general economic activity. These estimates give local administrative authorities the opportunity to work out an interim economic framework for the municipality. Politicians and administrative authorities then have an initial overview of the affordable level of services for the following budgetary period according to existing tax levels.

In the municipality of Allerød all municipal institutions draw up “business plans”. These plans describe the individual institution’s objectives and aspirations for the coming budgetary year as well as other factors. Hence the business plans provide in-depth information, when building up an impression of the economic framework. The municipality of Allerød applies “dialogue budgeting” and business plans are one of the tools in the dialogue budgeting process – in the paragraph on June below, the particular features of the dialogue budgeting process are described.

Because of its important share in the budget – approximately 60 per cent – wage composition is one of the most important budgetary factors for assessment. Municipalities use detailed estimates of wage development among different groups of public employees. Changes in labour market regulations regarding the number of holidays, pension schemes, etc., derived from the labour market’s collective bargaining are a part of these estimates. The expected price formation involves, for instance, estimates of changes in the price of fuel, contractors and other services.

While general energy and wage/price indexes can often be taken as read, it is more common for local authorities to adjust income estimates according to specific local conditions.

The basic income from levying taxes constitutes a significant part of the estimate. As a consequence of this, municipalities estimate changes in the development of different items that make up incomes. As far as company taxes are concerned local authority organisations supply disaggregated estimates for different types of businesses and trades. This is necessary due to the variation in the composition of businesses and industry between municipalities. Besides using these estimates, the municipality of Langeskov also uses special estimates for selected local businesses and industry. The reason for this is that the municipality of Langeskov is characterised by a few dominant firms. Accordingly, economic decisions taken by these firms have a significant impact on the budget. Dialogue with local businesses also provides important information for estimating the number of unemployed people who are on welfare benefits.

*March*

The finance committee makes up the economic framework for all the municipalities' political committees. This is done in the light of a general priority debate – often the council holds a prolonged budget seminar for this purpose.

These frameworks take into account the economic consequences of the council's previous decisions, e.g. the construction of a new road or a guarantee of provisions for young children.

*May*

The individual committees draw up their individual budget proposals. These are collected and a budget proposal is established. New estimates of changes in prices, wages and incomes are incorporated.

Every year the council of Langeskov chooses to develop a special "budget theme". Politicians have chosen the following sectors for the 2000 budget: the elderly, preventive health care services and the investment and development of the municipality of Langeskov. Each area is described according to:

- the objectives of the functions;
- the current state of affairs and planned developments in years to come;
- matters relating to legislation;
- matters relating to changes in the population.

Langeskov previously used the block budgeting method but politicians and administration felt, after a couple of years, that this method was not promising. Another reason for abandoning this method was that it had often been applied in connection with retrenchment, and hence the employees felt unsafe. The teachers' trade union and the committee for children and cultural affairs therefore recommended a switch to norm budgeting.

*June*

The budget proposal is discussed by the finance committee. The different committees are asked to adjust their respective budget proposals accordingly.

As mentioned above, the municipality of Allerød uses dialogue budgeting. This method is reflected throughout the whole process of budget formation. In May-June the municipal council and administration holds "dialogue meetings", where stakeholders – the users and representatives – of the individual sectors are invited<sup>1</sup>. On 7 June 1999 a meeting was held to discuss state schools. Some of the aspirations expressed in the business plans were on the agenda. The dominant theme was the school sector's physical needs: buildings, equipment, IT etc. – one of the biggest challenges for the municipality of Allerød is that the number of school pupils will increase by approximately 40 per cent over the next seven years. Other topics referred to in the business plans, included more time being allocated to management

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<sup>1</sup> Representatives are for example school boards (including parents, teachers and other representatives of employees) and senior citizens' councils.

studies and information and communication technology. At the dialogue meetings, local consumers and managers have a genuine opportunity to discuss problems and possibilities for their respective institutions with the politicians responsible. Thus the dialogue budget allows individual representatives to exert direct influence on the budget. This is thought to improve the “budget ownership” and hence adherence to the budgetary framework.

The municipality of Alleroed has adopted dialogue budgeting for both internal and external matters. Over the last few years a couple of legislative initiatives have prescribed decentralisation and user influence for specific institutions, e.g. the school board and senior citizens’ councils. At the same time the municipality of Alleroed has been facing demands for retrenchment. In order to carry through the retrenchment with a higher degree of acceptance and to satisfy demands for legislative decentralisation the council chose the dialogue budgeting method. Thus one can say that the shift to dialogue budgeting is related to the requirements of democracy rather than incorrect budgetary estimates.

As far as detailed estimating methods are concerned Alleroed uses a mixture of norm, block and frame budgeting. However the municipality is now moving away from norm budgeting because this method is seen as difficult to manage. The municipality of Alleroed will gradually introduce contract management to all areas of the municipality.

#### *August*

The committees draw up revised budget proposals. Final spending and revenue estimates are composed in accordance with the agreement on budgetary co-operation between central government and organisations of municipalities (usually, the results of the negotiations are published in June). For example if the budget has operated with a tax rate increase, and the agreement does not allow for a general tax rate increase the revenue estimate will have to be adjusted accordingly. The agreement is not legally binding on the authorities, a fact that allows space to make adjustments both in terms of spending/revenue and specific local conditions. However the council of Alleroed feels committed to following the line decided on as a result of negotiations. In the budget schedule this commitment is reflected in the statement that: “budget areas are adjusted at the budget conference according to the result of the budgetary system and the co-operation system”.

The priorities between sectors may also be affected by the budget co-operation system. If the central negotiators have stressed a stronger priority on other subjects than those suggested by the municipality this provides an opportunity for there to be fresh debate on priorities in the municipal council.

#### *September*

The council discusses the budget proposal for the first time.

As part of Alleroed’s implementation of “dialogue budgeting” individual institutions submit their observations on the budget. Furthermore the council holds a common dialogue meeting for all stakeholders.

*October*

The budget is given its second and final reading by 15 October.

#### **IV. Case studies – the municipalities of Allerød, Langeskov and Aarhus**

In tables 1-3 on the following pages financial data on Allerød, Langeskov and Aarhus municipalities are presented.

**Table 1: Financial data on the municipality of Alleroed (22 911 inhabitants)**

		1996			1997			1998		
		Estimate (in 1 000 DKK)	Actual (in 1 000 DKK)	Difference (percentage)	Estimate (in 1 000 DKK)	Actual (in 1 000 DKK)	Difference (percentage)	Estimate (in 1 000 DKK)	Actual (in 1 000 DKK)	Difference (percentage)
Expenditure	Compulsory <sup>a</sup>	89 369	83 633	-6.4	89 792	92 952	3.5	96 862	96 438	-0.4
	Optional	616 124	640 826	4.0	662 430	704 672	6.4	692 333	697 083	0.7
	Investment	31 210	52 772	69.1	40 010	71 911	79.7	33 290	31 269	-6.1
	Operational	674 283	671 687	-0.4	712 212	725 713	1.9	755 905	762 252	0.8
	Total	705 493	724 459	2.7	752 222	797 624	6.0	789 195	793 521	0.5
Revenue	Own taxes	-554 073	-560 646	1.2	-616 840	-620 363	0.6	-634 329	-634 246	-0.0
	Shared taxes	-26 700	-28 432	6.5	-26 250	-26 732	1.8	-29 736	-33 245	11.8
	Charges and fees	-143 337	-174 753	21.9	-146 500	-195 221	33.3	-177 943	-172 430	-3.1
	General grants	49 406	43 968	-11.0	55 400	57 900	4.5	59 592	67 644	13.5
	Earmarked grants <sup>b</sup>	-53 573	-50 147	-6.4	-46 391	-52 836	13.9	-48 988	-47 363	-3.3
	Other revenue <sup>c</sup>	34 756	33 348	-4.1	42 189	44 454	5.4	48 419	48 285	-0.3
	Total	-693 521	-736 662	6.2	-738 392	-792 798	7.4	-782 985	-771 355	-1.5

Note: Estimate refers to the current budget. Actual refers to the current account. “-” denotes revenue.  
The figures are based on the current rate for DKK.

a Income transfers.

b Reimbursements.

c Net interest and equalisation of VAT expenditure.

Source: Statistics Denmark, ksdb database.

**Table 2: Financial data on the municipality of Langeskov (6 198 inhabitants)**

		1996			1997			1998		
		Estimate (in 1 000 DKK)	Actual (in 1 000 DKK)	Difference (percentage)	Estimate (in 1 000 DKK)	Actual (in 1 000 DKK)	Difference (percentage)	Estimate (in 1 000 DKK)	Actual (in 1 000 DKK)	Difference (percentage)
Expenditure	Compulsory <sup>a</sup>	27 817	27 861	0.2	33 820	34 325	1.5	32 442	33 413	3.0
	Optional	159 431	167 702	5.2	163 144	165 301	1.3	173 092	186 775	7.9
	Investment	5 195	11 224	116.1	6 211	7 354	18.4	6 664	17 355	160.4
	Operational	182 053	184 339	1.3	190 753	192 272	0.8	198 870	202 833	2.0
	Total	187 248	195 563	4.4	196 964	199 626	1.4	205 534	220 188	7.1
Revenue	Own taxes	-112 545	-112 690	0.1	-115 310	-114 810	-0.4	-117 262	-116 559	-0.6
	Shared taxes	-3 000	-3 708	23.6	-4 750	-4 704	-1.0	-5 213	-6 032	15.7
	Charges and fees	-41 601	-46 534	11.9	-43 627	-49 267	12.9	-47 095	-53 085	12.7
	General grants	-19 795	-18 984	-4.1	-18 840	-18 240	-3.2	-25 232	-25 620	1.5
	Earmarked grants <sup>b</sup>	-14 572	-14 538	-0.2	-17 140	-15 707	-8.4	-17 419	-17 825	2.3
	Other revenue <sup>c</sup>	6 148	6 174	0.4	7 153	6 890	-3.7	8 282	7 757	-6.3
	Total	-185 365	-190 280	2.7	-192 514	-195 838	1.7	-203 939	-211 364	3.6

Note: Estimate refers to current budget. Actual refers to current account. “-” denotes revenue.  
The figures are based on the current rate for DKK.

a Income transfers.

b Reimbursements.

c Net interest and equalisation of VAT expenditure.

Source: Statistics Denmark, ksdb database.

**Table 3: Financial data on the municipality of Aarhus (283 673 inhabitants)**

		1996			1997			1998		
		Estimate (in 1 000 DKK)	Actual (in 1 000 DKK)	Difference (percentage)	Estimate (in 1 000 DKK)	Actual (in 1 000 DKK)	Difference (percentage)	Estimate (in 1 000 DKK)	Actual (in 1 000 DKK)	Difference (percentage)
Expenditure	Compulsory <sup>a</sup>	2 898 342	2 748 992	-5.2	2 904 904	2 848 217	-2.0	2 995 013	3 004 391	0.3
	Optional	9 642 389	9 509 415	-1.4	10 192 974	9 953 383	-2.4	11 059 044	10 801 808	-2.3
	Investment	588 497	504 307	-14.3	621 488	505 080	-18.7	900 454	625 063	-30.6
	Operational	11 952 234	11 754 100	-1.7	12 476 390	12 296 520	-1.4	13 153 603	13 181 136	0.2
	Total	12 540 731	12 258 407	-2.3	13 097 878	12 801 600	-2.3	14 054 057	13 806 199	-1.8
Revenue	Own taxes	-6 116 150	-6 191 357	1.2	-6 493 180	-6 494 126	-0.0	-6 661 733	-6 654 718	-0.1
	Shared taxes	-165 700	-185 912	12.2	-239 700	-242 636	1.2	-330 300	-338 502	2.5
	Charges and fees	-3 798 958	-4 040 174	6.3	-4 075 058	-4 290 284	5.3	-4 372 694	-4 525 918	3.5
	General grants	-1 064 405	-1 020 828	-4.1	-976 417	-949 524	-2.8	-1 151 767	-1 159 044	0.6
	Earmarked grants <sup>b</sup>	-1 929 389	-1 665 088	-13.7	-1 827 998	-1 798 291	-1.6	-1 944 940	-1 889 429	-2.9
	Other revenue <sup>c</sup>	393 897	386 913	-1.8	426 874	399 919	-6.3	450 303	418 762	-7.0
	Total	-12 680 705	-12 716 446	0.3	-13 185 479	-13 374 942	1.4	-14 011 131	-14 148 849	1.0

Note: Estimate refers to current budget and Actual refers to current account. “-” denotes revenue.  
The figures are based on the current rate for DKK.

a Income transfers.

b Reimbursements.

c Net interest and equalisation of VAT expenditure.

Source: Statistics Denmark, ksdb database.



## FINLAND

### Spending and revenue information

Those who use and produce information on spending and revenue are the local municipalities themselves and central government. Both need these forecasts in order to prepare their annual budgets (central government awards state grants to municipalities), economic plans and their economic framework for the future.

It is important to note that local municipalities are dependent on the results of spending and revenue estimates made by central administration in the following respects:

- municipalities are more or less dependent on state grants, decided at national level. Even if the volume of state grants has decreased in recent years, grants still have an important role in balancing municipal budgets;
- the need to increase or cut expenditure at local level (according to changes in the volume of tasks) is dependent upon legislation. It is legislation which itself defines municipal tasks. Which tasks should come under the responsibility of local municipalities and which should not is constantly being debated;
- the possibility of satisfying demands for local services also depends on tax revenue, even when the municipalities can decide on the municipal tax rate independently. For example, reductions in municipal taxation are prepared yearly by central government and are decided on by parliament. So, the possibility of providing municipal services (to satisfy demands) depends on decisions taken by central government, as well as on decisions taken by municipal councils. The municipalities can evaluate spending and revenue independently but they are, however, dependent on central government decisions.

### Non-mathematical formulae

It is worth pointing out that there is no one estimation method for spending needs and revenue which is accepted by everyone. Relevant estimates are carried out as part of the annual budgetary process in different ministries and municipalities, mainly when preparing the budget (income and expenditure adjustment).

Proceedings within central government are led and modified by the Ministry of Finance. In municipalities the organ responsible is the municipal executive board. The Ministry of Finance is responsible for laying down general directions and guidelines, according to which all state organs prepare their budgets. Changes in state grants are defined as part of this process. In municipalities the executive board is responsible for the same process. Central government does not set any limits concerning municipalities' spending needs. In practice, municipalities follow the general guidelines set forth in the central government's budget concerning public consumption. There are, however, in this respect differences between the municipalities. These differences depend on differences in the financial position of the municipality.

In state administration, the role of the Ministry of Finance is based on the State Budget Act. In municipalities the executive boards' position is based on the Local Municipal Act.

The budgetary process does not exclude the fact that all ministries are responsible for the evaluation of spending needs and revenue as part of their long-term planning. For example, the Ministry of Social Affairs and Health evaluates long-term expenditure on pensions, day care for children and the cost of the national health service. The Ministry of Education and Culture evaluates, for example, future demand for vocational education, based on age-structured models.

In municipalities, the evaluation of spending needs (or expenditure on municipal tasks) is based on local needs, and takes into account estimated income (revenue) and costs. It is carried out over a yearly period but also over a longer period of time.

Each municipality uses its own methods for estimating spending needs and revenue. However, general guidance and estimates are provided by the central organisation of the municipalities, ministries and research institutes. Municipalities use this information and adjust it according to their own experiences, circumstances and knowledge at local level.

This information on evaluation, both at national and municipal level, can contain data such as:

- the actual situation of the national economy as a whole and short-term forecasts (relating to growth in the economy, employment, inflation, interest rates and changes in incomes);
- information on taxation, estimated changes in tax revenue;
- information on state grants;
- other up-to-date information (legislation concerning organisations of municipalities, tasks and duties, future legislation).

The Ministry of the Interior, in co-operation with the Ministry of Finance, and the central organisation of the municipalities, drafts at least two or three times a year, a forecast including probable developments in the municipal economy. This document is sent to all municipalities. It contains estimated changes in the total national economy, changes in municipal expenditure and income, and changes in the financial situation of the municipal economy. The main indicators when defining the financial position of municipalities are as follows:

- the gross margin;
- the operating margin;
- the annual margin;
- investments;
- overall long-term debt;
- cash reserves/net debts (long term debt minus cash reserves).

