

## I

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## LIMITS OF DECENTRALIZATION IN LOCAL FINANCE

I. It is not easy to fix a set of problems which should become a subject of discussion of our conference in the aspect of a comparison of solutions in particular countries. Although the local economy involves more common problems than any other field of finance, the actual differences in legal-administrative structure and conceptions of management result in specific solutions in different countries where some problems do not exist or take a different legal form.

It seems that the proposed selection of subjects for the three successive sessions will allow a rather comprehensive presentation of problems important for particular conceptions in different countries represented here. The most general, somehow a model problem, is determining certain limits of decentralization in local finance. So I suggest to discuss that question today, as it is the problem which decides about further detailed solutions.

For the second day a discussion is planned about forms and constructions of various kinds of compensation revenues, constructions of grants, shares, etc., as well as credits and loans which appear in almost all systems, for various reasons. A brief introduction with a stress on Polish problems will be presented by Professor T. Romanowska.

On the third day I suggest to consider the problems of the legal-financial systems of local enterprises in the Polish situation, introduced by Professor C. Kosikowski.

In all countries municipal economy has a long tradition. However, now the situation allows, at least in Poland, to establish other local enterprises, bringing marked economic and financial profits to the councils. Here the question arises of people's councils influencing the existing in their areas central enterprises, cooperative and private enterprises in form of companies,

handicraft, including those of mixed capital – joint ventures, etc. It seems that also this subject is worth a detailed discussion in a comparative aspect.

The indication and introduction of the three problems relating to local economy are meant only to encourage a broader discussion. It does not complete the list of problems not mentioned here, but characteristic for particular countries. It would enrich our discussion and considerations. A discussion of various problems is an open issue.

At present in Poland economic reforms of the model of management are introduced and further ones are postulated for the next future. In this field a substantial decentralization and giving a larger than before economic and financial independence to local units is planned. This is why the question of limits of local decentralization becomes essential. Besides it is a major problem to be approached by theoreticians in every country, so these questions are worth a wider discussion.

II. 1. The notion of limits of decentralization in local economy may be considered in some aspects. First of all one may start with, and most often it is so, determining firstly the division of tasks between central and local economy. Secondly, defining the property of local units. Thirdly, determining the proper degree of independence as regards expenditure, including planning of tasks and development of the area. And finally fourthly, existence of proper sources of revenue. Extending the limits of decentralization should be realized in those four aspects.

Local units may now undertake different tasks, in various fields, such as administrative and cultural services, health service, education, sport, security, typical municipal services, as well as a wide range of economic matters. The range of matters and tasks left to the councils has been essentially extended, as well as the competence of taking decisions.

First of all, a large number of tasks has been passed from the central to local authorities. It is a well-marked trend with a tendency toward a further increase.

2. The situation in the area of property has substantially changed. In 1988 the constitution was amended by introducing an article, so far unprecedented, excluding municipal property from national property and passing it to the people's councils as their own property. In this way a new form of municipal property emerged, controlled by local authorities. It is certainly a big step toward decentralization. Unfortunately, so far there are no executive acts which would determine details and actual rights and duties of particular units and division of the property between them. So far there is no uniform conception in this aspect.

A wide discussion revealed very different views and diverse propositions as to the scope, conditions of functioning and content of the notion „municipal property”. The discussion is far from closed. First of all, it is difficult to

determine the division of property between particular tiers. Secondly, an important problem arises: how to determine the role to be played by the region (voivodship) in the future structural model. In the system of functioning of local economy many matters call for synchronization and harmonization. Several common problems and tasks arise which must be combined in a broader aspect. Finally, it can be assumed that there will always be a need for joint financing of common tasks by different councils, as well as various kinds of redistribution of financial means between particular units within a macro-region. Those aspects cannot be neglected and are really essential from the point of view of constructing a rational and economical financial model of the councils. The fact that at the present stage of discussion there is no fully determined model of people's councils means that the presented legal-financial solutions of the local economy are only an introductory general proposition of the issue, pointing to the direction of future changes of the financial system of people's councils.

It must be stated above all that giving the councils the status of legal person and introduction of municipal property are not an aim in itself. It is a clear symptom of the trend toward legal independence of people's councils, at the same time extending the scope of economic activity and economic forms of managing the local economy.

