Subnational Finance

Thematic Working Group Meeting
October 9, 2024

LOCAL PUBLIC SECTOR ALLIANCE

Thematic Working Group Co-Chairs

Titilola Akindeinde

Gundula Löffler

Elton Stafa

LOCAL PUBLIC SECTOR ALLIANCE

Subnational Finance

Thematic Working Group Meeting

October 9, 2024

Intergovernmental transfers and equalization systems

LPSA Sub-National Finance Thematic Working Group

Wednesday, October 9, 2024 - 9:00 EDT/ 14:00 BST/ 15:00 CEST

Elton Stafa
NALAS & LPSA Co-Chair, Subnational Finance Working Group

Aleksandar Marinković
Standing Conference of Towns and Municipalities of Serbia

Thomas Prorok
KDZ Centre for Public Administration Research

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Network of Associations of Local Authorities of South-East Europe

CENTRE FOR PUBLIC ADMINISTRATION RESEARCH

Intergovernmental Transfers and Equalization

Elton Stafa

NALAS Fiscal Decentralization Expert; LPSA Co-Chair Subnational Finance Working Group

LPSA Thematic Working Group on Subnational Finance – Open Meeting – October 2024

WITH FUNDING FROM AUSTRIAN DEVELOPMENT COOPERATION

BACID.eu BUILDING ADMINISTRATIVE CAPACITIES IN THE DANUBE REGION

Grants and transfers

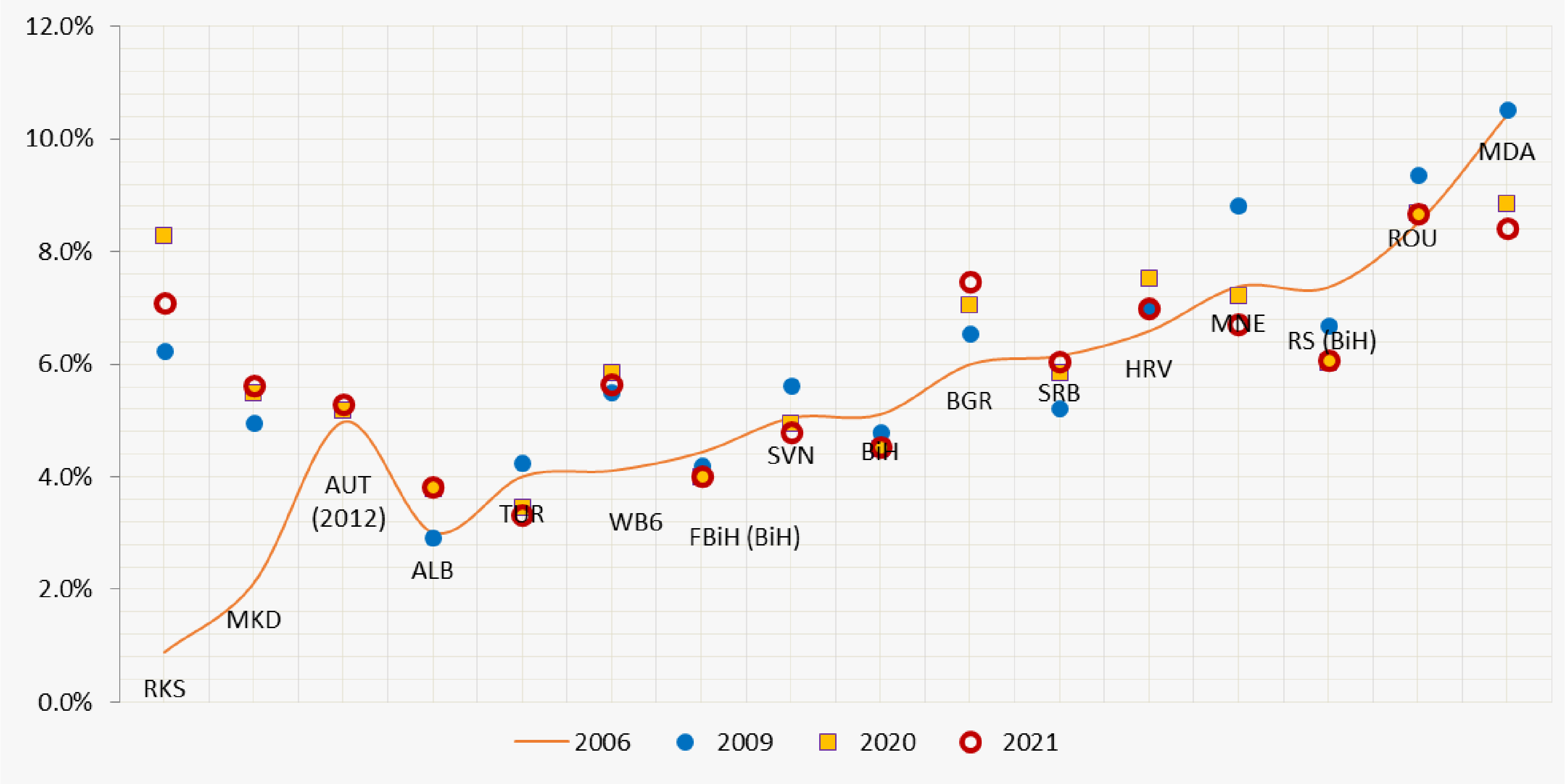
- Grants and transfers ensure local governments can provide quality public services, foster equity, and support local development.
- Grants and transfers represent more than half (51.5%) of subnational government revenues, globally
- Two broad functions
  - Ensuring financial sufficiency
  - Equalization: addressing disparities through redistribution of resources
- **Equalization** is fundamental in the **European Charter of Local Self-Government** → protection of financially weaker local governments
- **Rapid urbanisation and depopulation of rural areas** bring political challenges and disparities between local authorities in terms of their political leverage and financial resources.

Intergovernmental Transfers and Equalization

How can urban and rural local governments finance services in times of urbanization?

www.nalas.eu www.kdz.eu www.logov-rise.eu

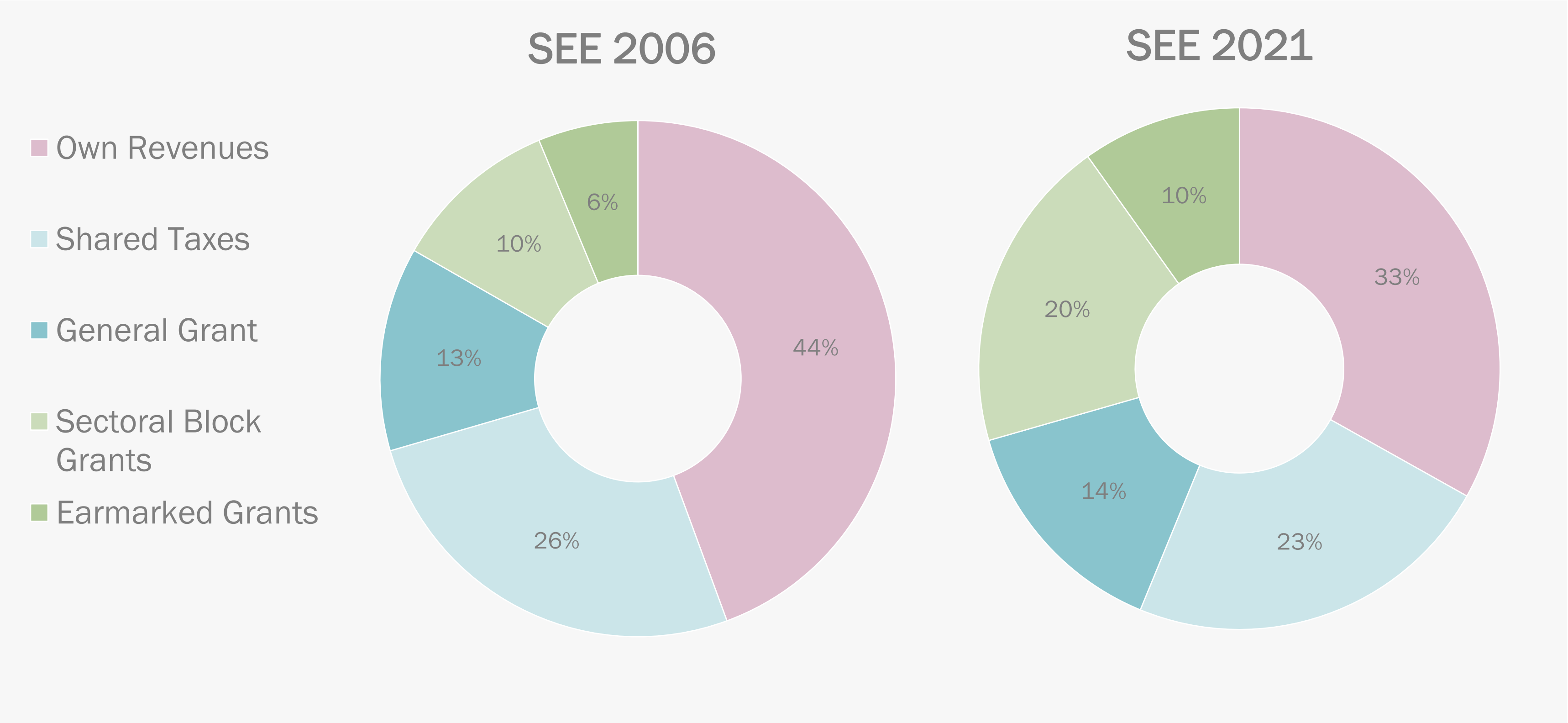
- LG revenues improved in only about half of SEE in 15 years