In the document drafted by the Ministry of the Interior in co-operation with the Ministry of Finance, changes in expenditure can be broken down into areas such as:

- changes in overall municipal personnel;
- changes in municipal wages and salaries;
- changes in municipal social security payments;
- estimated expenditure on tasks like day care for children, care for the elderly, municipal income support, maintenance of health services, comprehensive schools and vocational education. Estimated spending needs are mainly limited to municipal tasks which are covered by the state grant system. In areas such as land-use planning, traffic infrastructures, green belts, local public transport, street maintenance, water and energy supplies, all of which are financed by municipal taxes and fees or charges, the method for estimating spending needs is mainly chosen by municipalities without following any general guidelines from central government.

The Ministry of Finance is responsible for estimating overall spending. This estimation is carried out annually when central government is planning its budget. Estimated spending (public and private) is included in the overall plan for the annual budget.

Municipalities' spending needs are dependent on demand for municipal services. It is possible to evaluate this demand by using factors such as:

- the evolution of the GNP;
- the unemployment rate;
- changes in the age-structures of the population (long-term changes);
- the movement of the population;
- the size of the population;
- changes in municipal tasks and duties (compulsory/ non-compulsory tasks).

Spending needs are also estimated when central government's budget, and the local municipal budget are being prepared. In addition to the factors described above, the following factors also affect municipal budgeting:

- overall wages and salaries, and changes in their volume (the effects on municipal tax revenue);
- wages and salaries in the municipal sector;
- estimated changes in costs;
- changes in social insurance payments.

In practice, when preparing the budget, estimated spending needs and revenue must be kept together. They constitute the financial framework which can either limit the possibility of maintaining services or increase the quantity and/or quality of municipal services. Thus the process depends on a choice between cost-oriented and income-based budgeting. Successful evaluations of spending and revenue depend on the reliability and versatility of the information.

The national budget includes general assumptions about the following:

- the total national economy;
- the definition of the government's line on economic policy;
- the general prospects for the public economy;
- the main budgetary lines;
- the definition of principles concerning taxes and charges;
- business activities;
- central government funds;
- the balance between the budget and the state economy;
- changes in the budget deficit.

This information also serves to guide municipal budgets.

The size of the state grants which are received on a yearly basis is an essential factor in estimating municipal revenue. This process is supervised by the Ministry of Finance. Firstly, the framework for expenditure in each ministry is determined. The Ministry of Social Affairs and Health, the Ministry of Education and Culture and the Ministry of the Interior are all responsible for state grants. State grants are in competition with other expenditure needs within these ministries. If estimated expenditure can be kept within the framework set, there is no need to adjust the framework. If the framework is exceeded, it is the government's task to determine where there should be cuts and what the targets of these cuts should be.

So, the sources of finance for state grants are in competition with all the other spending needs in the government's budget. Central government chooses which expenditure or needs should be prioritised.

The overall amount of state grants awarded to municipalities depends primarily on the following factors:

- changes in the volume of tasks and duties to be covered by state grants (social and health care, education and culture);
- changes in wage and price indexes;
- changes in the municipal tax revenue (in each municipality the size of state grants is dependent upon the size of the municipality's own tax revenue);
- the criteria for deciding on state grants.

There are changes in the size of state grants if municipalities receive new tasks (which can mean changes in their quantity and/or the quality of the task to be provided). The size of state grants also depends on expenditure on staff costs. This is mainly based on general agreements between labour market organisations. Changes in prices depend on general factors such as inflation, employment, total demand and interest rates.

The overall amount of state grant in each municipality is based on municipal tax revenue. If the tax revenue of a municipality descends under the "levelling limit" (90 per cent of the average tax revenue), the remainder of the tax revenue is given to the municipality. The amount that is levelled off is the difference between the "levelling limit" and the municipality's own tax revenue. If the tax revenue exceeds the 90 per cent limit, the state subsidy is reduced by an amount that is 40 per cent of the amount exceeding the "levelling limit". The maximum reduction is 15 per cent of the municipality's calculated tax revenue.

According to this system, the self-financing share of social and welfare services and for education and libraries is the same for each resident in all municipalities. The state subsidy equals the difference between calculated expenditure in the municipality, which the municipality cannot influence, and the finances which the municipality can raise.

***The use of estimation methods in the preparation of the national budget and for apportioning financial support among local authorities***

Estimating local authorities' spending needs is part of central government's budgetary process. Central government's budget includes a general report on changes in local municipal services.

The overall size of state grants depends on the amount of municipal tasks there are and changes in the costs of these. The grants are based on calculated costs and are not dependent on actual municipal costs.

The criteria for state grants are based on statistical studies of costs, on the difference between municipalities, on the difference between different tasks and on the principle of equalising municipal tax revenue. The basic method and formulae used to define this are set forth in legislation.

The definition of state grants is dependent on the following criteria:

- the general grant: number of inhabitants; supplements for the amount of traffic, how remote the area is, archipelago bilingualism;
- the "levelling" of tax revenues: the "levelling limit" is 90 per cent of the average;
- social services and health services: the calculated average cost per inhabitant, age structures, the sickness index, and unemployment;
- education and culture: the calculated average cost per pupil, the number of students, the population density, bilingualism.

Grants for social and health services, and for education make up 70 per cent of overall municipal revenue. This makes these criteria for constituting grants the most important, and the most well researched. For example, in calculating the cost of health care per inhabitant, we would calculate the number of people between the ages of 7 and 74, giving FIM 3 000, and for people over the age of 85 it would come to FIM 23 400.

The specific grants for social and health services and education are made up by subtracting the municipality's own share (which is the same in each municipality) from the overall costs (which varies depending on the municipality).

The formulae used to calculate grants are defined by a specific law and can be corrected if the information includes mistakes.

### ***Complementary information concerning the estimation method described above***

There is an exception made for municipalities with economic difficulties. One per cent of state grants is given to them. This division is primarily based on the financial statements of these municipalities.

Central government must apply calculation formulae when working out state grants, excluding some unimportant details and extra grants for municipalities with some economic difficulties. Municipalities are involved in estimating spending needs and revenue mainly via their central organisation. Local authorities usually consider estimation methods to be fairly reliable and transparent.

### ***Use of estimation methods for the preparation of local authorities' annual budgets***

In order to estimate expenditure local authorities mainly apply information collected by the municipality's central organisation. There are no harmonised calculation formulae but the basic information on expenditure and spending is based on harmonised data produced by the ministries and the central organisation of municipalities. There are discrepancies between estimated and actual expenditure, but these failures are typical in all kinds of municipalities. The most common mistake when estimating revenues or expenditure take place when estimating tax revenue and expenditure on health services.

## MALTA

### Preamble

In Malta, there is general consensus, both at central and local level, that, given the size of the country (with a population of 400 000, and a surface area of 316 sq. km) and other considerations peculiar to a small state, the introduction of local taxation could transform local authorities into mini-bureaucracies, which is undesirable.

It is for this reason that, at the time of ratifying the European Charter of Local Self-Government, Malta did not undertake to consider itself bound by Article 9.3. which states as follows: “Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they [local authorities] have the power to determine the rate”.

Otherwise, all local authorities’ basic funding needs are expected to be fully subsidised by central government. The present policy is that local public services should be mainly funded by state grants, as the main component of municipal funding, but the local authorities may and are encouraged to provide or introduce other services for which they may impose fees and charges, subject to ministerial sanction.

Thus, fees and charges may be imposed for the following services or facilities, in particular:

- parking;
- use of public gardens;
- skips;
- information services;
- public library services;
- renewal of trading licences;
- issue of certain licences;
- advertising.

With the delegation of the power to enforce certain legislation (including legislation relating to traffic and litter) local authorities’ potential to increase revenue (by imposing and keeping revenue from fines) is considered to be substantial. This devolution initiative came into effect in February 2000.

State grants will continue to constitute an important source of local authority finance (currently central government provides 97 per cent of finance) but, in due course, this will become less so following the increasing imposition of fees and charges for community services and fines for legal infringements.

State grants are applied and distributed in accordance with criteria established by law on a non-discretionary basis. In estimating funding needs account is mainly taken of:

- the preferences expressed by the citizens from time to time;
- local authorities' own priorities;
- inflation.

The information which now follows mainly relates to spending needs.

## **I. Use of estimation methods in the preparation of the national budget**

The financing of local authorities' basic spending needs was, until March 1999, regulated by the following statutory provisions from the Local Councils Act (No. XV, 1993) – see also item C of the Addendum, "Revised financial allocation for local authorities".

### ***Section 55***

1. Each year the Minister responsible for finance shall allocate a provision under the Appropriation Act which shall serve for the exercise of the functions of [local authorities] as appear under this act.
2. The amount appropriated shall be allocated to each [local authority] on the basis of the formula determined in terms of the Tenth Schedule to this Act.<sup>1</sup>

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1 "Grants given to local councils in terms of Section 55 shall be allocated to each Council as follows:

$$S_n = \{0.75 \times S_t \times P_n/P_t\} + \{0.25 \times S_t \times A_n/A_t\} \text{ where:}$$

$S_t$  is the total appropriation made by the minister responsible for finance in terms of Section 55;

$P_n$  is the population of locality (n); provided that for the purpose of this formula each locality shall be assumed to have a population of at least 1 000;

$P_t$  is the population of all localities added together, provided that for the purpose of this formula each locality shall be assumed to have a population of at least 1 000;

$A_n$  is the surface area under the responsibility of locality (n); provided that for the purposes of this formula national territories marked on the maps in the Second Schedule of this act shall be excluded; and

$A_t$  is the surface area under the responsibility of all localities added together; provided that for the purposes of this formula national territories marked on the maps in the Second Schedule of this act shall be excluded."

## **Section 58**

Payments for the special needs of a locality or localities shall only be made exceptionally and after a resolution to that effect has been carried by the House of Representatives.

There are basically three main areas of local authority functions; these are set forth in Section 33 (1) of the Local Councils Act. They are as follows:

### **1. *Basic community services regulated by ad hoc service contracts which determine standard national minimum technical requirements, working methods and procedures***

These functions are statutorily regulated by contracts and include the following services:

- upkeep and maintenance of roads and pavements;
- upkeep and maintenance of “soft areas” within roads;
- re-surfacing of roads;
- collection of household and commercial waste;
- collection and separation at source of household and commercial waste;
- collection of bulky refuse;
- cleaning and maintenance of beaches;
- street sweeping and cleaning;
- cleaning and upkeep of public conveniences;
- cleaning and clearing of surfaced non-urban roads;
- cleaning, clearing and maintenance of public parks and gardens;
- maintenance of traffic signs and traffic markings.

### **2. *Consultative tasks***

This category includes the following consultative functions:

- making proposals for, and being consulted about, any changes to be made to traffic schemes;
- making recommendations about planning or building schemes;
- fully participating in decisions on the naming or renaming of streets;
- issuing guidelines to be followed in the upkeep, restoration, design or alteration of any building (in particular, the building’s façades), including the type of lighting to be used etc.;
- advising those bodies empowered to take decisions which could affect the council and the residents it is responsible for.

### **3. *Tasks relating to the establishment and maintenance of certain community facilities as part of a national scheme, in conjunction with the competent national authorities***

This refers to functions relating to the following community facilities: information centres, crèches, kindergartens, educational buildings, health and rehabilitation centres, government dispensaries, district health offices and homes for senior citizens.

## **II. Use of estimation methods for apportioning financial support among local authorities**

The annual allocation granted, in accordance with the Local Councils Act 1993, Section 55, is intended to cover the local authorities' basic tasks mentioned in the first category above, that is, basic community services.

The extent of local authorities' total spending needs is assessed on the basis of the cost estimations of all service contracts relating to tasks listed in the first category. Cost estimations are conducted through work studies which take into account prevailing market rates.

The total state grant is then apportioned between all the local authorities (sixty-seven in all) in accordance with the basic funding formula, which only takes into account population and surface area as the parameters for calculating each local authority's share (entitlement) of the total national budget allocation.

As a result, not all authorities receive adequate funds to meet all their needs. To remedy this situation and to achieve financial equalisation, a "special funds" formula has been introduced. This mechanism serves to bridge the gap, to a certain extent, between the overall level of allocated grants and each authority's specific financial needs.

The criteria and parameters used take into account certain imbalances of a socio-economic nature.

"Special funds" are also used for other purposes such as road re-surfacing (based on a nine-year programme), special paving and street structures in historical centres, the development of children's playgrounds and football grounds, the installation of amenities on beaches and in the countryside and provision for the special cultural needs of old historic cities. They are the "tool" in use at present to offset discrepancies between estimated needs and annual state grants allocated to local authorities.

Figure 1 illustrates the extent to which the "special funds mechanism" is used, as a percentage of the total annual grant allocation.

**Figure 1: Funds for local authorities' special needs**

<b>Fund</b>	<b>Description</b>	<b>Approved 1994/95 (in MTL)</b>	<b>Approved 1995/96 (in MTL)</b>	<b>Approved 1996/97 (in MTL)</b>	<b>Approved 1997/98 (in MTL)</b>	<b>Approved 1998/99 (in MTL)</b>	<b>1999/2000 (in MTL)</b>
Historic Centres Fund	Paving of streets and footpaths		49 000	60 000	60 000	51 498	
Historic Centres Fund	Street furniture and fixtures		10 000	60 000	60 000	56 359	
Sports and Cultural Amenities Fund	Children's playgrounds		20 000	50 000	50 000	25 929	
Sports and Cultural Amenities Fund	Football grounds and sports facilities		20 000	50 000	50 000	31 558	
Recreational Amenities Fund	Beach facilities		10 000	50 000	50 000	37 034	
Recreational Amenities Fund	Country/park facilities		10 000	50 000	50 000	45 232	
Equalisation Fund	Authorities with a public conveniences cost equal to or greater than 10% of the total allocation	51 124	55 000	28 533	20 193	20 193	
Equalisation Fund	Heavily built-up localities (more than 700 residences/sq. km)	161 615	180 000	140 790	138 940	138 940	
Equalisation Fund	Localities which serve as national, regional or local shopping centres	130 733	177 309	239 253	239 253	239 253	
Equalisation Fund	Authorities with a small surface area (less than or equal to 3 sq. km) and a population of less than or equal to 5 000			130 000	265 000	265 000	
Infrastructure fund	Road reconstruction		700 000	1 400 000	1 400 000	1 400 000	
Infrastructure fund	Infrastructure		50 000	100 000			
Special obligations	Valletta		10 000	20 000	30 000	30 000	
Special obligations	Mdina		10 000	20 000	20 000	20 000	
Special obligations	Birgu				20 000	20 000	
Planning Authority/Warden Services	Planning authority scheme			100 000			
Planning Authority/Warden Services	Local wardens services				45 000	45 000	
<b>Total special needs funds</b>		<b>343 472</b>	<b>1 301 309</b>	<b>2 498 576</b>	<b>2 453 386</b>	<b>2 425 996</b>	<b>2 500 000</b>
<b>Allocation according to the formula</b>		<b>4 499 532</b>	<b>6 315 000</b>	<b>7 249 996</b>	<b>6 250 005</b>	<b>5 831 000</b>	<b>6 500 000</b>
<b>Total allocated funds</b>		<b>4 843 004</b>	<b>7 616 309</b>	<b>9 748 572</b>	<b>8 703 391</b>	<b>8 256 996</b>	<b>9 000 000</b>

The criteria applied so far have been the subject of periodical reviews which take into particular account the local authority's registered performance and effectiveness according to the amount of funds available (state grants).

No general or specific grants are provided for the offsetting of costs for specific tasks. However, financial support on a national basis is given in conjunction with the introduction and installation of computerised systems and other support services to facilitate and support the administration of devolved functions.

### **III. Complementary information about estimation methods**

Central government discretion is limited to the "special funds" mechanism but the criteria and parameters applied are the result of full consultation and agreement with the Local Councils Association.

As explained in Section II, the existing statutory funding mechanism has created a situation whereby a few local authorities are receiving funds relatively in excess of their annual basic needs; this, at the expense of several other local authorities which are underfunded. To solve this, an extensive survey has been carried out to establish what each local authority's specific functional demands are, based on each authority's particular circumstances and situation. In practice, this costing exercise simply involves evaluating the cost of each service contract and the relevant scope of supply available for each local authority, including for:

- the collection of refuse;
- public toilets;
- bins-on-wheels services;
- skips;
- road maintenance;
- the maintenance of parks and gardens;
- street cleaning;
- the cleaning of beaches;
- the maintenance of road signs and road markings.