The conception of granting the councils the status of legal person, certainly favourable for the economy of councils, is also relatively easier to introduce than a practical realization of the conception of municipal property. It creates a number of legal and financial rights and increases the responsibility of councils. These are very desirable, if not even necessary features of the new much more economized and decentralized model of management. Such trends are expressed now by giving a number of budgetary units, both of central and local level, some rights connected with so-called legal-financial subjectivity, which extends their civil and financial rights. It seems that the status of legal person can be given to the councils earlier, even without settling the conception of municipal property. Creation of proper forms and rights of control and use of property, and an extension of civil legal and financial rights give reason to give the local units the status of legal person.

However, that kind of legal property solution must be accompanied by a substantial increase of own revenue of the councils and a possibility to decide expenditure. Generally it may be stated that an extension of financial independence should be realized, irrespective of the conception of scope and content of municipal property accepted for communes, towns and perhaps regions.

A very important problem, connected with possession of status of legal person and municipal property, is an extension of limits of credit for tasks executed by councils. Application of various forms of credit given for

investments and other tasks to councils, using also such forms as selling stocks and shares, etc. should markedly contribute toward an improvement of financial situation of the councils in long-term economy. They are necessary forms when the scope of economic activity of councils is extended. Those forms of financing have many advantages. They are a rational complement and occasionally may eliminate a need for some kinds of centrally decided subventions given in an unreturnable form, which is naturally less inspiring to economical and independent deciding about economic and social development than returnable financing.

3. The third area, referring to the rights of deciding expenditure shows a clear tendency toward decentralization. Also the rights of local units to plan and decide expenditure independently have markedly extended. Here the progress is great. At present people's councils independently work out their socio-economic and 5-years plans and a yearly plan of local development. This is in fact an essential progress toward real decentralization as compared with the former models, where the central plan strongly determined and controlled the local economy.

Only one part of the central plan, the so-called „determinants of the plan” may have a binding character, directive for determined tasks. The other three parts of the central plan have only an informative-analytical character.

In the people's councils legislation it is said *expressis verbis* that people's councils independently work out their socio-economic and development plans. They may also vote various kinds of special programmes. In this way the rights of the councils to decide local tasks and expenditure have been confirmed. It is a remarkable achievement, in fact deciding about decentralization of the local management system. In the theory of finance it is in general admitted, today already universally, that the scope of independence is above all decided by a right to independent policy of expenditure. In this field decentralization of local management has reached the proper limits.

4. Extension of the scope of tasks passed by central authorities to the councils, together with an ability to decide independently the policy of expenditure, is now accompanied by a parallel proportional increase in sources of own revenue, as it should be expected. Big tasks have in fact been passed from central authorities to councils, but the same mistake has been made for a long time, evident not only in the model of financing the councils in Poland, but also in many other countries – a sufficient number of sources of revenue has not been passed under control of the councils. Although, both in theory and practice, the literature claims the necessity of extending the sources of own revenue of the councils, the state of affairs is far from satisfactory. In the new law of people's councils the own revenue passed to the councils is still not large, though a little larger compared with the past years, but what is worse, it has a character of contract, which means it is unstable. Apart from more fiscal



taxes from own enterprises, it is those established by people's councils, the other taxes are rates on cooperatives, on the private sector and on the population, as well as some duties. All most fiscal taxes burdening the nationalized sector are still received by the central budget, although enterprises are situated in the area of a given council and require many expensive services within the infrastructure. Only one exception has been made, namely the councils can use 85 per cent of the wage tax collected for the central budget. However, it does not solve the problem of financing.

In order to cover deficit various forms of subvention financing have been preserved, that is general and objective grants and shares in central budget revenues, determined for five-years periods as a percentage of the value of retail sale of products and services, supplying the budgets by revenue from so-called common and accompanying investments financed jointly by a number of units not controlled by the council. There is also a possibility to use 5–10 per cent of revenue from income tax on central enterprises. By the way, this typical revenue, commonly known from the literature as redistribution-compensation or subvention revenue, has been misleadingly named „local budget own income”. This kind of revenue will be discussed as a form of typical redistribution on the second day of our conference. However, it must be stated, not entering the merits of the question, that it is certainly not an own revenue because, firstly, it is not decided by councils which cannot influence its size. Secondly, it is not stable. It is granted by central authorities for certain periods, generally for five years. So its size may change. Thirdly, it has clearly compensatory character, as the granted sums are adjusted to own revenue of councils. So that revenue cannot be treated as a source of own revenue. Its name is wrong and misleading.