Volatile Local Government Revenues

LG Revenues, percent of GDP

- Decrease of own revenues = increase of dependency
- The share of sectoral and earmarked grants doubled

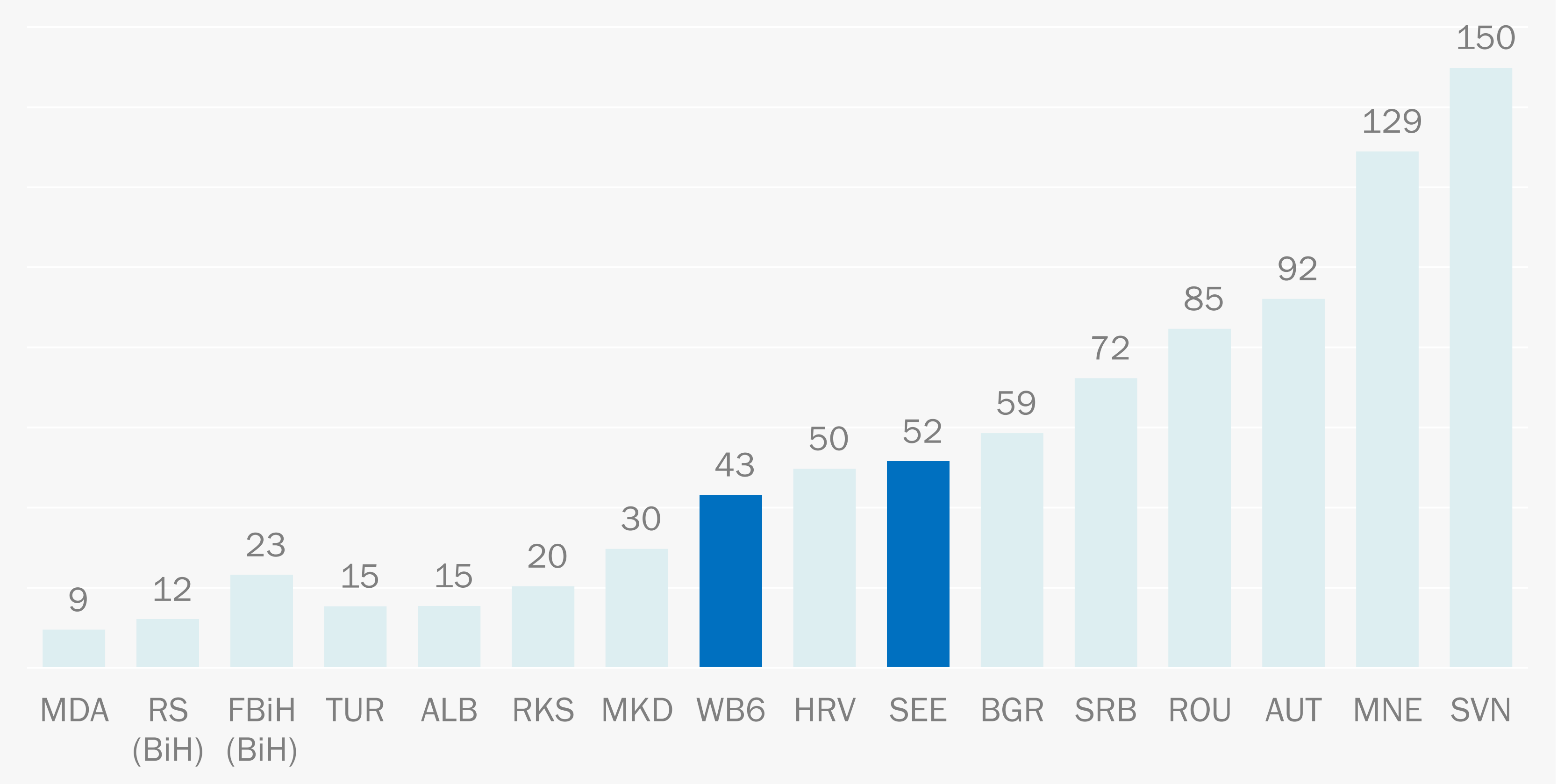


Fiscal Autonomy is Declining

Composition of LG revenues, % of total

- **Wide disparities in the property tax revenues** in SEE LGs

- The fiscal **scope**, **capacity** and **success** of local tax collection varies significantly across SEE countries;



Wide Disparities and Limited Revenue Raising Capacities

Property Tax Revenues, EUR per capita, 2021

Equalization Grants to Local Governments in SEE

	Albania	Slovenia	Croatia	Montenegro	Bulgaria	North Macedonia
General & Equalization Grant	General Grant 50+% of LG revenue	Shared Tax for Current Expenditure	Fiscal Equalization Fund (FEF) (10% LGR)	Equalization Fund (11% LGR)	General Equalizing Subsidy (4% of LGR)	Shared Taxes (4% of LG Revenue)
Annual Size	LGs: 1% GDP, no less than in previous year	LGs: 54% of PIT	17% of PIT until 2021; after, State funded	% Shared Tax Rev	10% of total OSRs	6% of VAT
Allocation	Formula: • Population (Adjusted Census data) • Density • No. of pupils • Horizontal equalization	Formula: **Estimated costs**, *corrected by* - population - territory - road length - youth pop (<15) - elderly pop. (>65) - equalization (if costs > PIT Revs)	• Formula **estimated individual shares**, as a difference between (5-year average) target per capita PIT revenues and the (5-year average) actual per capita PIT revenues.	Formula: • 15% lump sum • 35% territory • 50% population • Equalization: per capita PIT in N-1 vs. national average)	Formula • Revenue potential • Expenditure needs • Low revenue capacity (OSRs<25%of LGR) • Tax effort (rates above national average)	Formula • population; • surface; • no. settlements • Performance Fund (higher OSRs outturn) • Equalization Fund (better OSR collection compared to 3-year average)

Thank you

Elton Stafa, NALAS Fiscal Decentralization Expert
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STANDING CONFERENCE OF TOWNS AND MUNICIPALITIES
NATIONAL ASSOCIATION OF LOCAL AUTHORITIES IN SERBIA