In addition, an evaluation was also conducted to assess each local authority's administrative costs, including the cost of its manpower resources.

Following the results of a comparative analysis on the funding needs of each local authority it is now possible to propose a replacement of the existing basic funding formula by one which gives a much more realistic assessment of funding needs.

Extensive information concerning this costing exercise is presented in the addendum to this document.

The Local Councils Association is being fully consulted in connection with the findings of the costing exercise mentioned earlier on the basis of which the new basic funding formula will be statutorily applied.

#### **IV. Use of estimation methods for the preparation of the local authorities' annual budget**

Section 56 of the Local Councils Act obliges every local authority to consider and eventually approve the estimated income and expenditure for the following financial year, by not later than 15 February in the current financial year. Before approving these estimates (the annual budget) local authorities are required by law to call a "local residents' meeting" during which the local electorate is briefed by the mayor on the past year's performance of the local authority and also about its future plans.

When preparing the annual budget, local authorities must follow the regulations and the procedures established by statute. These are primarily intended to achieve a nationwide uniformity of presentation which will facilitate comparisons of performance by the National Audit Office and the House of Representatives (Parliament).

The Local Councils (Financial) Regulations, 1993 (Legal Notice No. 155 of 1993) and the Local Councils (Financial) Procedures, 1996 (LCP 1/96), deal extensively with the methods to be followed by all local authorities as regards the systems of accounting and financial reporting to be adopted as well as the procedures to be followed in conjunction with the preparation of the annual budgets and business/financial plans.

Besides dealing extensively with all aspects of financial accounting and reporting, the financial procedures include templates to facilitate the compilation formalities, and, in the process also achieve total standardisation and uniformity of presentation.

However, when forecasting expenditure and revenue, each local authority adopts its own criteria based on previous experience as well as its spending priorities.

The only significant discrepancy which may occur between a local authority's estimates and its actual expenditure is in the area of earmarked grants (Funds for Special Needs of Localities in terms of Section 58 of the Local Councils Act). There are instances where local authorities consider that they are going to receive much less or vice versa. This is clearly shown in the three case studies presented. There are no specific categories of authority which are most at risk. There are two main items of expenditure where local authorities' estimates vary considerably from their actual expenditure. These are:

- repair and upkeep: this item of expenditure covers the cost of road maintenance; often there are instances where the actual cost varies considerably from the original estimate; this is mainly due to very old water and drainage mains which need replacing;
- investment: here, certain local authorities plan to use large sums of money for particular projects which for some reason or other do not materialise.

Local authorities which are most at risk in these areas are those with a relatively high demand for road maintenance and small localities which are underfunded.

## V. Case studies

**Iklin:** Iklin has a population of 3 100 inhabitants and covers an area of 1 726 sq. miles.

**Table 1: Estimated and actual expenditure in Iklin from 1995 to 1998**

Type of expenditure	1997/98 Estimate (in MTL)	1997/98 Actual (in MTL)	1996/97 Estimate (in MTL)	1996/97 Actual (in MTL)	1995/96 Estimate (in MTL)	1995/96 Actual (in MTL)
Compulsory <sup>a</sup>	12 859	13 365	16 903	14 202	15 592	15 916
Optional	22 512	12 901	20 535	14 616	15 124	11 049
Investment	20 752	18 254	20 827	15 362	108 840	8 372
Operational	68 985	10 414	299 695	23 092	13 545	10 813
<b>Total</b>	<b>125 108</b>	<b>54 934</b>	<b>357 960</b>	<b>67 272</b>	<b>153 101</b>	<b>46 150</b>

a This includes expenditure incurred in respect of Section 33 of the 1993 Local Councils Act XV – Functions of local councils, procedures and meetings.

**Table 2: Estimated and actual income in Iklin from 1995 to 1998**

Source of income	1997/98 Estimate (in MTL)	1997/98 Actual (in MTL)	1996/97 Estimate (in MTL)	1996/97 Actual (in MTL)	1995/96 Estimate (in MTL)	1995/96 Actual (in MTL)
General grants <sup>a</sup>	46 119	46 119	51 867	51 867	44 100	44 100
Earmarked grants <sup>b</sup>		13 879	232 000	23 515	99 000	59 366
Other revenue <sup>c</sup>	5 160	3 803	5 787	3 585	3 510	972
<b>Total</b>	<b>51 279</b>	<b>63 801</b>	<b>289 654</b>	<b>78 967</b>	<b>146 610</b>	<b>104 438</b>

a This includes financial allocations awarded by central government in respect of Section 55 of the 1993 Local Councils Act, XV

b This includes financial allocations awarded by central government in respect of Section 58 of the 1993 Local Councils Act, XV – funds for special needs of localities.

c This is mainly made up of interest from the bank.

**Zabbar:** Zabbar has a population of 14 790 inhabitants, and a surface area of 5 349 sq. km.

**Table 3: Estimated and actual expenditure in Zabbar from 1995 to 1998**

Type of expenditure	1997/8 Estimate (in MTL)	1997/8 Actual (in MTL)	1996/7 Estimate (in MTL)	1996/7 Actual (in MTL)	1995/6 Estimate (in MTL)	1995/6 Actual (in MTL)
Compulsory <sup>a</sup>	72 059	82 689	65 771	64 749	77 650	39 883
Optional	154 681	74 702	100 551	70 455	82 500	22 499
Investment	135 000	13 597	230 000	153 540	44 907	31 534
Operational	52 248	44 878	45 183	39 994	64 000	15 479
<b>Total</b>	<b>413 988</b>	<b>215 866</b>	<b>441 505</b>	<b>328 738</b>	<b>269 057</b>	<b>109 395</b>

a This includes expenditure incurred in respect of Section 33 of the 1993 Local Councils Act XV – Functions of local councils, procedures and meetings.

**Table 4: Estimated and actual income in Zabbar from 1995 to 1998**

Source of income	1997/98 Estimate (in MTL)	1997/98 Actual (in MTL)	1996/97 Estimate (in MTL)	1996/97 Actual (in MTL)	1995/96 Estimate (in MTL)	1995/96 Actual (in MTL)
General grants <sup>a</sup>	204 342	204 342	238 743	238 743	205 380	205 380
Earmarked grants <sup>b</sup>	1 466	107 513	1 143	107 606	1 143	26 143
Other revenue <sup>c</sup>	7 000	12 430	5 000	13 084	2 000	5 566
<b>Total</b>	<b>212 808</b>	<b>324 285</b>	<b>244 886</b>	<b>359 433</b>	<b>208 523</b>	<b>237 089</b>

- a This includes financial allocations awarded by central government in respect of Section 55 of the 1993 Local Councils Act, XV
- b This includes financial allocations awarded by central government in respect of Section 58 of the 1993 Local Councils Act, XV – funds for special needs of localities.
- c This is mainly made up of interest from the bank.

**Quormi:** Quormi has a population of 17 999 and covers a surface area of 5 030 sq. km.

**Table 5: Estimated and actual expenditure in Quormi from 1995 to 1998**

Type of expenditure	1997/98 Estimate (in MTL)	1997/98 Actual (in MTL)	1996/97 Estimate (in MTL)	1996/97 Actual (in MTL)	1995/96 Estimate (in MTL)	1995/96 Actual (in MTL)
Compulsory <sup>a</sup>	80 514	69 440	112 729	103 310	149 352	70 321
Optional	120 557	119 844	144 506	129 913	104 224	51 258
Investment	193 500	208 722	231 000	81 131	35 000	150
Operational	41 630	33 058	36 961	26 508	43 251	23 119
<b>Total</b>	<b>436 201</b>	<b>431 064</b>	<b>525 196</b>	<b>340 862</b>	<b>331 827</b>	<b>144 848</b>

- a This includes expenditure incurred in respect of Section 33 of the 1993 Local Councils Act XV – Functions of local councils, procedures and meetings.

**Table 6: Estimated and actual income in Quormi from 1995 to 1998**

Source of income	1997/98 Estimate (in MTL)	1997/98 Actual (in MTL)	1996/97 Estimate (in MTL)	1996/97 Actual (in MTL)	1995/96 Estimate (in MTL)	1995/96 Actual (in MTL)
General grants <sup>a</sup>	246 298	242 298	290 976	290 976	253 890	253 890
Earmarked grants <sup>b</sup>		96 093	57 600	57 600		3 087
Other revenue <sup>c</sup>	5 300	11 802	9 403	11 202	2 150	5 158
<b>Total</b>	<b>251 598</b>	<b>350 193</b>	<b>357 979</b>	<b>359 778</b>	<b>256 040</b>	<b>262 135</b>

- a This includes financial allocations awarded by central government in respect of Section 55 of the 1993 Local Councils Act, XV
- b This includes financial allocations awarded by central government in respect of Section 58 of the 1993 Local Councils Act, XV – funds for special needs of localities.
- c This is mainly made up of interest from the bank.

**ADDENDUM****Pricing methods for estimating local authorities' financial requirements****A. Standard times and performance measurements**

After an intensive exercise was carried out to evaluate the costs incurred by each local authority, it was felt that the funding formula needed to be revised to better reflect the financial needs of each locality. The revised funding formula is based on the cost of the service contracts which fall under the responsibility of the local authorities and their administration costs.

A detailed updated database known as the FAST (Fast Access To Standard Times) Database is kept by the Technical Unit within the Local Councils Department. The data collected is used to update the service contracts which have been undertaken by local authorities. This database forms the basis on which the service contract estimations were established.

All data in the FAST Database is converted from the Work Measurement Studies, which were carried out by the Technical Unit, from 1992 to 1996, on the following activities: works, tourism (cleaning beaches), agriculture, posts, refuse collection, street sweeping, roads, non-urban roads, tarmac laying, road markings and signs.

The studies were carried out with four main aims in view:

- measuring government departments' existing performance, efficiency and productivity;
- arriving at standard times for the estimation of jobs;
- launching work planning systems with the ultimate aim of improving the departments' overall efficiency, and thus enabling them to compete for the local authorities' service contracts; and
- using the standard times derived from the work measurement studies, to work out, in terms of costs, all the local authorities' service contracts.

The method used in work measurement studies consisted of directly observing workmen, rating them minute by minute, measuring the units performed during their task, thus producing after allowing for relaxation and contingency time, a final standard time for every unit of work produced. With this method, percentage efficiency was measured concurrently.

The studies were carried out according to the British Standards Institute regulations on work measurement. Under license from Tectime Data Systems, all study work on site was done on electronic data capture boards. The data was later transferred to a specific programme on a PC capable of analysing and producing the required results.

The criteria observed in determining the standard time required all data to be within reach of 95 per cent confidence limits, with a margin of error of + or -5 per cent. Thus, a standard time of sixty minutes for building one square metre of rubble wall, meant that the result was 95 per cent certain to be between fifty-seven and sixty-three minutes.

All this data remains the critical factor in the drafting of all the local authorities' service contracts.

The FAST programme transforms all work measurement data into a very detailed database, in order that non-practitioners in work study are able to arrive at any standard time required for any such purpose, such as:

- cost of a task;
- planning and allocating tasks to employees under one's charge;
- measuring performance against a full day's work; and
- pay for performance bonuses.

## **B. The service contracts costs**

The contracts which fall under the responsibility of local authorities are the following:

1. cleaning and maintenance of parks and gardens;
2. cleaning and maintenance of "soft areas";
3. street sweeping;
4. household refuse collection;
5. cleaning of bins on wheels;
6. cleaning of skips;
7. bulky refuse collection;
8. maintenance of traffic signs and road markings;
9. cleaning and maintenance of public conveniences;
10. cleaning of surfaced non-urban roads;
11. road and street maintenance;
12. cleaning and maintenance of coastal areas and beach cleaning.

### **1. Cleaning and maintenance of parks and gardens**

The Parks and Gardens Contract Cost was calculated by first listing all the operations required for this contract. Each public garden was measured and structures within the gardens were taken into account. Each garden was classified according to the operations required for its upkeep and the level of maintenance. The frequencies of each operation were calculated and the labour cost of these operations was established. Occasional costs (costs which are incurred for the maintenance of the fixtures and fittings in the parks and gardens such as play equipment; replacement/addition of benches, lamp poles and litter bins; introduction of water tanks and fountains; cleaning and maintenance of fountains and reservoirs; innovations to paved areas and boundary walls; development of leisure areas; checking of stakes and ties; general repair to hard areas e.g. kerbs) were estimated at 20 per cent of this cost.

When estimating the costs of this contract for each locality every public garden in the Maltese Islands was classified under one of four categories. The amounts involved for each category were estimated and each public garden was costed (per square metre) according to its classification.

## **2. Cleaning and maintenance of “soft areas”**

The Soft Areas Contract covers all verges (planted areas within roads) in each locality. The costing exercise covers all the operations required for this contract. There is one category for soft areas since the operations required for their upkeep and maintenance are the same. The soft areas were measured against the map of each locality. The frequencies of the maintenance of these areas was established. The operations required for the maintenance and upkeep of soft areas were costed on the work measurement values of labour, plant and material. Occasional costs (costs which include seasonal plants and repairs and upkeep to retaining walls) were estimated at 20 per cent of this cost.

When estimating the costs of this contract for each locality the two factors which were taken into consideration were the area of soil and the number of trees planted in the “soft areas”.

## **3. Street sweeping contract**

The street sweeping contract incorporates the sweeping, litter picking and weeding of the roads and streets within the urban development zone of each locality. The frequencies of these operations were estimated after consultations were made with the local authorities themselves. These were revised and adapted depending on the flow of pedestrian and vehicle traffic in the area. The contract defines four classifications in order to categorise each street according to its usage:

- Type 1: A flow of heavy pedestrian traffic and/or the congregation of a considerable number of people on a daily basis (concentrated retail areas, entertainment areas, promenades, and open markets);
- Type 2: a medium flow of pedestrian traffic (local main streets and centres, places in the vicinity of public service facilities);
- Type 3: a light flow of pedestrian traffic (residential areas outside the cores of towns and villages, and government apartment blocks/housing estates);
- Type 4: predominantly vehicle traffic as opposed to pedestrian traffic (outskirts of most villages).

Different weightings were given to each type of urban street depending on the frequency of the operations. The street sweeping contract costs were estimated depending on the length of urban streets in each category. The work measurement value of labour (including incentive pay), material and plant were used to establish the cost of each street.

When estimating the costs of this contract for each locality the road and street lengths in each road classification are considered.

#### **4. Household refuse collection contract**

The household refuse collection contract was based on the number of properties per local authority. The operations involved in the collection of refuse were timed and costed. The standard minute value for the collection of refuse per property was established. The refuse collections vehicle (including insurance, maintenance and the driver) was also costed. Refuse is collected six times a week in each locality (excluding Sundays and public holidays). The estimated yearly total cost consists of the total labour cost for three operators per refuse collection vehicle together with the cost of the refuse collection vehicles. The cost of this contract was calculated per local authority.

#### **5. Bins-on-wheels contract**

The bins-on-wheels contract is complementary to the refuse collection contract. This is based on the number of properties per local authority. Historical data regarding the actual expenditure by local authorities on this contract was examined. Based on this data, the number of bins per day per local authority (two bins per 1000 properties) and the rate charged per bin per day (average rate of 554 bins sampled from twenty local authorities) were estimated. These estimations were used to calculate the yearly cost per local authority.

#### **6. Skips contract**

The skips contract is complementary to the refuse collection contract. This is based on the number of properties per council. Historical data regarding the actual expenditure by Councils on this contract was examined. Based on this data, the number of skips per day per local authority (one skip per 3 000 properties) and the rate charged per skip per day (average rate of thirty-five skips sampled from six local authorities) were estimated. These estimations were used to calculate the yearly cost per local authority.

#### **7. Bulky refuse collection contract**

The bulky refuse collection contract is based on the number of properties per local authority. The estimated number of collections per local authority was based on historical data on a sample of twenty local authorities. This data was analysed to establish the average number of collections per locality. Time and motion studies, carried out by the Technical Unit of the department, established the standard minute value of the operations involved. The hourly rate was calculated including incentive pay and overheads. The yearly standard hours were calculated per local authority (based on the number of properties), which when multiplied by the hourly rate would give the yearly estimated labour cost per local authority. The cost of the vehicles required for the collection of bulky refuse was calculated and added on to give the estimated yearly total cost per local authority.

