Fifteenth amendments to the Local Government Unit Financing Act

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PRESS RELEASES

Fifteenth amendments to the Local Government Unit Financing Act

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The Government has submitted for urgent parliamentary procedure the fifteenth Proposal for an Act on Amendments to the Act on the Financing of Units of Local and Regional Self-government with the final Act Proposal. Let us recall that the Act on the Financing of Units of Local and Regional Self-government has underwent numerous changes since its adoption in 1993 (OG 117/93, 69/97, 33/00, 73/00, 127/00, 59/01, 107/01, 117/01, 150/02, 147/03, 132/06, 26/07, 73/08, 25/12 and 147/14). Therefore, the Government should finally prepare a consolidated version of the Act.

Frequent changes in the Act. As of 2001, the fiscal decentralization process started by transferring powers and responsibilities to finance decentralized public functions from the central government to counties, cities and municipalities. Since then, the decentralization policy has changed constantly. The new Act proposal envisages further changes in the distribution of personal income tax revenues, but only in respect of the local government units in the hill and mountain areas classified into groups III and IV according to the economic development index. These changes might adversely affect the fiscal positions of the counties in whose territories such units are located and disturb fiscal interrelationships between various levels of government.

Criteria for a preferential position in the financing scheme. Until recently, the policy of supporting economically less developed local government units was mainly based on geographical criteria. A privileged financing status was enjoyed by local units in the areas of special national concern (ASNCs) and hill and mountain areas (HMAs). The classification of the units into these groups occurred without the assessment of their economic capacity (except in the case of the units located in Group III ASNCs), or a comparison with other units on the basis of economic criteria. As a result, the preferential status has also been given to local units far better-off than average. It was only after introducing the Regional Development Act (OG 147/14) and Amendments to the Act on the Financing of Units of Local and Regional Self-government (OG 158/13), as well as adopting the Decision of the Government of the RC on the Classification of Units of Local and Regional Self-government According to Level of Development (OG 158/13) that an administrative framework for more equitable and efficient redistribution was created.

New proposals. Under the new administrative framework, local units in ASNCs and HMAs which have not been classified into the supported areas (groups I and II) according to the development index have lost preferential financing treatment and have been made equal to other local units. However, in order to mitigate potential budget shocks, a transitional period has been introduced during which subsidies of limited duration would be provided by Section 025 - Ministry of Finance to local units in ASNCs and

HMAs, classified into groups III, IV and V according to the development index. The latest proposal offers the replacement of the temporary payment of subsidies to local units in HMAs (of groups I and II according to the development index) by permanent measures that involve additional benefits in the personal income tax distribution. The Government proposes that the general-purpose share in personal income tax revenues should be raised for these local units from 60% to 70.5% and that they should be entitled to an additional 10% share in personal income tax for the funding of capital projects (Table 1). As a result of these changes, the share of counties in personal income tax revenues would decline from 16.5% to 12% and their entitlement to equalisation grants for decentralized functions would be abolished. The shares for decentralized functions and grants for projects co-financed from EU structural and investment funds would remain unchanged.

Table 1 *Distribution of personal income tax revenues among local units in HMAs classified into groups III and IV according to the development index (%)*

Distribution	Municipality and/or city	County	Decentralized functions	Equalization grants for decentralized functions	EU project grants	Capital projects	Total
Current	60	16.5	6	16	1.5		100
Proposed	70.5	12	6		1.5	10	100

Source: A Proposal for an Act on Amendments to the Act on the Financing of Units of Local and Regional Self-government.

The proposed way of capital project funding is not common in practice, neither does it have any theoretical basis. It should therefore be abandoned also in respect of local units on the islands which have entered into agreements on the joint financing of capital projects of interest for the development of the islands. Local units are usually given capital grants for the financing of capital projects (with or without their participation), taking into account their respective economic potential and financial capacity.

The „almighty“ personal income tax. It is unfortunate that this Government, like others before it, perceives personal income tax as an „almighty tax“, using it as a means of solving all fiscal problems that haunt local government units and achieving any possible fiscal policy goal (fiscal redistribution, allocation or stabilization). Introducing such changes is a step backwards from a simple, effective and transparent redistribution system. In other words, if the territorial redistribution will again be based on geographical or any other non-economic criteria, then it is reasonable to ask for the purpose of setting up the new administrative framework for regional policy implementation. Should the proposed amendments to the Act be enacted, other local units which used to enjoy a privileged financing status (ASNCs, groups I, II and III) could also reclaim their acquired rights. Unfortunately, however, introducing a simple and effective fiscal equalization system based on relevant criteria and high-quality fiscal instruments still remains a challenge to a future Government.