The Equalization System in Serbia

LPSA Thematic Working Group on Subnational Finance

Aleksandar Marinkovic
9 October 2024

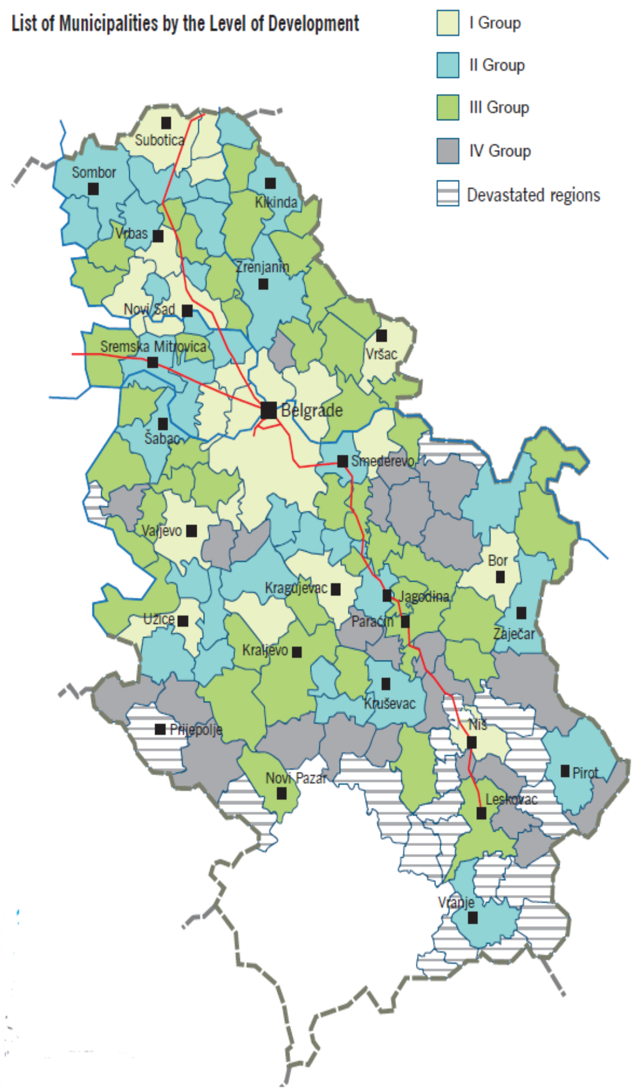
STANDING CONFERENCE OF TOWNS AND MUNICIPALITIES
NATIONAL ASSOCIATION OF LOCAL AUTHORITIES IN SERBIA

Content

- Local government system in Serbia
- The Law on Local Government Financing – how it should be
- The Local Governments finances - how it is
- Conclusions

Local governments in Serbia

- 6.6 million inhabitants
- 145 local governments (LG)
- Important competences
- Average number of inhabitants per LG 45 thousand
- 34 thousand if Belgrade is exluded
- Median number of inhabitants 19 thousand
- Average size of LG 500 square km
- Huge differences between LGs in terms of level of development – historical reasons and (hyper) globalization



Changing Urban-Rural Interplay

Cities - “Urban”

28 cities including Capital City

The average number of inhabitants 150 thousand – 100 thousand if Belgrade is exluded

Median size 97 thousand – almost 65% less than 90 thousand

% of total country population:

in 1948 Cities represented 44%,

in 1991 - 56%, in 2022 - 67%

12 Cities (43%) were in group I, 11 (39%) in group II, 5 (18%) in group III

Municipalities – “Rural”

117 municipalites

The average population 18 thousand inhabitants

Median size 15 thousand – almost 65% less than 20 thousand

% of total country population:

in 1948 municipalities represented 56%, in 1991 - 44% , in 2022 - 33%

8 municipalities (7%) were in group I, 23 (19%) in group II, 42 (36%) in group III, 44 (38%) in group IV

,

I faze/2006-2011

- Adopted in 2006 with aim to establish a predictable, objective and sustainable management system LG finances.
- Joint effort of relevant representatives of municipalities, national authorities, the academic community and foreign donors

Own revenues

Property tax (immovable properties)

Tourist tax

Own fees and charges

- Administrative
- for environmental improvement;
- for usage of public spaces/surfaces
- for usage of natura healing factor

Contribution for land development

Revenue from property, donations……

Shared revenues

Personal Income Tax (PIT)

- 40% gross wages tax- shared
- agriculture and forestry,
- independent activities,
- leasing of movable property,
- personal insurance

Inheritance and gift tax

Tax on property transfer)

Assigned (shared) fees

Transfers

Total unconditional transfer (1,7% of GDP)

- Equalization Grant
- Compensatory Grant
- Transitional Grant
- General Grant

Conditional grants (both CG and PG)

Equalization Grant

- The first call of funds within the total non-earmarked grant pool aimed at horizontal equalization
- LGs entitled to receive funds from this grant are those whose estimated per capita revenues from assigned (shared) taxes are less than 90% of national average for municipalities (without cities)
- Their amount of transfer are equal to a percentage of the difference between their per capita revenue from shared taxes and a 90% of the national average multiplied by their populations.

General grant

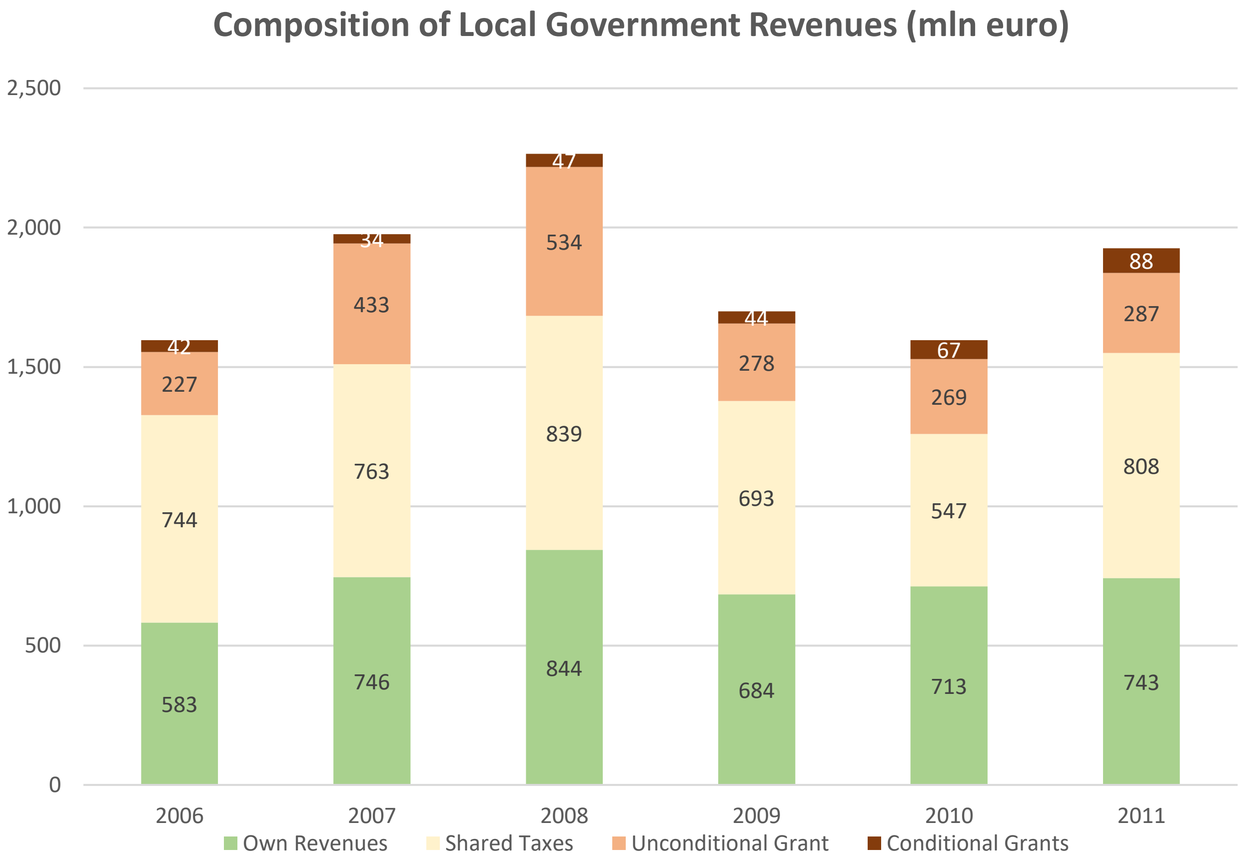
The total amount of funds for the General transfer is obtained when the necessary amount of the equalization transfer, transitional and compensatory transfer is deducted from the total amount of the non-earmarked transfer and is allocated by formula to all LSGs .