## **8. Maintenance of traffic signs and road markings contract**

The road signs and markings contract is based on the total road lengths within the urban zone of each local authority. The different operations involved in erecting the various types of traffic signs, both if these were being replaced or done for the first time, were timed and costed. The operations involved in road markings (for each type of road marking) were timed and costed. The frequencies for the maintenance and upkeep of the road signs and markings have been calculated depending on the density of vehicle traffic. The work measurement value of labour, material and plant were used to establish the cost per local authority.

## **9. Cleaning and maintenance of public conveniences contract**

The public conveniences contract is based on the number of public conveniences in each local authority. The operations involved in the maintenance and cleaning of the public conveniences were timed and costed depending on the number of urinals and toilets in each location. The number of cleaning sessions was calculated depending on the location and frequency of use of the public conveniences. The work measurement value of labour and material were used to establish the cost per local authority.

## **10. Cleaning of surfaced non-urban roads contract**

The cleaning of surfaced non-urban roads contract is based on the lengths of roads in the non-urban zone of each locality. Historical data regarding the actual expenditure by local authorities on this contract was examined. Time studies were carried out per activity including mechanical sweeping, weed cutting, clearing of roads from demolished rubble walls and repair of walls. The operations involved in the cleaning of these roads was costed and the frequencies were calculated. The work measurement value of plant, labour and material were used to establish the cost per local authority.

## **11. Road and street maintenance contract**

The road and street maintenance contract is based on the lengths of roads and streets in the urban and non-urban zones of each local authority. The operations of this contract were classified under three main headings namely carriageways and footways works; curb works; and patching works. Standards were set for carrying out each operation in this contract. The work measurement value of plant, labour and material were used to establish the cost per local authority.

## **12. Cleaning and maintenance of beaches and coastal areas contract**

The beach cleaning contract has been estimated according to the type of beaches and coastal areas in each local authority. The beaches were classified under four types. The cost was calculated based on the type beaches and coastal areas within the boundaries of each local authority. The work measurement value of plant, labour and material were used to establish the cost per local authority.

### 13. Administration costs

The administration costs for each local authority have been calculated in relation to the size of the authority. The number of employees allowed in each council is dependent on the population of the locality. The employee salaries for each council were calculated, the other recurrent expenditure was extracted from the councils' financial reports and in some cases apportioned by the size of the local authority. The total administration cost was established for each local authority.

The relation between the characteristics of the local authority service contracts and the calculation of the funds allocated for each of these contracts is shown in Section C.

#### C. Revised financial allocation for local authorities

With effect from 1 April 1999, financial transfers awarded to local authorities in terms of Section 55 have been allocated to each authority in accordance with the following formula:

$$S_n = (G_t \times ([0.36 \times G_{an}/G_{at}] + [0.52 \times G_{bn}/G_{bt}] + [0.07 \times G_{cn}/G_{ct}] + [0.05 \times G_{dn}/G_{dt}])) + (V_t \times ([0.5 \times H_{vn}/H_{vt}] + [0.5 \times S_{in}/S_{it}])) + (K_t \times ([0.18 \times U_{1n}/U_{1t}] + [0.34 \times U_{2n}/U_{2t}] + [0.42 \times U_{3n}/U_{3t}] + [0.06 \times U_{4n}/U_{4t}])) + (R_t \times P_n/P_t) + (B_t \times P_n/P_t) + (S_{kt} \times P_n/P_t) + (W_t \times P_n/P_t) + (M_t \times U_n/U_t) + (L_t \times C_n/C_t) + (N_t \times N_{un}/N_{ut}) + (T_t \times [U_n + N_{un}]/[U_t + N_{ut}]) + (X_t \times ([0.04 \times X_{an}/X_{at}] + [0.378 \times X_{bn}/X_{bt}] + [0.316 \times X_{cn}/X_{ct}] + [0.266 \times X_{dn}/X_{dt}])) + (A_t \times E_n/E_t)$$

where :

$S_n$  is the allocation which will be received by locality (n)

$S_t$  is the total appropriation made by the Minister responsible for finance in terms of Section 55;

$$S_t = (G_t + V_t + K_t + R_t + B_t + S_{kt} + W_t + M_t + L_t + N_t + T_t + X_t + A_t);$$

and where:

$G_t$  is the total appropriation for the maintenance of parks and gardens of all localities added together;

$G_{an}, G_{bn}, G_{cn}, G_{dn},$  are the four types of classifications of areas in the parks and gardens of locality (n);

$G_{at}, G_{bt}, G_{ct}, G_{dt},$  are the four types of classifications of areas in the parks and gardens of all localities added together;

$V_t$  is the total appropriation for the maintenance of soft areas of all localities added together;

$H_{vn}$  is the area of soil for the soft areas of locality (n);

$H_{vt}$  is the area of soil for the soft areas of all localities added together;

$S_{in}$  is the number of trees in the soft areas of locality (n);

$S_{it}$  is the number of trees in the soft areas of all localities added together;

$K_t$  is the total appropriation for the street sweeping and weed cutting of all localities added together;

- $U1n, U2n,$  are the road lengths for the four categories of urban roads of  
 $U3n, U4n$  locality (n);  
 $U1t, U2t,$  are the road lengths for the four categories of urban roads of  
 $U3t, U4t$  all localities added together;
- $Rt$  is the total appropriation for the refuse collection from all localities added together;  
 $Pn$  is the number of properties of locality (n);  
 $Pt$  is the number of properties of all localities added together;  
 $Bt$  is the total appropriation for the bulky refuse collection of all localities added together;  
 $Skt$  is the total appropriation for the use of skips of all localities added together;  
 $Wt$  is the total appropriation for the use of bins on wheels of all localities added together;  
 $Mt$  is the total appropriation for the maintenance road signs and markings of all localities added together;  
 $Un$  is the road lengths of the urban zone of locality (n);  
 $Ut$  is the road lengths of the urban zone of all localities added together;  
 $Lt$  is the total appropriation for the maintenance of public conveniences of all localities added together;  
 $Cn$  is the number of urinals and WCs in the public conveniences of locality (n);  
 $Ct$  is the number of urinals and WCs in the public conveniences of all localities added together;  
 $Nt$  is the total appropriation for the maintenance and cleaning of roads in the non-urban zone of all localities added together;  
 $Nun$  is the road lengths of the non-urban zone of locality (n);  
 $Nut$  is the road lengths of the non-urban zone of all localities added together;  
 $Tt$  is the total appropriation for the maintenance of roads of all localities added together;  
 $(Un + Nun)$  are the road lengths of the urban and non-urban zone of locality (n);  
 $(Ut + Nut)$  are the road lengths of the urban and non-urban zone of all localities added together;  
 $Xt$  is the total appropriation for the cleaning of beaches and coastal areas of all localities added together;
- $Xan, Xbn,$  are the areas for the four categories of beaches and coastal  
 $Xcn, Xdn,$  areas of locality (n);
- $Xat, Xbt,$  are the areas for the four categories of beaches and coastal  
 $Xct, Xdt,$  of all localities added together;
- $At$  is the total appropriation for the administration costs of all localities added together;  
 $En$  is the number of councillors forming part of the authority of locality (n);  
 $Et$  is the number of councillors forming part of the council of all localities added together;

## NETHERLANDS

### I. Municipal revenue from the national budget

There have traditionally been two ways for municipalities and provinces to carry out their tasks. Those that are carried out by local authorities on their own initiative are autonomous tasks. The municipality or province itself then determines which tasks it wants to perform and how to go about this. Joint administrative tasks are imposed on municipalities by the state. Autonomous tasks are financed preferably from general funds (local levies, and the general grants from the Municipal Fund or the Provincial Fund). Joint administrative tasks are, in practice, often financed predominantly through specific grants and for the rest by general funds. Specific grants must be based on a law.

More than 70 per cent of Dutch municipal revenue come from the national budget. Specific grants are the main source of the municipality's income. The state generally makes the funds available when these tasks are imposed on the municipality. The grants have to be spent on achieving the specific goals assigned to the municipalities by the ministry concerned, such as urban redevelopment or the social assistance programme. Specific grants (of which there are about 110) account for around 40 per cent of total municipal income (see Association of Netherlands Municipalities (VNG), 1999, page 22). The second source of municipal revenue from the national budget comes from general grants which come out of the Municipal Fund.

#### 1. *General grants from the state to municipalities and provinces*

The general grant from the Municipal Fund and the Provincial Fund is used to finance autonomous tasks and general statutory tasks imposed on municipalities and provinces. The two funds are part of the national budget and since 1995 the volume has been linked to the development of central government expenditure ("the net corrected central government expenditure"). To put it simply, if the state spends 3 per cent more, the Municipal and Provincial Fund also increases by 3 per cent and *vice versa*. This rule is not based on a law.

In short, local authorities' spending needs and/or revenues are not used in the preparation of the national budget in order to determine the overall amount of state grants (or of a particular grant) to be allocated to local authorities.

##### 1.1. *The allocation system of the Municipal Fund*

Each year the municipalities receive a grant from the Municipal Fund, calculated in accordance with the allocation system stipulated in the Allocation of Finances Act. The allocation system is based on two principles, both of which it has to take into account:

1. the differences in costs that municipalities are faced with themselves;
2. the financial capacity of the municipality (i.e. its tax-bearing capacity).

When allocating the total general grant to be awarded to the separate municipalities, the state uses a number of objective allocation criteria. These criteria are applied for equalisation purposes. In 1997, a new allocation system was included in the Allocation of Finances Act. This new allocation system is much more cost-oriented than the previous one (dating from 1984). In addition to characteristics related to size, the social structure and regional function of a municipality are particularly taken into account. Added to these criteria, the municipality's own tax-bearing capacity is now also taken into consideration. As it now stands there are thirty-six allocation criteria (see the appendix).

Municipalities were not formally involved in the construction of the new allocation system. The only way municipalities could express their feelings, was by lobbying by way of the Association of Netherlands Municipalities (VNG). In fact there was a "national" debate about the new system. With the new allocation system, a more equitable allocation method has been created. Municipalities can raise their services to an equal level at a more or less equal tariff for the real-estate taxes. The contrast between the relatively poor regional towns with low tax rates, where citizens profit from the facilities in the regional town could be reduced as a result of this.

Situations may arise in which, despite the allocation system, a municipality is structurally incapable of financing its essential expenditure and is therefore unable to draw up a balanced budget. Provided that the deficit is due to factors over which the municipality has little or no control, the municipality qualifies for a supplementary grant, which may be given for one or more years. This system of supplementary grants is based on Section 12 of the Allocation of Finances Act. "Section 12 municipalities" are supervised by both the Minister of the Interior and the Minister for Finance.

Table 1 shows the development in the number of "Section 12 municipalities" in the Netherlands from 1980-1999. Over this period of time the number of "Section 12 municipalities" decreased significantly and declined in relation to the overall number of municipalities. This means that Dutch municipalities are capable of financing their essential expenditure.

**Table 1: "Section 12 municipalities" from 1980-1999**

	1980	1985	1990	1995	1996	1997	1998	1999
Number of "Section 12 municipalities"	52	26	17	21	19	13	9	7
Number of municipalities in the Netherlands	811	741	672	633	623	572	548	538
Relative number of "Section 12 municipalities" (percentage)	6.4	3.5	2.5	3.3	3.0	2.3	1.6	1.3

Source: B & G, 1999, page 30

The fact that the number of “Section 12 municipalities” in the Netherlands has declined over the last few years, does not automatically mean that Dutch municipalities do not have bottlenecks in their budgets. A publication produced by the Ministry of Finance, the Ministry of the Interior and the VNG, published last year, showed a (slight) tendency towards there being an insufficient increase in specific grants and general grants, provided for in the Municipal Fund, in relation to the programmes for which they are needed to provide a sufficient level of goods and services. The “deficit” has been financed by higher municipal taxes and a different allocation between municipal programmes.

Municipalities are informed about important budgetary issues in different ways:

- there is a detailed discussion of municipal budgetary issues (every year);
- central government publishes circulars, especially about the Municipal Fund. The municipalities can take note of the circulars and calculate the amount of money they will receive themselves; e.g. the development of the indicators (the number of inhabitants, pupils etc.);
- the VNG publishes the so-called “member letters”;
- municipalities can take part in conferences;
- benchmarking for budgets is becoming more and more appropriate.

### *1.2. The allocation system of the Provincial Fund*

The Provincial Fund has five allocation criteria:

1. A set area.
2. The number of inhabitants.
3. The surface area of the land and inland waterways.
4. The surface area of outlying waterways.
5. The surface area of the channels (this is very precise, and includes an evaluation of the capacity of the subsoil).

The allocation system has a relatively high fixed amount per province, as a result of which it is only possible to incorporate scale changes of provinces in the Provincial Fund by using cunning manoeuvres.

Last year, the allocation system of the Provincial Fund was changed. The new allocation system is more flexible than the previous one and fits in better with the differences in cost structures and in the capacity between the provinces. To a large extent, the new allocation

system takes into account factors which incur costs and the possibility of provinces obtaining income from taxes. To realise the basic assumption of cost-orientation, a package deal was composed with similar, commonly recurring provincial tasks. All provinces have to deal with these tasks to a greater or lesser extent. The tasks have been divided into five cluster areas:

- road and water, nature conservation, the environment and rural planning;
- economics and tourism;
- art and welfare,
- general administration;
- public order and safety.

The differences in costs and tasks between provinces are due to population size, the activity and the physical circumstances. The general grant from the Provincial Fund is determined per province on the basis of the added costs for the five areas that are made by all provinces. Along with this, the tax-bearing capacity of a province is taken into account.

## 2. *Specific grants*

Legislation on specific grants is set down in the Allocation of Finances Act. It is a characteristic of specific grants that the state informs a municipality or province before 1 October about the size of the grant to be awarded and on what it should be spent in the next year (Allocation of Finances Act, Article 20). Thus, municipalities and provinces have no or limited freedom with regard to choice of expenditure of specific grants.

There are a number of drawbacks attached to specific grants. Sometimes they are accompanied by very detailed instructions from central government. It is not impossible that a service is created which the municipalities or provinces themselves would not have given a local priority to if they had had any freedom in the spending of the funds. The discretionary power of the local authorities is restricted in this way. Owing to this, public funds may be spent inefficiently. In addition, specific grants may hamper a flexible and coherent financial policy in municipalities and provinces. The indirect costs for specific grants happen to be higher than those for general grants from the Municipal or Provincial Fund.

Many specific grants have been reorganised since the beginning of the 1980s (see Table 2). In addition to this, the central authorities' decentralisation policy has brought the administration closer to the citizens. Even today, specific grants are due to be abolished, combined or transferred to general grants from the Municipal and Provincial Fund. Besides this, a number of developments have led to an even greater decrease in the number of specific grants. The traditional specific grant, with detailed regulations, has in many cases made way for a different type of specific grant. Out of the latter, the so-called multi-purpose grants draw most attention. These are specific grants for which there is only a rough indication as to what the money should be spent on. Within reasonable limits, municipalities and provinces can decide on their own policy. Over the past few years, various specific grants have been combined to create "versatile" specific grants. In this way, available financial funds can be employed on a wider scale and municipalities are in a better position to be able to bring their policy into line with local requirements. Examples of this are:

- the multi-purpose grant for social redevelopment;
- the combined purpose grant for infrastructure projects of less than NLG 25 million;
- urban redevelopment funds.

**Table 2: Specific grants: numbers and amounts**  
(in billions of NLG)

	1983	1986	1989	1992	1995	1997	1998
Number of specific grants	514.0	406.0	243.0	208.0	143.0	125.0	114.0
Total amount (in billions of NLG)	41.5	40.6	33.9	37.8	32.3	28.4	30.7

Source: Ministry of Finance, 1998, page 24

It is expected that the number of specific grants will decrease even more during the coming years. However, specific grants are still the largest source of income for provinces and municipalities, even larger than the general grants from the Municipal Fund and the Provincial Fund.