In a decentralized model of management an extension of the scope of local finance is necessary, irrespective of the form of the future model of people's councils. In fact the legislation on people's councils and local government has extended the scope of legal and financial independence of the councils, but to a far unsatisfactory degree. It is necessary to extend more the process of decentralization and consequently to create a strong and stable basis for financial economy of people's councils. Irrespective of the future conceptions of people's councils and municipal property it is necessary to begin changes with extending the basis of self-financing of particular tiers of people's councils. Without an extension of the scope of own revenue a process of decentralization is quite impossible, and giving the status of legal person would practically be of no importance.

A reform of financial system of the councils should move in several directions. Changes should cover first of all: 1) an increase of own revenue of people's councils, from taxes and from local enterprises; 2) determination of new objective criteria of subvention revenue, common revenue, etc.; 3)

extension of influence on local and central enterprises, small producers, etc.; 4) extension of the scope of credits and other forms of returnable financing in the financial system of the councils.

An increase of revenue should be found first of all in a larger number of financially efficient taxes, permanent and not arbitrary, passed to people's councils as their own revenue. A much more decentralized system of tax revenue division between the central authorities and people's councils should be accepted. So far there is no definite conception which tax revenues should be passed to the councils. In the new division of revenues the financial importance of a tax should play a major role, as well as the forms and scope of the council's influence on the source of revenue. Besides, the councils should be given much more authority to decide the taxation policy, it is to decide tax reductions, exclusions or rises of taxes. In the present shape of taxation system, besides very fiscal and criticized, the councils are not given that important instrument of financial influence. The limited and insufficient competence of the councils covers only the land tax and the real property tax. In general these are half-measures.

It can be stated that in their present form people's councils do not have an authority to shape a local taxation policy. It is a very unfavourable situation. It can be stated that there is still no decentralization of management.

We can suppose that a consequent realization of the reform will in future develop various forms of private sector activity, including handicraft, small producers, as well as various kinds of companies, also joint ventures and companies with foreign capital, and others for which possibilities of development are open. When these forms of initiative develop in future, it can be assumed that the revenue from taxes will be much larger than before. If we assume that the revenue from those taxes become the source of local revenue, we can suppose that the financial situation of the councils will have a chance to improve.

The new model should also move toward a broader scope and larger own revenue of councils. It should move here toward an extension of range forms of local enterprises. Above all, according to the concept of reform, economic activity should develop. In the accepted parametric model of management enterprises established as local ones can compete with central enterprises. It can encourage some inventiveness and initiative of particular groups of enterprises. From the point of view of the councils it creates a possibility of an essential increase of own revenue and also a possibility to extend influence on directions of local development. The existing small range of local enterprises, mostly public utility enterprises and the so-called municipal enterprises, should become extended by various kinds of economic enterprises, strong economically and financially. A more detailed presentation of them is planned for the third day of our conference.

The economic reform assumes an essential extension of the scope of financial independence of enterprises, both central and local. It results in a need for different new, much more economical and not administrative forms of influence of the councils on those enterprises. Various forms should be introduced here, such as joint financing, application of funds, participation in and financing of joint and accompanying investments, granting various kinds of loans, warrants, security, guaranty, etc.

5. Considering the state of finance of people's councils today we can find that the independence of the councils, already realized in some spheres, is still limited in the sphere of revenue. The postulated passing to the so-called self-financing of the councils has not been realized. The limits of financial decentralization are very narrow. Instruments of control of local economy by the central authorities by means of subvention revenue have been preserved in this model. Only the forms of local economy management have changed. In the old model they had a character of direct deciding, in an administrative way, planning of expenditure, determining various forms of objective and subjective compensation financing from the budget. At present not so many administrative forms are applied as before, some freedom of deciding expenditure is allowed, but within the limits of the small revenue. The lacking part of revenue, necessary to cover the extended tasks of people's councils, is provided as subvention revenue, which is an instrument of control of local economy.

Subvention revenue is inevitable in every model as a form of partial redistribution and covering deficit of particular areas, joint financing of national tasks, financing of many forms of social infrastructure and common tasks. A complete abandoning of application of subvention revenue is not postulated, even by most keen supporters of far-reaching independence of people's councils. However, the subvention revenue, including grants and in particular shares, should take a different form from the present form of construction. It should become a form of subsidizing based on objective criteria of granting, determined in general for long terms, without an ability to interfere in the inner economy and forms of management of the councils, which unfortunately happens at present. In no case, however, should the compensation revenue, what unfortunately happens now, become an instrument of balance, which is reduced when a larger own revenue is achieved, or even the surplus is confiscated by the central government. Local self-financing must be assisted and not corrected. If it is not so the situation is highly incorrect, denying and breaking the model of decentralization.