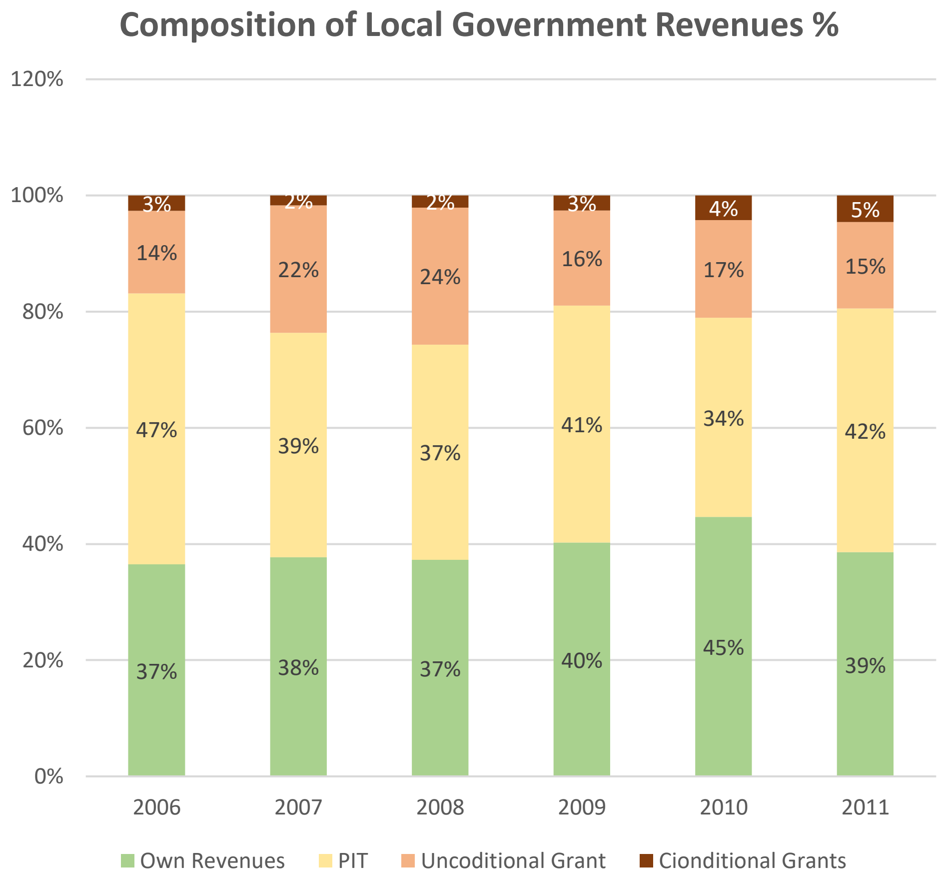
The allocation of this grant to individual LSGs is determined in accordance with uniform criteria;

- number of inhabitants (65.0% of the total amount of funds designated for the general transfer),
- size of territory (19.3%),
- number of classes in elementary and secondary education (4.56% and 1.14% respectively),
- number of elementary and secondary school facilities (2% and 0,5% respectively),
- number of children attending preschool education (6%) and
- number of pre-school facilities (1,5%).

For the LGs that have estimated per capita revenues from assigned taxes 50% more than national average for all LGs (index 150), the transfer is reduced., so that 40% of the amount over that limit is transferred to all LGs that have per capita revenues from assigned taxes less than national average for all LGs using the same uniform criteria. This transfer thus has also an equalizing effect, independent of the equalization grant.

I faze/2006-2011





II faze/ 2011 - 2016

- Changes adopted in 2011 as a result of the political bargain in the governing coalition.
- The outcome was change of share of the wage tax (raised from 40% to 80%, for Belgrade to 70%) and change of provision for total unconditional transfer from 1.7% of GDP to 1,7% of GDP as accounting category)

Own revenues

Property tax (immovable properties)

Tourist tax

Own fees and charges

- Administrative
- for environmental improvement;
- for usage of public spaces/surfaces
- for usage of natura healing factor

Contribution for land development

Revenue from property, donations……

Shared revenues

Personal Income Tax (PIT)

- 80% gross wages tax- shared
- agriculture and forestry,
- independent activities,
- leasing of movable property,
- personal insurance

Inheritance and gift tax

Tax on property transfer

Assigned (shared) fees

Transfers

Total unconditional transfer (1,7% of GDP but as accounting category)

- Equalization Grant
- Compensatory Grant
- General Grant
- Solidarity Grant

Conditional grants (both CG and PG)

General grant

The total amount of funds for the General transfer is obtained when the necessary amount of the equalization transfer, transitional and compensatory transfer is deducted from the total amount of the non-earmarked transfer and is allocated by formula to all LSGs .

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- number of elementary and secondary school facilities (2% and 0,5% respectively),
- number of children attending preschool education (6%) and
- number of pre-school facilities (1,5%).

New provision – Inclusion of the level of development as additional criteria

General grant – new provision

This amount of transfer for each LG is multiplied with a certain coefficient depending on the level of LG development, thus general transfer has also an equalizing effect

Coefficient 1 for LGs from development group IV; 0.9 for LGs from development group III; 0.7 for LGs from development group II; and 0.5 for LGs from development group I.

The degree of development of an LGs is determined according to the single list of development of LGs, in accordance with the Law on Regional Development.

group I – LGs with development degree above the national average;

group II - LSGs with development degree ranging from 80% to 100% of national average;

group III – insufficiently developed LSGs with development degree ranging from 60% to 80% of national average;

group IV – extremely underdeveloped LGs with development degree below 60% of national average (includes a number of LGs categorized as devastated, i.e., with development degree below 50% of national average).

Solidarity grant

New part of total unconditional grant that all LGs, except Belgrade, are entitled to receive.

The size of the Solidarity Transfer is equal to the transfer that the City of Belgrade was entitled to receive by General Grant according to the original Law adopted in 2006.

The reason for introduction of this transfer- the increase of the share of Wage Tax for LSGs from 40% to 80% that caused a reduction of the amount of the unconditional grant, leaving a smaller pool of grant funds which are being allocated to other LGs.

Determination of the amount of solidarity transfers for individual LSGs is based on the level of development, according to the single list of development of LSGs.