## II. Use of estimation methods in the preparation of local authorities' annual budgets

The fact that Dutch municipalities are autonomous is one reason why there is no uniform or harmonised method (compulsory or recommended) of estimating expenditure and/or revenue to be included in their budget. Important determinants in estimating the budget are:

- wages/prices (increase of CIP as a general indication);
- volume indications, for example:
  - expected number of inhabitants;
  - expected length of roads/waterways;
  - expected number of pupils;
  - expected number of people that receive social security payments.

Tables 3 and 4 show the available financial data, for the last three years, for a large Dutch municipality, The Hague (which has 440 000 inhabitants) and a small Dutch municipality, Bergschenhoek (which has 10 000 inhabitants).

**Table 3: Financial data for a large municipality** (all amounts in thousands of NLG)

Financial year	1997 (in thousands of NLG)	1998 (in thousands of NLG)	1999 (in thousands of NLG)
Estimated compulsory expenditure	406 953	246 267	220 266
Actual compulsory expenditure	477 311	Not applicable	Not applicable
Estimated total expenditure	4 637 851	3 968 079	4 005 947
Actual total expenditure	5 078 668	4 117 604	Not applicable
Estimated own tax revenue	356 365	260 676	228 833
Own tax revenue received	351 167	277 900	Not applicable
Estimated transfers	2 260 429	2 258 945	2 505 900
Actual transfers	3 543 539	2 190 400	Not applicable
Estimated total revenue	4 465 607	3 781 142	4 005 947
Actual total revenue	6 067 851	4 117 604	Not applicable

**Table 4: Financial data for a small municipality**

(all amounts in thousands of NLG)

<b>Financial year</b>	<b>1996 (in thousands of NLG)</b>	<b>1997 (in thousands of NLG)</b>	<b>1998 (in thousands of NLG)</b>
Estimated compulsory expenditure	8 943	7 265	5 429
Actual compulsory expenditure	6 586	10 233	4 144
Estimated total expenditure	102 658	86 575	102 146
Actual total expenditure	1 321 648	88 893	111 322
Estimated own tax revenue	1 906	2 108	2 276
Own tax revenue received	1 839	2 174	2 375
Estimated transfers	8 501	9 270	10 707
Actual transfers	8 253	10 098	11 519
Estimated total revenue	102 658	86 575	102 095
Actual total revenue	1 346 871	937 321	111 322

With a few exceptions, these municipalities are able to estimate their expenditure and revenue quite well. This does not automatically mean that large municipalities are capable of estimating their expenditure and revenue correctly. Nor does it mean that one of the two municipalities is more capable of estimating its own expenditure and revenue than the other.

**APPENDIX****Allocation criteria in the allocation system of the Municipal Fund**

1. Real-estate taxes
2. The number of inhabitants
3. The number of young people
4. The number of older people
5. The municipality is located on an island
6. The number of people with a low income
7. The number of people that receive a social security payment
8. Administrative costs for the implementation of social security
9. Scale of administration costs for the implementation of social security
10. The number of people that receive unemployment benefit
11. The number of minorities
12. Customer potential at local level
13. Customer potential at regional level
14. The number of pupils
15. The surface area of the land and inland waterways
16. The surface area of outlying waterways
17. The nature of the soil
18. Sewerage in inland areas with poor quality soil
19. Sewerage in outlying areas with poor quality soil
20. Surface of the built-up area
21. The amount of living accommodation
22. The surface area of the historical centres of the municipality
23. The length of historical waterways
24. The number of historical houses in inhabited areas
25. The number of historical houses in historical centres of the municipality
26. Reconstruction of the city
27. The density of addresses in the neighbourhood
28. A fixed amount for each municipality
29. A fixed amount for Amsterdam
30. A fixed amount for Rotterdam
31. A fixed amount for The Hague
32. A fixed amount for Utrecht
33. A fixed amount for municipalities located on an island
34. An incidental grant when borders of municipalities have been changed
35. Refinement for large numbers of new houses in selected municipalities
36. Refinement for redrawing municipal boundaries

Source: Ministry of the Interior and Kingdom Relations, 1999, Appendix 2.



## NORWAY

### Preamble

In Norway, the municipal sector is responsible for a considerable amount of public expenditure. The level of activity, and, hence, the municipal sector's expenditure, must be continuously adjusted to be in accordance with national economic priorities. Instead of setting specific target amounts in order to limit municipal expenditure, the national budget operates with a revenue framework. Municipalities are, within this framework, responsible for adjusting expenditure in accordance with economic limits set by the framework.

Setting the revenue framework for each year is a complicated process and it is impossible to operate with fixed criteria and weights in this model, which is what normally occurs when models for the distribution of grants for municipalities are being designed.

The Norwegian municipal sector is basically financed through:

- taxes collected by the municipalities themselves;
- income from payment for services provided by the municipalities;
- grants awarded by central government;
- specific transfers from central government including special grants;
- transfers from other municipalities and counties.

### I. Use of estimation methods in the preparation of the national budget

Every year in its national budget, the government stipulates the total level of revenue to be awarded to municipalities and counties in the following fiscal year. In a proposal concerning local finance presented annually to Parliament in the May preceding the fiscal year, the government gives an estimate of the level of revenue municipalities and counties can expect. But the estimate is not binding on the government.

#### 1. Total revenue scheme

When the government sets down the total revenue scheme for the next fiscal year, its judgment is based on a range of considerations:

- fiscal capacity;
- changes in spending needs owing to socio-demographic changes;
- the total revenue scheme for the previous fiscal year;
- changes in the distribution of powers;
- how effective it will be.

### **1.1. Fiscal capacity (ceiling on government expenditure growth)**

The total revenue scheme is decided on each year, but may be revised in relation to the revised national budget. In the long-term programme, the government presents estimates for the next four fiscal years.

The scheme is based on macroeconomic models such as the demand-model MODAG and the equality-model MSG. The growth in private and public consumption and investments is forecast by these models. The estimated growth-rate in public consumption will help when drafting the national budget but will not restrict the budgeting process.

### **1.2. Expected expenditure**

Statistics Norway has developed a model for estimating employment in the municipal sector, MAKKO, to help the ministry to establish the revenue framework when preparing the national budget. The model estimates employment in the municipal service sector based on general standards, degree of fulfilment, and demographic developments. The following formula is used:

$$L_j = s_j \times c_j \times p_j$$

$L_j$  = completed labour hours per person;

$S_j$  = standard for service  $j$  measured by labour hours per person per service-equivalent;

$C_j$  = degree to which service  $j$  is fulfilled;

$P_j$  = population to whom service  $j$  is offered.

For example, if service  $j$  is a kindergarten and the number of 1-5 year-old children increases by 10 000, with a degree of fulfilment ( $c=65$  per cent) and the standard for the service ( $s=250$ ) is constant. The hours completed in the kindergarten sector will increase by 2.5 million or the equivalent of approximately 1 500 labour years per person.

The increase/decrease in the population included in the model is based on a population estimation model for various age groups. These estimations are based on parameters for birth rates, immigration/emigration rates, mortality rates, and so on.

To supplement to the model describing changes in the need for municipal labour for various services as a consequence of demographic changes, Statistics Norway is, as requested by the ministry, developing a model that will try to predict marginal costs caused by population change. The model and the results are briefly described in the appendix. It must be noted that the model is being developed and changes may be made.

### ***1.3. Previous year's revenue framework adjusted for inflation***

The importance of incremental budgeting cannot be underestimated either at national level or at local level. The previous year's revenue framework is one of the elements considered when the framework is decided on. Evaluation of growth or cutbacks takes place after the previous year's target revenue has been adjusted for inflation. A special index for municipal consumption where wage growth and inflation on production are weighted 2:1 is used to compute deflation. An expected 6 per cent wage growth and 3 per cent inflation will result in a deflation figure of about 5 per cent. The total revenue framework will then be deflated according to the national budget's forecasted wage growth and levels of inflation for the following year.

### ***1.4. Changes in tasks***

During a normal fiscal year, tasks may be reassigned from one level of administration to another, or new tasks may be assigned. Especially relevant here are cases where tasks are transferred from national level to municipal or county level.

When tasks are transferred from national level to municipal level, the inflation-adjusted grant for the task related to the previous budgetary period will be assigned to the municipal sector's revenue framework if no changes to the transferred task are made. If the transferred task will increase the administrative burden, the framework may be increased.

### ***1.5. Possibilities for increased efficiency***

When the size of the annual revenue framework is evaluated, possibilities of improved efficiency may be taken into consideration. As requested by the ministries, research institutions have analysed the possibility of improved efficiency in the performance of services.

## **2. The division of the total revenue framework into main components**

As mentioned earlier, the total revenue framework is composed of five main components. When it comes to the amount distributed to each of these main components, the method of distribution varies. All the components mentioned play a role when the revenue framework is distributed. None of the components plays a direct role, but all are used in the overall evaluation. The different elements that are relevant for the size of the revenue framework are discussed with the municipal organisation both in connection with indications about coming years' revenues as well as in connection with the national budget. However, there are no negotiations between the municipality and central government.

During the spring of 1998, the Norwegian Storting (national assembly) discussed a suggestion from the government about principles for financing the municipal sector. The Storting's decision will be used as the basis for work on the revenue frameworks developed for the municipal sector each budgetary year. The Storting has also asked the government to develop a model with extended consultation between the municipal sector and central government as regards the relationship between the revenue framework and expected costs.

### **2.1. Local taxes**

Local taxes make up 45 per cent of the municipal sector's total revenue. Local taxes are composed of income tax (for both municipalities and counties), capital tax (for municipalities), and property tax (for municipalities).

### **2.2. Income tax**

Municipalities and counties may set the conditions for income tax within rules that are laid down each year by the Storting. All municipalities and counties have used maximum income tax rates over the last twenty-five years. All estimates presented in the national budget are based on the assumption that maximum income tax rates are used.

The municipalities' tax income is also based on the development of the tax basis. For the same reason, calculation of the tax income in the national budget is based on the following factors:

- changes in the tax basis;
- changes in tax laws;
- demographic changes;
- development of the trade cycle;
- wage-growth estimates;
- decisions on tax rates.

The basis for the estimates mentioned is the most recent tax statistics available for individual taxpayers, as well as temporary tax statistics from the tax authorities. The goal is that the estimates should be based on objective and known facts, as well as on legitimate and relevant factors.

Income tax, including municipal income tax, is an important factor when distribution rules are made. Changes in tax laws made because of new distribution rules, are not considered when the municipal sector's revenue is evaluated. If changes in tax laws or other factors result in significant changes in the tax basis, the maximum income tax rate will be adjusted so that municipalities' revenues will not change in proportion to the changes in the tax basis.

### 2.3. *Capital tax*

Municipalities and counties may decide on the conditions for capital tax within rules that are laid down each year by the Storting. The maximum tax rate is assumed when planning the national budget. The basis for capital tax is the value of assets based on standardised valuation rules, deducted from the taxpayer's debt. The value of a household's capital together with current and savings accounts helps to decide most of the basis. The value of a household's capital is increased by a standardised rate each year. Revenue from capital tax may therefore be estimated based on specific assumptions regarding the household's financial assets and liabilities.

### 2.4. *Property tax*

The principal municipalities can decide whether or not property tax should be paid to municipalities. About half of Norway's municipalities have chosen to impose property tax. The municipalities have to set, by law, a tax rate of between 0.02 per cent and 0.07 per cent. Rules for evaluating how much property tax is to be paid for a property are provided for by law. The rules give some room for manoeuvre. In addition, statistics about the property tax basis are not published. Hence, the national budget's property tax section is solely based on numbers from the previous fiscal year adjusted according to the inflation factor for municipal consumption.

## 3. **Central government transfers**

The distribution of welfare services between the three tiers of government is laid down by law. In addition municipalities and counties may carry out other services, when not prohibited by law. Central government transfers to municipalities and counties are composed of earmarked grants and block grants which may be used to cover all types of services. The main principle states that welfare services should be financed by block grants and by local taxes. There are, however, a few exceptions:

- services where objective criteria (general grant schemes) are not applicable;
- services where the principle of activity-based financing is followed.

In general, there is no provision for central government discretion in applying the results of the calculation formula. Exceptions are made for "discretionary grants" (part of the block grant).

Except for the activity-based grants no *ex-post* measures are applied if discrepancies between estimated and actual figures are identified.

The ministries responsible for the different grants have an obligation to verify how appropriate the results of the methods are for the actual situations. The normal procedure, when significant discrepancies have been identified, is to appoint a committee to deliberate the issue. The committee will normally have members representing both central and local government.

### **3.1. *The block grant***

The block grant is composed of four parts:

- a population grant (in order to bridge the gap between local authorities' own resources and their financial needs);
- a revenue equalisation grant (for financial equalisation);
- a discretionary grant;
- a regional grant.

The block grant and revenue from income tax and capital tax make up the municipalities' unrestricted funds. When deciding on the national budget, the Storting determines the municipal sector's expected revenue from tax revenue and block grants. The basis for the forecast of the municipal sector's unrestricted funds is the previous year's unrestricted funds adjusted according to inflation (the method for deflation is described in Section 1.3.). Because there are significant variations in tax revenue and block grants among the municipalities, the government tries, for political reasons related to distribution and within the framework for unrestricted funds, to grant the municipalities a relatively equal growth in tax revenue and block grants. The growth in tax revenue is regulated through the maximum income tax rate.

The use of block grants is not regulated by law, but is instead based on majority decisions by the Storting. When the decision to use such grants and when changes for principals for such grants were decided on, the municipal sector were greatly involved. It has been a priority to legitimise the use of block grants for the municipal sector. Funds granted by the block grant will usually remain fixed throughout the fiscal year and no changes will be made at the end of the fiscal year.

#### *3.1.1. Revenue equalisation grants*

All municipalities are compensated for the difference between their tax revenue (income tax and capital tax) and a reference level of 110 per cent of the average municipality (120 per cent for counties) with a 90 per cent degree of compensation. The compensation is calculated in NOK per inhabitant. The basis for the compensation is the tax assessment from two years before. For the 1999 national budget, the basis is the tax assessment for 1997. In the 1999 national budget, the monetary size of grants to municipalities may be computed by using the standard formula.

### 3.1.2. *Discretionary grants*

A smaller part of the block grant is the discretionary grant. The framework for the discretionary grant is set when the revised national budget is adopted. The framework for the discretionary grant is evaluated annually based on a discretionary evaluation of monetary necessities. The basis for the ministry's evaluation of the monetary size of the discretionary grant is the previous year's framework adjusted according to inflation.

### 3.1.3. *Population grants*

When limits on the municipalities' unrestricted funds have been set, the municipalities' tax revenue forecast, the revenue equalisation grant calculated, and the discretionary grant determined, the population grant will be made up of the remaining available funds. In other words, no specific calculations are made when the population grant is distributed.

## 3.2. *Earmarked grants*

No standard method is used regarding the annual need for earmarked grants. The methods used will vary depending on the various kinds of grants. To simplify, three broad categories may be used:

- activity-based grants;
- grants based on objective criteria;
- grants based on a standard financing key.

### 3.2.1. *Activity-based grants*

Government grants for hospital treatment are, to a certain degree, calculated on the basis of determined activity. The annual need for grants that is presented in the national budget is calculated on the basis of a formula that includes the following criteria:

- amount of hospital treatment carried out (historical data);
- indexed cost per treatment type based on the DRG-index;
- planned/expected activity growth measured as a percentage of historical data;
- expected development in the index for municipal consumption (see Section 1.3.);
- marginal costs for hospital treatment (variable costs as a share of total costs = 85 per cent).

The need for grants is computed as a product of the above-mentioned criteria. The grants are not regulated by law, but are based on majority decisions by the Storting. The grant arrangement introduced in 1997 is discussed regularly with the municipal sector.

### 3.2.2. *Grants based on objective criteria*

The municipalities are responsible for the care of senior citizens, and this responsibility is regulated by law. In 1997, the Storting decided on a national plan to improve care of senior citizens. Among other things, the activity plan includes target numbers to increase the numbers of available capacity in institutions for senior citizens. To forecast funds to cover expenditure, and grants in the national budget, the following parameters are used:

- plans for the new capacity for the next fiscal year;
- person-labour years per user (for example, senior citizens institutions 0.9 person-labour years per user);
- total expense for man-labour years;
- deflation (Section 1.3.).

The total amount of grant awarded from the national budget will result from the above-mentioned parameters.

### 3.2.3. *Grants based on a standard financing key*

The municipalities are responsible for kindergartens. The responsibility of financing kindergartens is shared among parents, municipalities, and earmarked grants from the government. Currently, the following financing key is used: parents (30 per cent), earmarked grants (40 per cent), and municipalities (30 per cent). This financing key was decided on by the Storting in 1998. The financing key is only used as a basis, so differences may occur both for different fiscal years and for different municipalities.

During the 1990s new targets for the size of kindergartens have been revised annually in the national budget. The cost per kindergarten unit based on historical data multiplied by the number of new units is added in the total revenue framework. The financing key (30/40/30) determines how the increase is distributed on earmarked grants, the municipality's unrestricted funds, and funds paid by users.

## 3.3. *Funds paid by users*

Approximately 50 per cent of the municipalities' revenues from users concerns household services such as water supplies, renovation services, and so on. The municipalities are, by law, ordered to offer such services, but the costs of these services are supposed to be covered by user fees. Therefore, incremental budgeting is generally used to budget the municipalities' costs and revenues. Additional expenses derived from the supply of such services should be completely covered by increased user fees.

## II. Use of estimation methods for apportioning financial support among local authorities

### 4. Methods for estimating expenses incurred when block grants are apportioned

#### 4.1. *Methods used to estimate local authorities' spending needs and revenue for the purpose of apportioning a general grant for equalisation purposes*

The overall political aim at stake when allocating the general grant is to achieve equalisation. The general grant is allocated to municipalities and counties in the form of a block grant through the general purpose grant scheme. The general purpose grants scheme is made up of six different components. The municipalities receive all of these and the counties receive five:

Municipalities receive	The counties receive
The per capita grant/equalisation of expenditure	The per capita grant/equalisation of expenditure
The equalisation of income	The equalisation of income
The grant for northern Norway	The grant for northern Norway
The grant for the remote regions	
The discretionary grant	The discretionary grant
The grant for the capital	The grant for the capital

The largest component, the per capita grant/equalisation of expenditure is allocated by assessing certain criteria, others are allocated through different methods.

##### 4.1.1. *The per capita grant/equalisation of expenditure*

The purpose of equalisation of expenditure is to compensate for the different levels of costs connected with giving the same standard of services to the public in different municipalities and in different counties.

Differences in the levels of costs are caused by two main factors:

- differences in demand for particular services. A municipality with a higher number of older inhabitants, has to supply better services in the sector of care for the elderly than a municipality which has many young and middle-aged people. A municipality with more children in the 6-15 age range, will have relatively high costs related to supplying a sufficient range of good schools;
- geographical differences can also engender high costs. A sparsely inhabited municipality will have to build more schools with fewer pupils than a densely-populated one.

With the per capita grant distribution is primarily based on their being a similar amount for all inhabitants throughout the country. The equalisation of expenditure is carried out by calculating the objective expenditure needs for each municipality. These calculations are based on the principle of a zero-sum allocation. Municipalities and counties that have cheaper production costs allocate parts of their share of the grant to the counties and municipalities with more expensive production costs. The allocation is based on special criteria, seventeen of which are applicable to the municipalities and sixteen to the counties.

### Calculation matrix for the general purpose grant in 1999

**Table 1: Calculation matrix for the municipalities**

Criteria	Weight
Basic grant 1/435	0.028
Share of population 0-5 years	0.025
Share of population 6-15 years	0.309
Share of population 16-66 years	0.130
Share of population 67-79 years	0.082
Share of population 80-89 years	0.123
Share of population 90 years or over	0.045
Share of divorced and separated people 16-59 years	0.066
Share of unemployed people 16-59 years	0.023
Death rate	0.024
Share of non-married people 67 years and over	0.024
Immigrants	0.004
Average travelling time	0.037
Share of population in sparsely populated areas	0.011
Share of mentally retarded people of 16 years and over	0.066
Share of mentally retarded people under 16 years	0.003
<b>Total</b>	<b>1.000</b>

**Table 2: Calculation matrix for the counties**

Criteria	Weight
Share of population 0-15 years	0.072
Share of population 16-18 years	0.273
Share of population 19-34 years	0.084
Share of population 35-66 years	0.153
Share of population 67-74 years	0.072
Share of population 75 years or more	0.096
Death rate 0-64 years	0.049
Share of divorced and separated people 16-59 years	0.017
Share of single and single parents	0.030
Share of sea routes	0.014
Share of population living in sparsely-populated areas	0.009
Share of total area	0.004
Share of urban factor	0.007
Share of population living on islands	0.004
Maintenance costs for county roads	0.028
Reinvestment costs for county roads	0.014
Share of pupils in vocational courses	0.074
<b>Total</b>	<b>1.000</b>

#### *4.1.2. The equalisation of income*

The purpose of the equalisation of income is to level out differences in income tax between municipalities and between counties. All municipalities with per capita tax revenues below 106 per cent of the average receive an income grant to bring them up to approximately this level. The grant covers 92 per cent of the difference between the average level and the municipalities' own average tax income. All municipalities with per capita tax revenues above 140 per cent of the average are required to hand over half of the revenues above this level. Municipalities with an average income between these levels receive no compensation. Counties with per capita tax revenue below 118 per cent of the average receive an income grant of 92 per cent of the difference between the average for the country and the county's own average.

#### *4.1.3. The grant for northern Norway*

The municipalities and counties in the northern Norway receive an extra grant in recognition of the problems which are particular to the northern areas. It is politically accepted that this area has to have an especially high level of public services. The grant is given in a form of a lump-sum awarded to municipalities and counties in the three most northern counties based on the number of inhabitants.

#### *4.1.4. The grant for the remote regions*

This grant is distributed to small and remote municipalities with under 3 000 inhabitants. The level of the per capita tax has to be below 110 per cent of the average. This grant is in the form of a fixed lump-sum. The municipality in question also has to be situated in an area that is entitled to specific measures such as a remote district.

#### *4.1.5. The discretionary grant*

This grant is divided into two parts: the ordinary discretionary grant and the special discretionary grant. The former is awarded to municipalities and counties that are undergoing transitional economic problems. It is also given to compensate for special local economic difficulties that are not covered by other parts of the general grant system. The special discretionary grant is allocated to the municipalities and counties that experienced an economic loss as a result of the 1997 reform.

#### *4.1.6. The grant for the capital*

This grant was introduced in 1999 as a compensation for the loss of corporate tax in Oslo.

#### *4.1.7. Law/legal source*

The general purpose grant scheme is not provided for by law. The results of the calculations are automatically applied. The calculations are based upon the different criteria stated in the calculation matrix above. Most of these criteria are changed annually as the numbers of inhabitants and the figures of the other criteria actually change for the different municipalities and counties. These figures are sent to the local authorities to be checked each year before they are used in the calculations. The figures might then be corrected if proved false.

#### *4.1.8. Different criteria*

The different criteria and their weights are based upon a considerable revision of the general purpose grant scheme carried out by a report from a Committee for the General Purpose Grant Scheme in 1996. The weights are made by regression analysis of municipalities' spending costs. The criteria are objective and cannot be influenced by municipalities and counties.

It cannot be said that municipalities use a standardised method for estimating revenue and expenditure in their annuals budgets; although some methods are used by several municipalities, these methods are not compulsory.

The revenue framework model is generally used in municipal budgeting. The main question concerns how expected revenue will be apportioned to service sectors. It is important to note that 75 per cent of municipalities' revenue has no restrictions imposed on it.

The way in which money was distributed to different service sectors over the previous budgetary period serves as the basis for the next budgetary process in most municipalities. More than half of the municipalities have under 5 000 inhabitants. In such small units each transaction is accounted for in the budget. These municipalities differ from larger municipalities in that demographic changes will not necessarily effect expenditure forecasts. This conclusion is based on the fact that demographic changes, measured as absolute numbers in the various population categories, will (in most years) be able to be met by more efficient use of capacity, and not by establishing new business units as the most appropriate method to cover new need for capacity. Whether or not new business units should be established will be evaluated in each situation.

### **III. Use of estimation methods for the preparation of local authorities' annual budgets**

Municipalities' spending needs include expenditure as a product of service/volume, expenditure on each factor of production (the factor/contribution) and factor costs in the production of services. It is within the scope of municipal control to define service and volume and factor contributions. Factor costs is an exogenous variable in the local budgeting process. It is up to each municipality to estimate revenue and expenditure.

The Local Government Act of 25 September 1992 sets down that municipalities and counties should use realistic revenue estimates and appropriate funds in accordance with expected expenditure. However, a standardised method for how these requirements should be fulfilled has neither been proposed nor recommended. That the budget, by law, is required to be realistic means nonetheless that estimated revenue and expenditure should be based on professional judgments.

There are two main exceptions to this: earmarked grants and fees and charges.

#### **Earmarked grants**

Municipalities and counties are awarded earmarked grants every year to enable them to solve specific tasks. Expenditure on these tasks should tally with the revenue (the grants).

#### **Fees and charges**

Fees and charges apply, to some extent, to services for which revenue should neither be lower nor higher than local authority expenditure on the particular service. This principle applies to services such as renovation. Estimated fees and charges (from renovation) have to be equal to estimated expenditure (on renovation).

Municipalities' spending needs will change if one or more of these elements change. The criteria may be the elements mentioned on a disaggregated level. The ministry's impression is that the municipalities' budgeting process is naturally based on the above-mentioned elements, but at the same time is reached as a result of a much more complex process than is assumed by endogene variables in a model. This is also connected with the fact that, for several services, discretion is used for both service/volume and factor/contribution.

#### **IV. Case studies**

The following information is based on interviews with the assistant chief executives for the municipalities of Bergen and Bjerkreim.

#### **5. The municipality of Bergen**

The municipality of Bergen is the capital of Hordaland county. With 225 439 inhabitants it is Norway's second largest municipality. Only the capital, Oslo, with approximately 500 000 inhabitants, is larger.

The financial management of the municipality has mainly been based on appropriations to services from the city council. From 1 January 2000, Bergen will start using a decentralised financial management model. From this date, appropriations of funds to most of the individual-based services will be appropriated to eight sections of the municipality. The appropriations to the eight sections will be based on objective criteria (demographical and socio-demographic – see Section 5.3.). The final appropriation to service categories will be decided on by administrative units in each of the eight sections.

##### **5.1. Revenue**

###### *5.1.1. Own taxes*

The budgeted revenues for the previous year and the national budget's growth estimate compose the basis for the municipality of Bergen's budgeting for income tax and property tax. The national budget's growth estimate is adjusted to allow for changes in the tax basis based on possible changes in local employment compared to the national average and possibly other factors. Budgeted amounts from the previous year, adjusted according to changes in property rates, are used to forecast revenue from property tax.

###### *5.1.2. General grant*

The municipality of Bergen enters the amount apportioned to the municipality according to the figures in the national budget.

###### *5.1.3. Earmarked grant*

Budgeting for earmarked grants is based on governmental guidelines. When amounts are granted per unit or individual, the budgeted amount will be a product of rates and volume of the service. When other appropriation criteria are used, the amount appropriated by the government is entered, or an estimate based on governmental guidelines is calculated if the appropriation to municipalities is not known in the national budget.

#### *5.1.4. Charges and fees*

The budgeted revenue is a product of price per unit and volume. For services that by law are expected to be completely financed by user fees, budgeted expenditure will determine budgeted revenue. The price per unit is adjusted for inflation on all other services.

#### *5.1.5. Other sources of revenue*

This revenue category is composed of several items. The largest items are refunds from the National Insurance programme and transfers from municipal corporations. Estimates of refunds of sickness benefits are based on statistics for sick leave. Transfers from municipal corporations are budgeted based on the corporation's last known financial results for a fiscal year.

### **5.2. Expenditure**

The municipality of Bergen's estimated expenditure is based on appropriations to the various service categories from the previous year. The appropriations are then adjusted based on the following criteria:

- expected inflation and wage growth;
- planned and/or expected change in activity level;
- goals for cost-effectiveness in the specific service area.

There are two main exceptions to this.

#### *5.2.1. Exception 1*

The budgeting of expenditure on services financed by earmarked grants is based on appropriated amounts.

#### *5.2.2. Exception 2*

Municipalities use governmental rules to calculate expenditure associated with services completely financed by user fees. That means that budgeted expenditure determines budgeted revenue.

#### *5.2.3. Planned and/or expected changes in activity level*

Changes in activity levels will lead to changes in necessary expenditure as well as changes in the annual appropriations on the municipal budget. Activity changes are necessary because of changes in the population composition and the fact that people move within the municipality. To be able to consider such changes, municipalities use official statistics as a basis to estimate future activity levels. In addition, changes in activity level may be caused by politicians' wish to improve certain service areas.

### 5.3. *Establishing a general grant scheme for the municipality of Bergen*

An organisational reform proposed by the council of Bergen will mean that revenue from local taxes and the block grant are mainly apportioned to the eight districts in Bergen according to five calculation matrices. The council for each district will be responsible for carrying out services for the inhabitants. A special matrix is established for five categories of services (functions). The weight of each criterion is based on statistical analysis (regression) and the categories of services are:

- care for elderly and disabled persons;
- education, including kindergartens and leisure services;
- child welfare work;
- social services;
- health services

As with central government's "general grant scheme", the calculation matrix is based on each districts share of the criteria, which means that an increase or decrease in population, in real numbers, will have no influence on the district's revenue. On the other hand, a significant increase in the elderly may influence the amount to be apportioned according to the matrix.

#### **Care for elderly and disabled persons**

<b>Criteria</b>	<b>Weight</b>
Basic grant 1/435	0.000
Share of population 67-79 years	0.027
Share of population 80-84 years	0.027
Share of population 85-89 years	0.028
Share of population over 90	0.152
Share of non-married people 67-79 years	0.088
Share of not married people 67-79 years	0.020
Share of non-married people 80-84 years	0.125
Share of non-married people 85-89 years	0.133
Share of population 67-79 * index death rate 50-74 years	0.040
Share of population 80+ * index death rate 50-74 years	0.020
Share of population 67+ * index disabled persons 16-66 years	0.060
Share of population 67-79 years * index education level	0.060
Share of population 0-17 years	0.004
Share of populations 18-49 years	0.013
Share of population 50-66 years	0.020
Death rate 50-74 years * index share of population 50-66 year	0.011
Disabled persons 16-66 years	0.007
Share of mentally retarded people of 16 years and over	0.057
Share of mentally retarded people under 16 years	0.107
<b>Total</b>	<b>1.000</b>

## **6. The municipality of Bjerkreim**

The municipality of Bjerkreim is situated in the southern part of Rogaland county. Bjerkreim is a small agricultural municipality with 2 437 inhabitants as of 1 January 1999.

The city council of Bjerkreim uses a system that includes framework budgeting. This means that the administration may use relatively unrestrictive measures when it comes to the appropriations for each service area.

### **6.1. Revenue**

#### *6.1.1. Own taxes*

The budgeted revenue for the previous year and the national budget's growth estimate makes up the basis for the municipality of Bjerkreim's income tax budgeting. Of special interest is the income level within the agricultural sector. Any discrepancy between development within this sector and in society as all, normally implies that growth estimate in local budget will deviate from the estimate in the national budget.

#### *6.1.2. General grant*

The municipality of Bjerkreim enters the amount apportioned to the municipality according to figures in the national budget.

#### *6.1.3. Earmarked grant*

Budgeting of earmarked grants is based on governmental guidelines. When amounts are granted per unit or individual, the budgeted amount will be a product of rates and volume of the service. When other appropriations criteria are used, the amount appropriated by the government is entered, or an estimate based on government guidelines is calculated if the appropriation to municipalities is not mentioned in the national budget.

#### *6.1.4. Charges and fees*

The budgeted revenue is a product of price per unit and volume. The price per unit is adjusted for inflation on all other services.

#### *6.1.5. Other sources of revenue*

This category of revenue is composed of several items. The largest items are refunds from the National Insurance programme and transfers from municipal corporations. Budgeting of such revenues is mainly incremental.

## 6.2. Expenditure

In a municipality like Bjerkreim, with a population of 2 500, a large amount of discretion is necessary in local authorities' own budgeting. For instance, with an elderly population (over 80s) of 92 (1998), it is not possible to plan for capacity in elderly institutions according to some average national level on the share of the elderly who need care in institutions (the estimated national level is 20 per cent). The fact that for most services optimal capacity (based on national standard level) is too ambiguous a goal, implies that calculation methods based on statistics is inappropriate when budgeting.