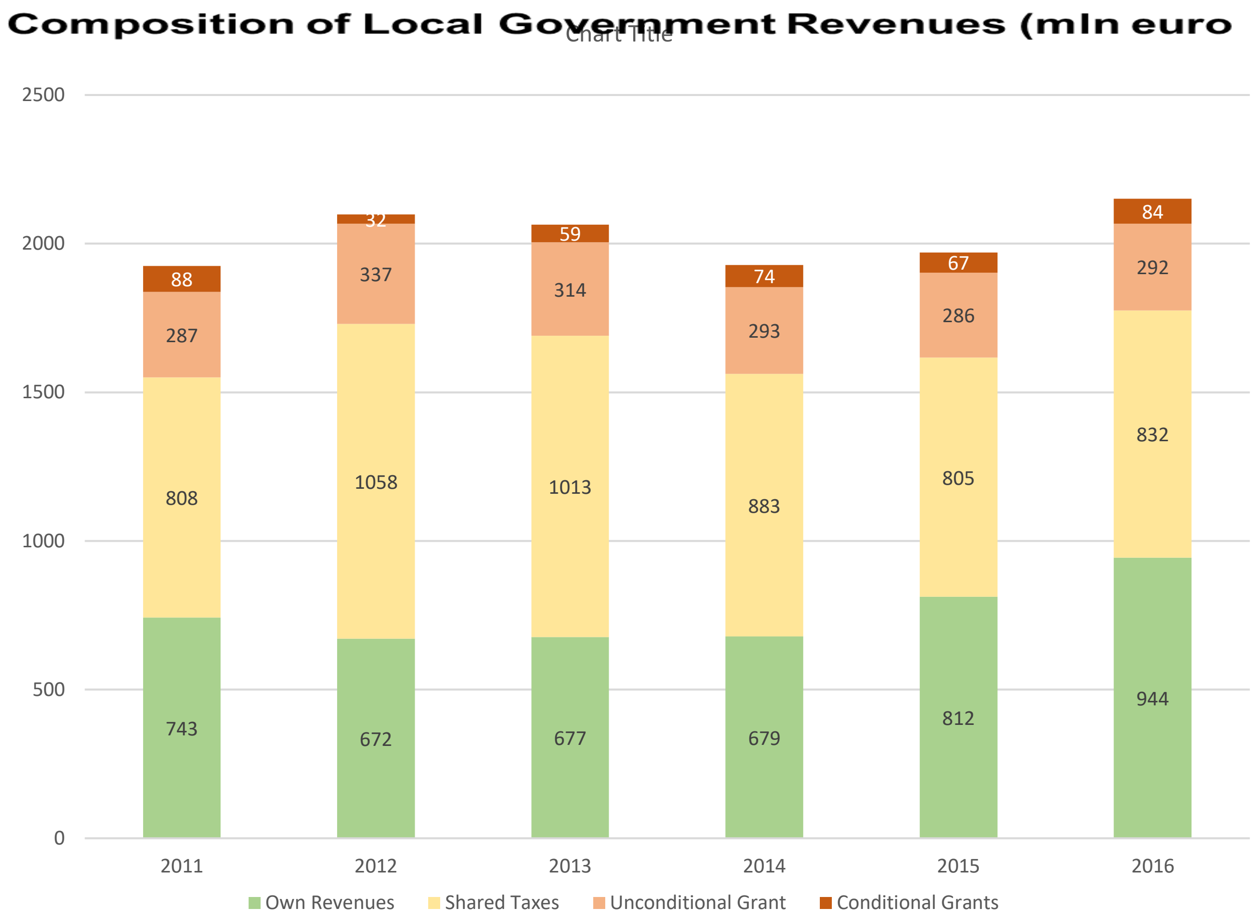
50% of solidarity transfer funds are distributed to LSGs in development group IV;

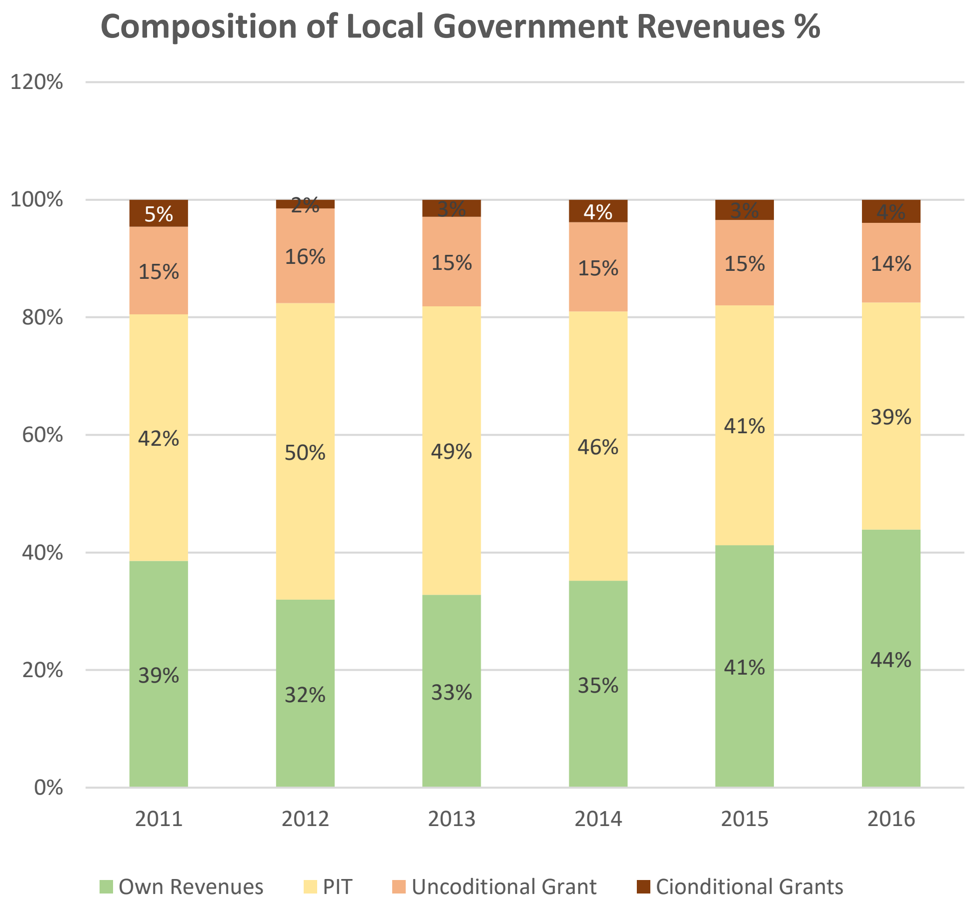
30% to development group III;

10% to development group II;

10% to development group I.

II faze/20012-2016





III faze/ 2017 - present

- Changes adopted in 2016 after unsuccessful negotiations between central government and LGs.
- The outcome was only change of share of the wage tax (reduced from 80% to 74% for municipalities and 77% for cities, for Belgrade from 70% to 66%)

Own revenues

Property tax (immovable properties)

Tourist tax

Own fees and charges

- Administrative
- for environmental improvement;
- for usage of public spaces/surfaces
- for usage of natura healing factor

Contribution for land development

Revenue from property, donations……

Shared revenues

Personal Income Tax (PIT)

- 74 % gross wages tax
- agriculture and forestry,
- independent activities,
- leasing of movable property,
- personal insurance

Inheritance and gift tax

Tax on property transfer)

Assigned (shared) fees

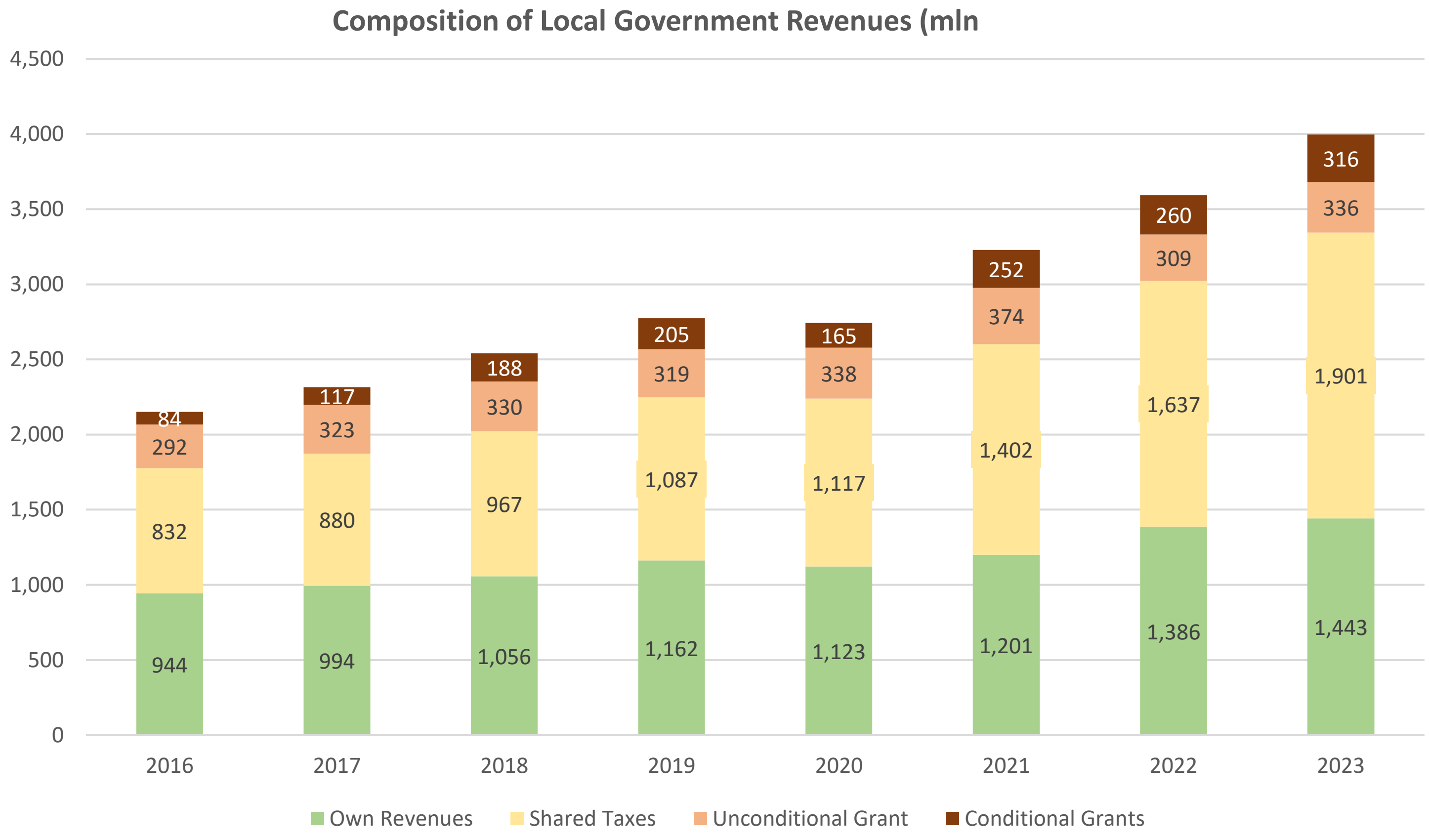
Transfers

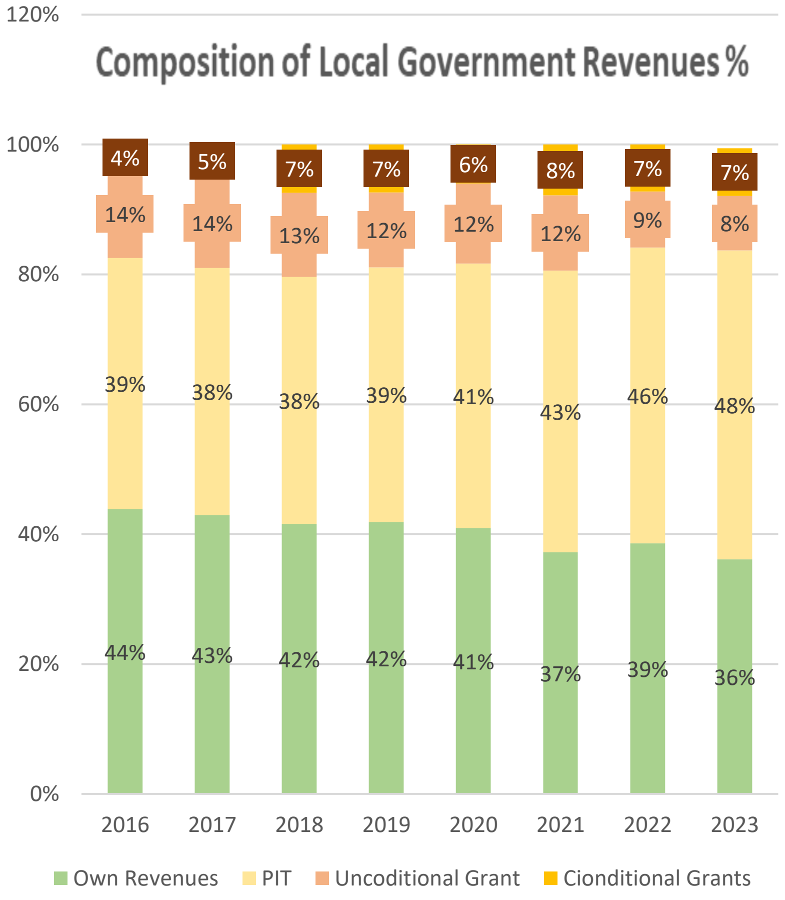
Total unconditional transfer (1,7% of GDP as accounting category)

- Equalization Grant
- Compensatory Grant
- General Grant
- Solidarity Grant

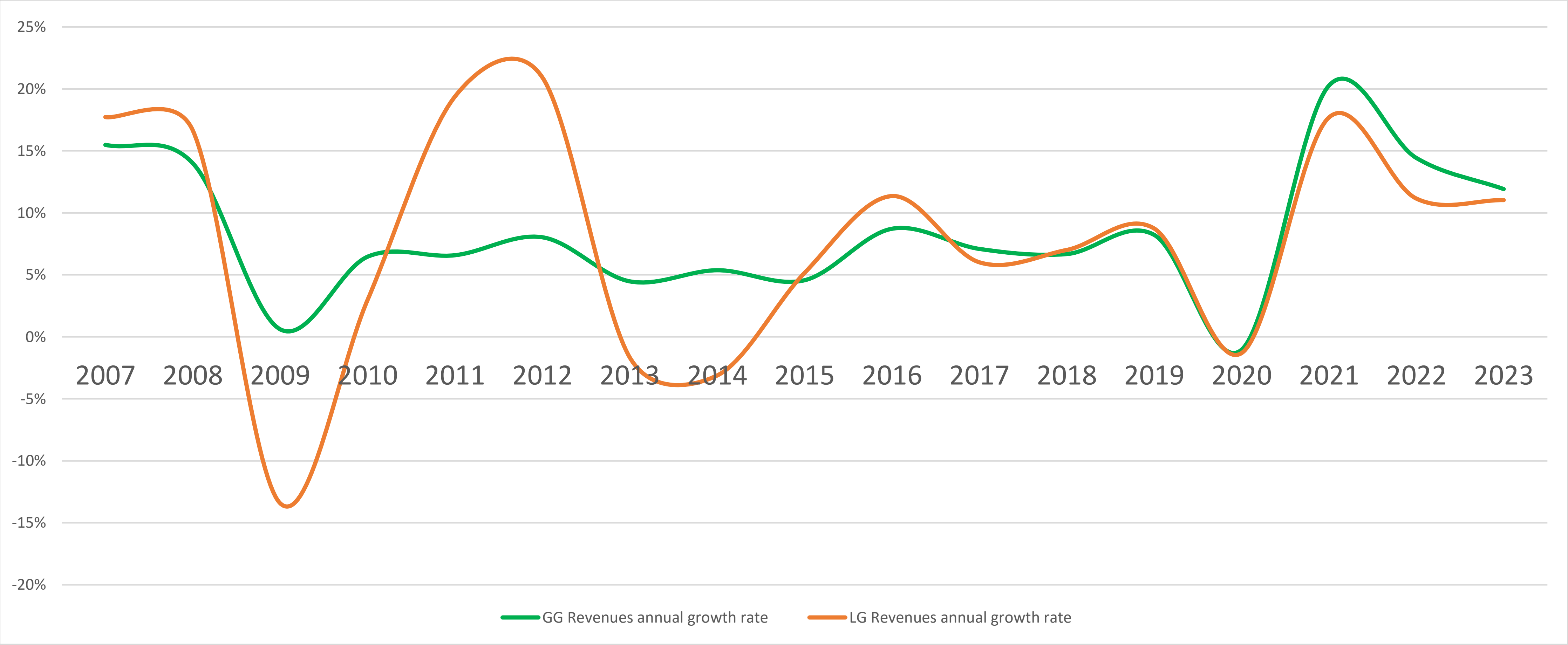
Conditional grants (both CG and PG)