As a consequence the municipality of Bjerkreim's budgeting of expenditure is based on previous year appropriations to the various service categories. The appropriations are then adjusted based on the following criteria:

- expected inflation and wage growth;
- planned and/or expected changes in activity levels (a large degree of local government discretion).

## 7. Estimated and actual revenue and expenditure in Bergen and Bjerkreim 1996-98

### Expenditure for Bergen

(in million NOK)

Year	1996	1996	1997	1997	1998	1998
Type	Estimate	Actual	Estimate	Actual	Estimate	Actual
Compulsory	680	688	642	631	607	630
Optional	5 464	5 541	6 028	5 928	6 518	6 547
Investment	452	403	655	527	627	522
Operation	5 691	5 825	6 015	6 032	6 498	6 655
Total	6 144	6 228	6 670	6 559	7 125	7 177

### Revenue for Bergen

(in million NOK)

Year	1996	1996	1997	1997	1998	1998
Type	Estimate	Actual	Estimate	Actual	Estimate	Actual
Own taxes	2 851	2 843	3 012	2 997	3 131	3 097
Shared taxes	0	0	0	0	0	0
Charges/fees	1 026	1 038	1 107	1 124	1 159	1 190
General grants	776	776	918	918	1 104	1 106
Earmarked grants	746	762	701	694	666	699
Other revenue	3 153	3 470	1 002	1 068	680	739

**Expenditure for Bjerkreim**  
(in million NOK)

<b>Year</b>	<b>1996</b>	<b>1996</b>	<b>1997</b>	<b>1997</b>	<b>1998</b>	<b>1998</b>
<b>Type</b>	<b>Estimate</b>	<b>Actual</b>	<b>Estimate</b>	<b>Actual</b>	<b>Estimate</b>	<b>Actual</b>
Compulsory	5.2	13.1	6.3	10.6	9.9	13.3
Optional	54	54.1	58.4	61.2	69.8	71.2
Investment	6.7	6.2	5.1	6.2	13.4	13.1
Operation	52.5	61	59.6	65.6	66.3	71.4
Total	59.2	67.2	64.7	71.8	79.7	84.5

**Revenue for Bjerkreim**  
(in million NOK)

<b>Year</b>	<b>1996</b>	<b>1996</b>	<b>1997</b>	<b>1997</b>	<b>1998</b>	<b>1998</b>
<b>Type</b>	<b>Estimate</b>	<b>Actual</b>	<b>Estimate</b>	<b>Actual</b>	<b>Estimate</b>	<b>Actual</b>
Own taxes	24.8	25.1	25.1	26	27.1	27.3
Shared taxes	0	0	0	0	0	0
Charges/fees	7.4	7.8	8.2	8.8	8.6	8.9
General grants	20.9	20.6	25.9	26.2	27.8	27.8
Earmarked grants	6.4	14.3	7.5	11.8	10.8	14.3
Other revenue	2.4	5.8	3.8	8.7	2.9	7.1

## APPENDIX

**Estimates of subsistence expenditure, minimum budget surplus and maximum user fees parameters<sup>a b</sup>**

	0	1	2	3	4	5	6	7	8	9
Constant	-0.41 (1.89)	-0.37 (1.62)	-0.77 (1.41)	-0.68 (1.98)	-1.06 (2.09)	0.18 (1.72)	-0.34 (0.62)	0.05 (0.35)	-0.26 (0.49)	1.62 (6.75)
Population share 0-6 years of age				8.17 (3.19)	5.52 (1.58)					
Population share 7-15 years of age			27.85 (8.53)							
Population share 80 years and above					7.95 (2.28)					
Population share 67-89 years of age							14.27 (6.20)			
Population share 90 years and above							150.84 (4.88)			
Children 0-6 years with lone mother/father per capita				13.66 (1.70)						
Mentally handicapped 7-15 years per capita			216.53 (2.33)							
Mentally handicapped 16 years and above per capita							363.78 (22.03)			
Unemployed 16-59 years per capita						12.78 (3.54)				
Divorced/separated 16-59 years per capita						14.71 (6.21)				
Foreigners from remote cultures per capita						12.67 (3.82)				
Population density			-0.47 (2.12)		0.32 (1.90)			0.15 (1.69)		
Person hours (average travelling time)			1.19 (5.97)		0.49 (3.19)					
Population inverted (thousands)		1.08 (6.08)					0.71 (2.40)			
Dummy for small municipalities		0.22 (2.45)	0.57 (4.65)	0.28 (3.29)	0.31 (3.85)				0.41 (2.14)	
Dummy for urban municipalities						0.19 (1.96)				
Dummy for suburban municipalities								-0.15 (2.89)		
Sewage purification degree									0.51 (3.14)	
Duration and severity of cold winter period		0.13 (6.55)	0.16 (7.18)	0.07 (3.42)	0.06 (3.22)		0.10 (2.53)	0.07 (6.41)	0.18 (3.80)	
Per capita change in municipal income	0.44 (8.51)									
Per capita exogenous income excl. of min. exp. Equations 2 and 5										0.18 (6.71)
R <sup>2</sup> adjusted	0.75	0.84	0.80	0.63	0.50	0.40	0.77	0.65	0.75	0.34

a The dependent variables are per capita operating result in equation 0, per capita expenditure in equations 1-8, and per capita fee income in equation 9. All pecuniary amounts are in thousands of Norwegian kroner. T statistics are in parentheses.

b The model equation numbers refer to:

Equation 0: Net operating result

Equation 1: Administration

Equation 2: Education

Equation 3: Child care

Equation 4: Health care

Equation 5: Social services

Equation 6: Care for the elderly and disabled

Equation 7: Culture

Equation 8: Infrastructure

Equation 9: Fee income

The set of demographic variables and other characteristics that are assumed to affect subsistence expenditure, minimum fiscal surplus and maximum user fees is shown in the table above, which also reports corresponding parameter estimates and t-values. The effects of the age structure of the residents on the subsistence expenditure allocation evidently conforms with theoretical reasoning. Children of pre-school age raise childcare expenditure, and children of school age raise education expenditure. We also find a positive, but only slightly significant effect of pre-school children on health care expenditure. The results show the significant effect on health care of those in the 80 and over age group. The estimated coefficient for the elderly under 80 years of age is insignificant for health-care services, but for the elderly aged between 67 and 89 there is increased expenditure for the care of the elderly and disabled. Moreover, it can be found that those of 90 years and above have a significant impact on expenditure in care for the elderly and disabled that is substantially higher than for the elderly of below 90 years of age.

For explanatory variables on a per capita form, the corresponding coefficients can be interpreted as effects of partial marginal changes. Thus, the partial effect of one more child of between 0-6 years of age is found to increase childcare expenditure by NOK 8 170. If the child is supported by a single adult, the expenditure increases by an additional amount of NOK 13 660. Children also increase costs in health care, but this effect is only slightly significant. When the population increases by one person in the age group 7-15 years, expenditure on education increases by NOK 27 850. If this person is mentally retarded there are additional costs that amount to NOK 216 530. By contrast, one additional mentally retarded person aged 16 years or more increases expenditure by NOK 363 780 on care for the disabled.

The marginal impact of the elderly of 80 years and above equals NOK 7950 in health services. In care for the elderly and disabled, one more person in the 67-89 and 90 years and above age group increases expenditure on average by NOK 14 270 and NOK 150 840, respectively. Mentally retarded children were, however, neither found to have a significant effect on expenditure in care for the elderly and disabled nor in childcare services. This result suggests that local authorities on average devote more resources to adults than to children who are mentally retarded. Thus, it seems that local authorities reduce their costs by limiting the benefits awarded to parents with mentally retarded children. Such cost savings can also induce increases in national insurance benefits to the parents. Therefore, national insurance regulations may in effect weaken incentives to assist the parents.

The larger occurrence of foreign citizens from remote cultural backgrounds, and unemployed, divorced and separated persons is found to significantly increase expenditure on social services. The estimates of marginal increases in expenditure for these groups are in the range of NOK 912 000 to 15 000 per person. These effects are due to the relatively high propensities for the unemployed, the divorced and immigrants to receive social benefits and other social services.

Expenditure on education decreases with population density and increases with average travelling time to the municipal centre. Such cost increases are due to a decentralised school structure with small classes in sparsely populated areas. The demand for accessibility also implies higher health-care expenditure when average travelling time increases. One hour increase on average travelling time increases expenditure by NOK 1 190 per capita in the education sector and by NOK 490 per capita in health care services.



## **POLAND**

### **I. Use of estimation methods in the preparation of the national budget**

The Minister for Finance presents to the Council of Ministers the basic figures for the following year's draft national budget.

The data necessary for the draft budget are produced and submitted to the Minister for Finance by the officials responsible for the different budget items. The Minister for Finance determines, by government order, the detailed principles, the method and deadline for the preparation of these data.

Two types of territorial authority revenue are taken into consideration in the preparation of the national budget as resources to provide for in this budget: grants et the subsidies.

As regards grants, they may be used by the local authorities for either investment or operation. It is the local councils who decide.

National budget expenditures on grants to local authorities are calculated according to specific algorithms, fixed by the Act on local authority revenues of 26 November 1998 as a proportion of the forecast national budget resources in 2000. (The details are described under point II below).

The subsidies for local authorities are of two types:

1. subsidies for the part financing of tasks proper to the local authority,
2. subsidies for offsetting the costs of the performance, by the local authority, of specific tasks within the domain of the central government.

National budget expenditure for the performance by local authorities of specific tasks within the domain of the central government are compulsory and must cover 100 per cent of the expenditure incurred by the local authorities for this purpose. The amounts of these subsidies are established in the national budget according to the principles adopted for determining this type of central government expenditure. The subsidies are transmitted by the voivodes (territorial representatives of the state).

On the other hand, the subsidies for the part financing of tasks proper to the local authority are allocated by the voivodes.

During the preparation of the national budget by the Ministry of Finance, the limits of the resources allocated to the authorising officers of the budget items (such as voivodes and ministers) for the apportioning of local authority subsidies are decided. The establishment of these limits for the individual national budget items take into account the following factors:

- the increase in GDP in 2000, with respect to 1999 (amounting to 5.6 per cent);
- the increase in the consumer price index (5.7 per cent);
- the forecast national budget revenue (138 784.5 million PL);
- the maximum level of the national budget deficit (12 700.0 million PL);
- the limit of national budget expenditure in 2000 (determined as 151 484.5 PL).

The information on the limits adopted is transmitted to the voivodes. Within twenty-one days of receiving this information, the voivodes submit to the Ministry of Finance the actual expenditure plans which must not exceed the permitted limits. These proposals are based on the requests previously submitted to the voivodes by the local authorities.

The voivodes' proposals are submitted to the Ministry of Finance on a form prescribed by the Minister for Finance's Order of 8 April 1999. The justifications for the investment and operation expenditures have to be given separately. These justifications have to clearly set out the forecast realisation of the plan, as well as its premises, taking into consideration:

- modifications in the amounts of particular items in the calculation;
- the factors that caused any change in the progressive or regressive trend;
- one-off or absent revenue and expenditure in the 1999 budget;
- the amounts of expenditure planned for particular items, for new tasks planned to be implemented in 2000.

The principles and criteria for allocating the resources for these subsidies to local authorities are established by the voivodes in line with the opinion of the voivodes (autonomous regional authority) respecting the provisions of the Act on local authority revenue.

Apart from certain exceptions provided for in the Act, the total amount of the subsidies paid for the part financing of investment projects implemented by the local authority must not exceed 50 per cent of the estimated value of the investment. In the first year of the investment, the amount of the subsidy must not exceed 80 per cent of the expenditure planned for this purpose in the local authority budget, and if the realisation lasts only one year – 100 per cent of the expenditure for this purpose.

## II. Use of estimation methods for apportioning financial support among local authorities

The apportioning of the grants for the local authorities is based on objective rules and precise algorithms fixed by the Act of 26 November 1998 on local authority revenue.

The methods for calculating the grants for municipalities, *powiats* and voivodes are set out separately below.

### 1. Municipalities

A general grant from the national budget is apportioned to the municipalities. It is in three parts:

- a. The residual part of the grant, paid to each municipality in Poland, the amount of which is calculated using an index based on the number of inhabitants

The residual part of the general grant comes on the one hand from a state grant of at least one per cent of its forecast revenue and on the other from contributions paid by the municipalities for horizontal equalisation purposes.

The method of apportioning is described below:

1. Four per cent of the total amount is earmarked for the residual grant reserve. It is the Minister for Finance who apportions this reserve, taking into account the opinion of the representative body of the local authorities;

The purpose of this reserve is to increase the residual part of the general grant for the municipalities not covered by the equalisation payment from the residual part of the general grant, and in which there has been a loss of revenue in the first half of the year due to the change in the principles for establishing the municipalities' share of the revenue from personal income tax. This loss must be demonstrated in the municipality's report for the first half of the year.

2. The equalisation payment is another component of the residual part of the general grant. This is paid to the municipalities in which the index of the base fiscal revenue for one inhabitant (the "G" index) is less than 85 per cent of the similar index calculated for all municipalities (the "P" index). Apart from certain exceptions, in order to obtain the "G" index, the base fiscal revenue of the municipality obtained in the first half of the reference year is divided by the number of inhabitants in the municipality.

To calculate the equalisation payment due to a given municipality, the method is:

- i. calculate the difference between 85 per cent of the P index and the G index;
- ii. calculate 90 per cent of the difference obtained in step "i";
- iii. multiply this 90 per cent by the number of inhabitants in the municipality;
- iv. multiply the result of step "iii" by the index determine by – for the reference year – the ratio between the forecast national budget revenue and the actual revenue in the first half.

The base fiscal revenue of the municipality includes in particular the municipality share of the revenue from personal income tax, corporation tax and the agricultural tax, as well as the property tax and other local taxes. The above-mentioned act sets out the method of calculation in detail.

The municipalities in which the “G” index is greater than the “P” index have to make payments to increase the equalisation component of the residual part of the general grant. The annual payment here is calculated by multiplying the number of inhabitants in the municipality by the index determined for the base year by the ratio between the forecast state revenue and the actual revenue in the first half and the sum calculated as follows:

- i. for municipalities in which the G index is not greater than 200 per cent of the P index: 20 per cent of the difference between the G index and 150 per cent of the P index;
  - ii. for municipalities in which the G index is greater than 200 per cent of the P index but not greater than 300 per cent of the P index: 10 per cent of the P index, increased by 25 per cent of the difference between the G index and 200 per cent of the P index;
  - iii. in municipalities, for which the G index is greater than 300 per cent of the P index: 35 per cent of the P index, increased by 30 per cent of the difference between the G index and 300 per cent of the P index.
- b. Grant for education tasks, intended to finance the schools which are the responsibility of the municipalities

The sum allocated for education tasks (forming part of the general grant) is established, for all of the local authorities, as an amount at least equal to 12.8 per cent of the forecast national budget revenue. one per cent of this amount is set aside to constitute the reserve, to be apportioned by the Minister for Finance, after seeking the opinion of the Minister for Education and the representative body of the local authorities.

The rest of this part of the general grant is apportioned between particular municipalities, voivodes and *powiats* according to the principles set out in the Minister for Education’s Order of 23 December 1998 (the Order having been issued after seeking the opinion of the representative body of the local authorities), and taking into consideration the types and categories of schools run by the local authorities, and the number of pupils in these schools.

c. Equalisation grant, paid to municipalities with financial difficulties

The equalisation part of the general grant for the municipalities is intended to compensate for:

- i. the loss of revenue due to the partial liquidation of the transport tax;

This grant, intended for all municipalities, is established for an amount at least equal to 10.5 per cent of the fuel tax revenue provided for in the Budget Act. The principles and detailed method for apportioning this grant to the municipalities are determined by the Minister for Finance's Order of 17 February 1999. The total amount, for all of the municipalities, is established each year by the Budget Act.

- ii. the loss of revenue caused directly by the deductions and allowances imposed by the law, concerning mainly the agricultural tax and certain other taxes, and by the reduction in the mining tax imposed by the Geology and Mining Act.