III faze/20017-present51

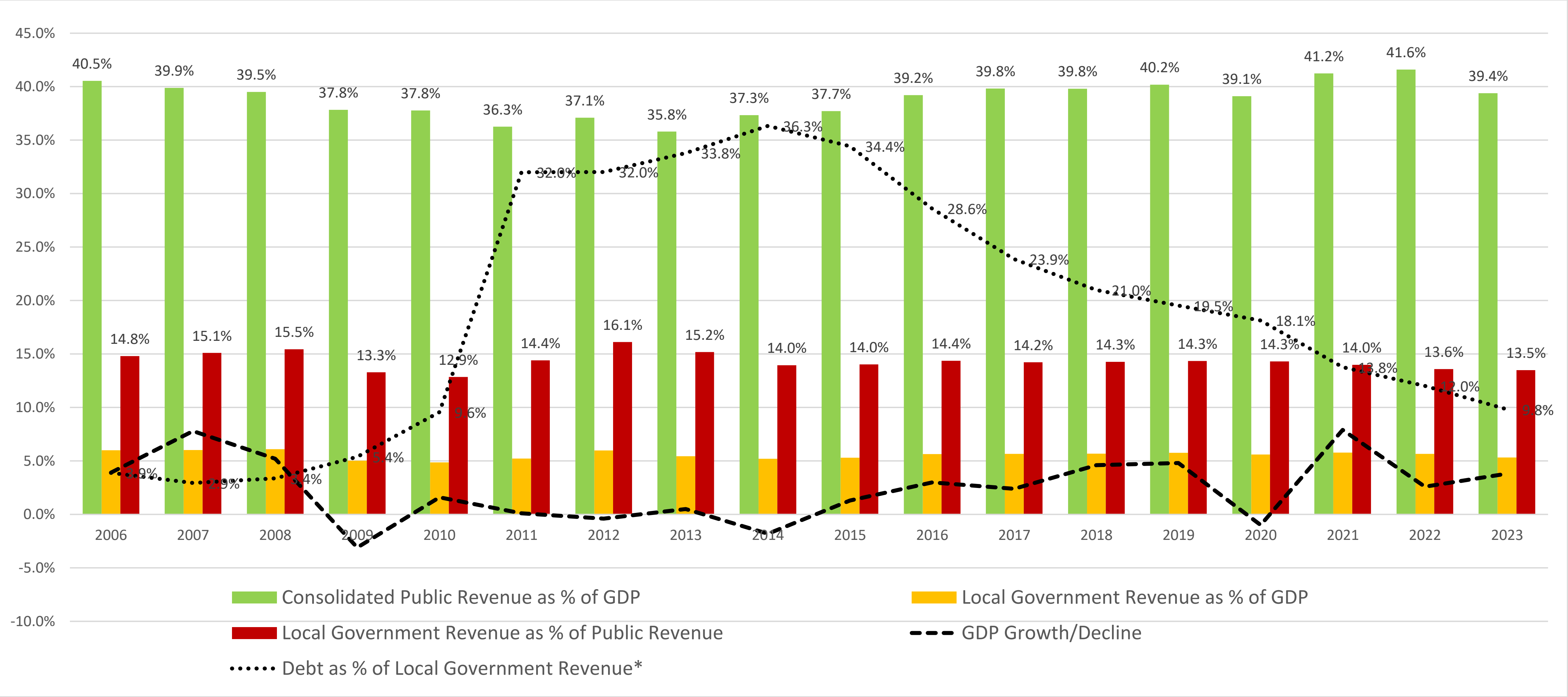




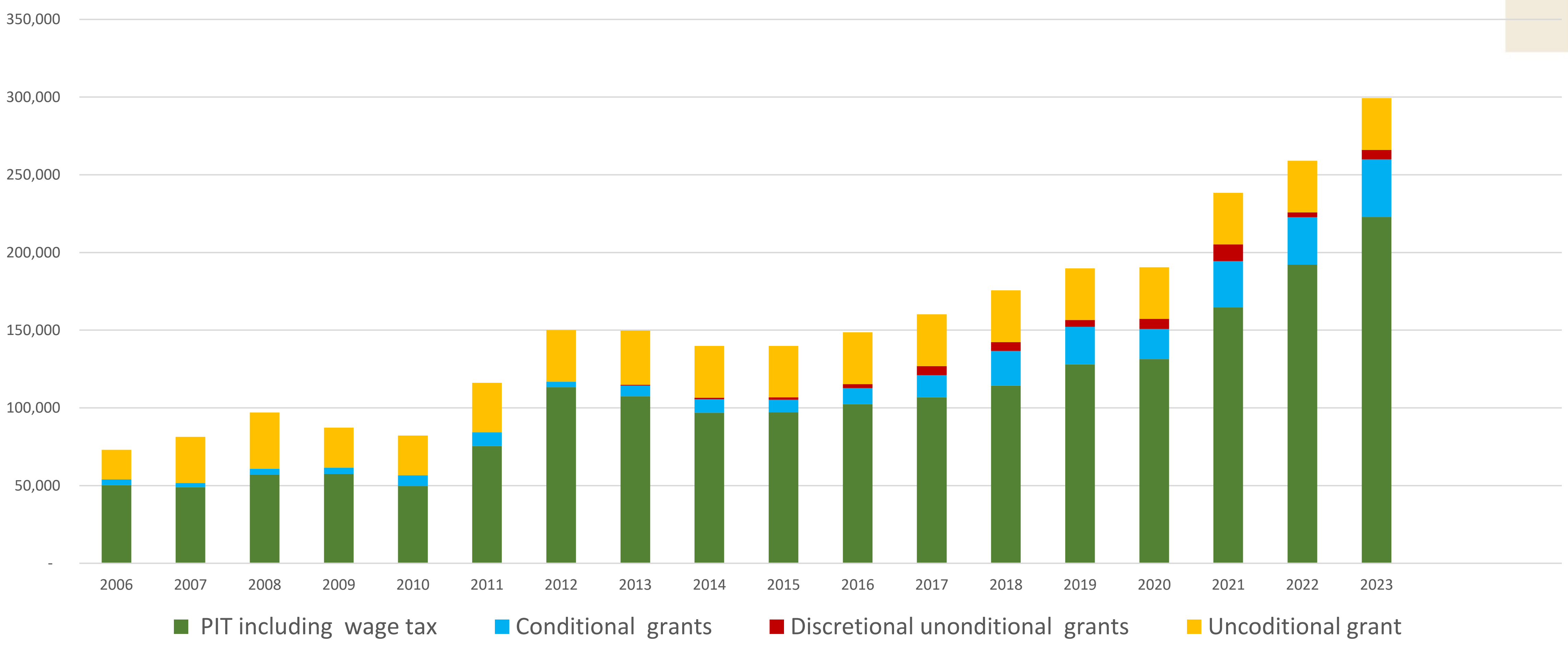
Annual Fluctuations in the Revenues of the General Government and Local Governments