The total amount of this grant is established each year in the Budget Act on the basis of the information given by the municipalities on the amount of local and mining tax revenue lost, and the corresponding proposals made by the municipalities.

**2. *Powiats (intermediate authorities of the first level)***

In accordance with the Act of 26 November 1998 on local authority revenue, a general grant from the national budget is apportioned to the *powiats*.

The destination of the general grant is not fixed in advance, which means that the *powiats* are free to use it for operation or for investment. The grant is in three parts:

- a. The part intended for education tasks

The method of calculation is as described above for the municipalities.

- b. The part intended for road infrastructures

The part intended for road infrastructures (construction, modernisation, maintenance, management and protection), for all the *powiats* and the voivodes is established at 60 per cent of the amount fixed by the Budget Act (on the basis of the Road Financing Act) and must not be less than 30 per cent of the fuel tax revenue (planned for the year).

Ten per cent of the sum calculated as above has to be set aside as the reserve of this part of the general grant, intended for investment. It is the Minister for Finance who apportions this reserve, after seeking the opinion of the Minister for Transport and of the representative body of the local authorities.

The apportioning of the part of the general grant intended for road infrastructures between the *powiats* and the voivodes takes into consideration above all the length and density of the road network, the technical infrastructure, the traffic density, the accident rate and the harmonisation of road infrastructure development.

The detailed principles of the establishment and method of transmission to the *powiats* and voivodes of the part of the general subsidy intended for roads are determined by Council of Ministers' Order, issued after consulting the representative body of the local authorities.

c. The equalisation part

The amount destined for the equalisation part of the general grant for all the *powiats* is determined for each year by the Budget Act.

The equalisation part is paid to the *powiat* in which the base fiscal revenue index for one inhabitant (the "S" index) is less than the maximum value of this index for the 1999 ("Sw").

To calculate the "S" index for a given *powiat*, the amount of the forecast revenue of this *powiat* for the budget year as its share of the personal income tax revenue, is divided by the number of inhabitants of this *powiat*.

The amount of the share due to the *powiat* is calculated by multiplying 85 per cent of the difference between the Sw index and the S index for the *powiat*, by the number of inhabitants in this *powiat*.

### 3. Voivodes

The diet (deliberative body) of the voivodes decides the destination of the resources received through general grant.

The general grant for the voivodes is in three parts:

a. The part intended for education tasks

The methods of calculation are the same as for the municipalities.

b. The part intended for road infrastructures

The methods of calculation are the same as for the *powiats*.

c. The equalisation part

The equalisation part of the general grant is paid to the voivodes in which the base fiscal revenue index for one inhabitant (the "W" index) is less than the Ww index. The Ww index is the maximum value of the W index for 1999.

The “W” index for a given voivode is calculated by dividing the amount of the forecast revenue of this voivode (as its share of the revenue from personal income tax and corporation tax, which is determined in detail by the law) by the number of inhabitants.

The amount of the forecast revenue of the voivode as its share of the personal income tax revenue (this being national budget revenue) is calculated by multiplying the forecast revenue of this tax, paid by the inhabitants of the voivode, by the index 0.015.

The amount of the forecast revenue of the voivode as its share of the corporation tax revenue (this being national budget revenue) is calculated in multiplying the forecast total revenue of this tax paid by corporations whose headquarters are in the voivode, by the index 0.005.

The amount due to the voivode as the equalisation part of the general grant is calculated by multiplying 70 per cent of the difference between the Ww index and the W index for the given voivode by the number of inhabitants in this voivode.

### **III. Use of estimation methods for the preparation of the annual local authorities' budget**

At present there are no uniform, compulsory or recommended methods for the evaluation of the expenditure or revenue of local authorities.

In accordance with the Municipality Act, the local council determines the procedure for the adoption of the budget; the council has a certain freedom in the determination of the type of information that accompanies the draft budget and the degree of detail.

According to the Public Finance Act of 26 November 1998, the degree of detail required in the preparation of a local authority budget requires at least the following elements:

- the revenue, with at least a breakdown according to sources and the parts of the budget classification;
- the expenditure, with at least a breakdown into parts and chapters, with the compulsory distinction of current expenditure (including wages and contributions, subsidies, expenditure for debt service, expenditure on guarantees and the heritage).

The forecast revenue of the municipalities (the other local authorities did not exist before 1 January 1999) is generally estimated on the basis of:

- estimated prices for the budget year;
- the rates of the different kinds of taxes (generally laid down by the law, allowing for some tax rates to be decided by the local council within certain limits);

- the forecast amounts of grants, subsidies and revenue from the apportionment of certain state taxes (according to the information received from the authorising officers for national budget resources, the main sources of information being the Ministry of Finance and the voivodes);
- the forecast rate of inflation, etc.

The forecast expenditures are determined on the basis of the plans for actual tasks submitted by the heads of the different municipal services. It is the council that finally decides whether they should be included in the budget or not.

The municipal council may introduce changes to the budget in the course of the budget year.

Such changes may become necessary due to such factors as:

- a change in the amount of subsidies received for imposed tasks or own tasks;
- a change in the amounts of the grants;
- changes in the forecast own revenue (for example inheritance, donations, etc.);
- the introduction of debt financing;
- changes involving the transfer of resources between tasks, an increase or reduction of existing tasks or the introduction of new ones.

The possibility of change is essential to provide flexibility in the use of budget.

It is estimated that the discrepancies between estimated and actual revenue and expenditure were as follows in 1998:

	<b>Discrepancies in revenue (percentage)</b>	<b>Discrepancies in expenditure (percentage)</b>
Poland as a whole	11.6	8.6
Towns	9.6	5.4
Warsaw municipalities	11.8	8.4
Urban municipalities	12.7	10.3
Rural municipalities	15.3	12.0

On the other hand, if we take into account the budget adjustments introduced in the course of the year, the discrepancies between actual and planned revenue and expenditures do not exceed one per cent for the country as a whole (revenue 0.6 per cent, expenditure 0.8 per cent).

## V. Financial data concerning three municipalities

### 1. Warsaw-Targowek

128 000 inhabitants

EXPENDITURE (in PL)						
Year	1996		1997		1998	
Type	Estimate	Actual	Estimate	Actual	Estimate	Actual
A						
Compulsory	79 866 261	84 995 692	95 665 981	116 728 112	121 934 909	197 517 226
Optional*	200 358	220 182	237 177	216 930	261 930	332 495
B						
Investment	14 927 000	18 137 491	1 950 300	38 970 084	32 016 965	45 337 827
Operation	65 139 619	67 078 383	76 399 658	77 974 958	90 179 874	92 511 894
<b>Total</b>	80 066 619	85 215 874	95 903 158	116 945 042	122 196 830	137 849 721

\* Concerning tasks entrusted by agreements, conventions etc.

REVENUE (in PL)						
Year	1996		1997		1998	
Type	Estimate	Actual	Estimate	Actual	Estimate	Actual
Own taxes	12 529 430	14 335 663	14 888 568	18 236 978	17 145 070	19 558 671
Shared taxes	33 900 000	32 308 598	42 579 656	43 159 841	49 302 114	51 319 412
Grants	13 944 521	15 537 678	15 860 774	17 561 668	18 986 299	22 615 554
Subsidies	5 628 866	5 675 642	6 995 479	7 853 246	6 948 087	8 222 735
Other revenue	9 029 035	16 507 590	12 043 697	33 658 154	21 908 163	35 381 320
<b>Total</b>	75 031 852	84 365 171	92 368 174	120 469 887	114 289 733	137 097 692

**2. Michalowice – rural municipality**

12 000 inhabitants

<b>EXPENDITURES (in PL)</b>						
Year	1996		1997		1998	
Type	Estimate	Actual	Estimate	Actual	Estimate	Actual
A						
Compulsory	10 095 984	12 155 449	14 915 929	15 897 863	21 973 640	21 589 398
Optional*	108 817	104 640	117 700	133 194	148 730	155 737
B						
Investment	2 329 311	4 218 246	4 361 773	5 531 060	10 306 176	9 550 418
Operation	7 875 490	8 041 443	10 671 856	10 499 997	11 816 554	12 194 717
<b>Total</b>	<b>10 204 801</b>	<b>12 260 089</b>	<b>15 033 629</b>	<b>16 031 057</b>	<b>22 122 370</b>	<b>21 745 135</b>

\* Concerning tasks entrusted by agreements, conventions etc.

<b>REVENUE (in PL)</b>						
Year	1996		1997		1998	
Type	Estimate	Actual	Estimate	Actual	Estimate	Actual
Own taxes	2 034 411	2 758 176	3 646 100	4 391 949	3 731 850	4 321 952
Shared taxes	2 996 913	2 865 689	3 944 912	3 864 415	5 032 837	5 211 378
Grants	2 560 051	2 722 043	3 169 855	3 332 894	3 868 591	4 360 280
Subsidies	597 020	1 497 356	824 784	909 176	961 222	1 500 144
Other revenue	469 707	1 767 987	2 059 306	4 584 256	4 098 043	4 963 271
<b>Total</b>	<b>8 658 102</b>	<b>11 611 251</b>	<b>13 644 957</b>	<b>17 082 690</b>	<b>17 692 543</b>	<b>20 357 025</b>

**3. Wolomin**  
50 000 inhabitants

<b>EXPENDITURES (in PL)</b>						
Year	1996		1997		1998	
Type	Estimate	Actual	Estimate	Actual	Estimate	Actual
A						
Compulsory	32 104 755	35 508 516	40 466 091	45 408 420	48 417 467	50 914 921
Optional*	67 000	80 428	86 166	92 526	63 313	93 102
B						
Investment	5 995 000	6 300 650	9 800 000	11 795 287	13 084 000	15 392 167
Operation	26 116 455	29 288 294	30 752 257	33 705 659	35 396 780	35 615 856
<b>Total</b>	<b>32 111 455</b>	<b>35 588 944</b>	<b>40 552 257</b>	<b>45 500 946</b>	<b>48 480 780</b>	<b>51 008 023</b>

\* Concerning tasks entrusted by agreements, conventions etc.

<b>REVENUE (in PL)</b>						
Year	1996		1997		1998	
Type	Estimate	Actual	Estimate	Actual	Estimate	Actual
Own taxes	6 347 000	6 668 261	4 960 000	8 068 365	7 043 500	7 800 942
Shared taxes	12 347 459	11 744 660	14 823 589	14 811 335	15 821 770	16 609 562
Grants	8 180 996	8 923 103	9 852 179	10 606 081	11 928 209	13 735 369
Subsidies	2 700 000	4 867 432	4 286 850	6 049 588	5 585 375	6 349 564
Other revenue	1 536 000	2 035 727	4 067 000	5 661 441	5 186 050	6 179 954
<b>Total</b>	<b>31 111 455</b>	<b>34 239 183</b>	<b>37 990 618</b>	<b>45 196 810</b>	<b>45 564 904</b>	<b>50 675 391</b>



## UNITED KINGDOM

### Preamble

This text refers to the existing system of local government finance in England, concentrating on running expenses and borrowing to pay for capital investment. The government has announced a fundamental review of the grant system, over the next three years, “to investigate thoroughly whether there is a better way of determining the distribution of [general grants] which is simpler, more stable, more robust and fairer than the present arrangements”. While that review is taking place, the government does not expect to change the formulae used in grant distribution.

The government has moved away from referring to “spending needs”. The amounts determined by formulae are regarded simply as a basis for distributing grants between authorities.

### **I. Use of estimation methods in the preparation of the national budget**

In preparing the National Budget, central government considers the cost and level of services provided by local authorities and the priority which they should be given in overall public expenditure plans. Local government organisations make representations about the increases in costs that they believe central government should take into account in public expenditure plans. Decisions on the public expenditure plans are ministerial judgements.

The overall amount of grants to local authorities is also a ministerial judgement. It reflects the balance ministers wish to achieve between financing expenditure from local taxation and financing it through grants met from central government taxation.

Exceptionally, where tasks are carried out by local government as agents of central government, with local government having very little discretion about expenditure, grants usually meet a very large proportion of the expenditure of local government and the totals of such grants tend to be based on projections of expected expenditure.

There are no relevant legal provisions governing the determination of overall spending or overall grants.

### **II. Use of estimation methods for apportioning financial support among local authorities**

The criteria, weightings and calculation formulae used for the purposes of apportioning grants are set out in documents approved by Parliament. The most significant are the Local Government Finance Report, the Police Grant Report and certain special grant reports.

The criteria used in the formulae follow extensive discussion with local government of the merits of alternative formulae, often informed by research. Final decisions on the formulae are taken by ministers, subject to approval by Parliament.

### **III. Complementary information concerning estimation methods**

Central government has discretion in determining the calculation formulae, but has no discretion in applying it once the formulae have been approved by parliament.

Most of the formulae are determined by regression analysis of past expenditure. But there is no expectation that the results of the formulae will necessarily be similar to actual expenditure. For individual local authorities, they are likely to differ because of differences in policies and differences in efficiencies.

There are no offsetting measures if there are differences between estimated and actual expenditure. But authorities are not allowed to budget for a deficit, and any overspend in one year has to be made good in the following year's budget.

The formulae on which the grants are based are the subject of extensive discussion with representatives of local authorities, with the effects of alternative formulae on each local authority being exemplified.

The formulae have been subject to annual revision. However, the current formulae are expected to remain unchanged for three years while a fundamental review of the system is carried out, although the data used in the formulae will be updated.

It is not known whether the behaviour of local authorities has been affected by the methods of calculation of grant entitlements that have been used. But there have been other policies to limit local authorities' budgets. These have worked by reference to the grant calculation. Local authorities say that this has led to their expenditure becoming more similar to the result of applying the formula.

The opinion of local government is sought this year, both through their representative bodies and through a survey of opinion in local government.

### **IV. Use of estimation methods for the preparation of the annual local authorities' budget**

Legislation sets a broad framework for the calculations that authorities have to make to establish their budget requirements, which includes amounts needed for financial reserves, but the details and criteria used are left to the professional judgement of authorities' chief financial officers, subject to guidance from their professional accounting body.

The differences between estimated and actual expenditure and revenue are generally small, but most authorities tend to underspend their estimates. This is because overspending carries greater penalties than underspending within the tight budgetary control system in existence in most authorities. Capital financing costs are particularly prone to overestimation/underspending, and hence small authorities where these costs constitute a larger proportion of the total are particularly prone to underspend.

There are no initiatives to introduce uniform or harmonised methods to be used by local authorities to estimate expenditure and revenue.

### **Total capital expenditure and financing of capital expenditure**

#### **Liverpool**

(all amounts in thousands of pounds)

	1997/98		1998/99	
	Estimated	Outturn	Estimated	Outturn
<b>Total capital expenditure</b>	<b>63 035</b>	<b>57 154</b>	<b>81 331</b>	<b>72 651</b>
Total resources used to finance capital expenditure:				
Grants	25 788	19 099	30 677	24 379
Capital receipts	7 380	8 146	8 959	7 370
Other*	19 108	11 914	15 434	12 853
Borrowing/credit cover	10 759	17 995	26 261	28 049

\* Includes finance from current revenue and amounts which had been put aside to provide for credit liabilities.

Data source: Capital Estimates Return; Capital Outturn Return

**Stratford-upon-Avon**

(all amounts in thousands of pounds)

	1997/98		1998/99	
	Estimated	Outturn	Estimated	Outturn
<b>Total capital expenditure</b>	<b>12 034</b>	<b>3 534</b>	<b>12 883</b>	<b>9 330</b>
Total resources used to finance capital expenditure:				
Grants	166	226	150	222
Capital receipts	4 880	976	4 000	3 611
Other*	6 988	2 330	8 733	5 490
Borrowing/credit cover	0	0	0	0

**Devon**

(all amounts in thousands of pounds)

	1997/98		1998/99	
	Estimated	Outturn	Estimated	Outturn
<b>Total capital expenditure</b>	<b>30 246</b>	<b>52 533</b>	<b>16 097</b>	<b>9 330</b>
Total resources used to finance capital expenditure				
Grants	2 232	4 907	2 963	222
Capital receipts	959	2 186	750	3 611
Other*	5 804	19 927	93	5 497
Borrowing/credit cover	21 251	25 513	12 291	0

\* Includes finance from current revenue and amounts which had been put aside to provide for credit liabilities.

Data source: Capital Estimate Return; Capital Outturn Return