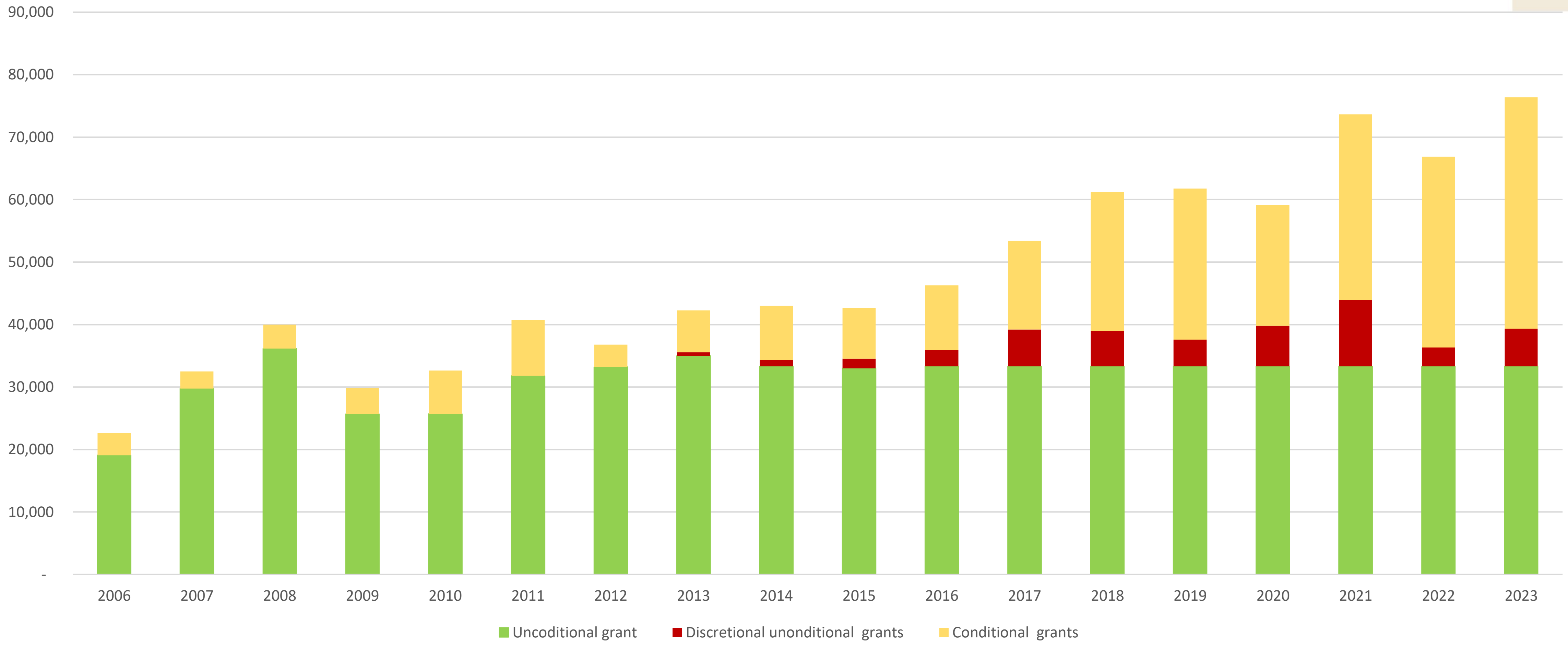
Local Government Revenue as a Share of GDP and Total Public Revenue 2006-2023



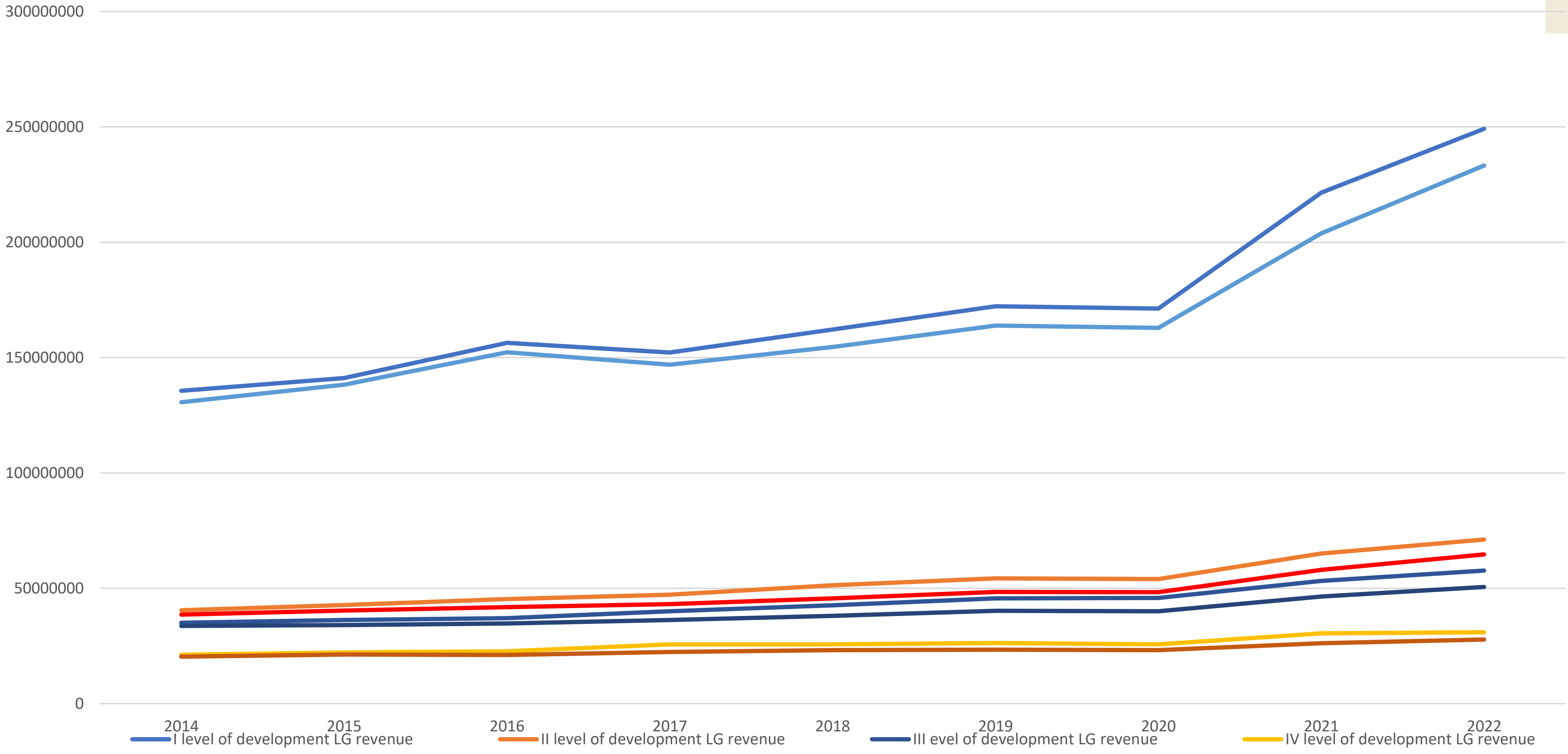
Intergovernmental fiscal transfers 2006-2023 in milion RSD



Unconditional and conditional transfers



Horizontal imbalance



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Conclusions

- Size and type of LG matters
- Reliance on revenue sharing enables vertical balance but leaves less space for horizontal equalization
- Equalization grant should be designed to enable horizontal balance (not only between LGs in different development groups)
- Politics could favor more vague than systematic solutions
- Dynamic (negative) demographic trends are challenge for systematic solutions – formula adjustment

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Thank you for your attention!

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