In conclusion it can be stated that in the present model of people's councils decentralization of the system of local economy, postulated by the doctrine, has not been realized. We have a model which can be called „mixed”. The limits of decentralization in legal, property and planning aspects have been

extended. It is a very positive symptom of economization of management. Within the limits of possessed property and rights of legal person people's councils have become much more independent than before. They are entitled to decide directions and expenditure financed from budgetary and off-budgetary means, including credits and loans, as well as to develop economic activity. It allows to state that in this aspect decentralization has been realized, and to a large degree confirms the statement that people's councils are becoming „masters of the area”, freely deciding the forms and directions of meeting the needs of the population and local development.

Decentralization, however, has not been realized in the sphere of extending the sources of own revenue of the councils. In the Polish model, similarly to many other countries, deficits appear permanently in financing large local tasks. In this state of affairs supplementary financing in form of various grants and shares, decided arbitrarily by the central government, becomes an instrument of directive managing the local economy. It is an instrument deciding the actual degree of decentralization of local economy. It can be admitted that the instrument acting through supplementary revenue is an instrument less centralizing the local economy than the administrative forms of deciding expenditure and forms of its financing, applied in the former model of management. Still, insufficient own revenue of the councils certainly restrains the local development, and the applied multidirectional forms of subsidizing, and even confiscation of local revenue surplus for the central government, are not synchronized with the theoretically declared decentralization of local economy.

Theoreticians of local economy, and in particular our conference, could be asked the question: to what degree the existing model is the right one, if along with passing substantial tasks from the central government to local organs, which is a clear and common tendency in majority of countries, proper richer sources of revenue are not provided for the local units. The existing model, which I call „the mixed model”, by which the limits of decentralization are decided, is not consistent and well synchronized in elements of its functioning. Some changes concerning the sources of revenue and its size should be postulated. Limitation of sources of self-financing in favour of subsidizing shakes the right and good conception of decentralized model.

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#### GRANICE DECENTRALIZACJI W LOKALNEJ GOSPODARCE FINANSOWEJ

Opracowanie dotyczy pojęcia granic decentralizacji w gospodarce lokalnej, które można rozpatrywać na kilku płaszczyznach. Po pierwsze – podziału zadań pomiędzy centrum i gospodar-



kę lokalną, po drugie – określenia majątku jednostek lokalnych, po trzecie – ustalenia odpowiedniego stopnia samodzielności w zakresie decydowania o wydatkach, po czwarte – posiadania odpowiednich źródeł dochodów.

Obecnie nastąpiło zarówno rozszerzenie się znaczne zakresu spraw i zadań przekazanych w gestię rady, jak i rozszerzenie kompetencji do samodzielnego decydowania. Mają miejsce znaczne zmiany na płaszczyźnie majątkowej. Powstała nowa forma własności komunalnej, będąca we władaniu samorządu terytorialnego. Rady uzyskały osobowość prawną. Tego rodzaju założeniom prawno-majątkowym musi jednak towarzyszyć znaczne rozszerzenie dochodów własnych rad, jak i stanowienia o wydatkach. Sfera decydowania o wydatkach wykazuje wyraźną tendencję do decentralizacji, nie towarzyszy temu jednak równoległy, proporcjonalny wzrost źródeł dochodów własnych.

Reforma systemu finansowego rad powinna pójść w kilku kierunkach. Zmiany powinny zostać dokonane przede wszystkim w zakresie: 1) zwiększenia dochodów własnych rad: podatkowych i od gospodarki przedsiębiorstw terenowych; 2) zwiększenia oddziaływania na przedsiębiorstwa lokalne, centralne, drobną wytwórczość itp.; 3) ustalenia innych niż dotąd kryteriów zobiektywizowanych dochodów zasilających, dochodów wspólnych itp.; 4) rozszerzenia zakresu kredytowania i innych form finansowania zwrotnego w systemie finansowym rad.

W konkluzji Autorka stwierdza, iż nie nastąpiła jeszcze decentralizacja systemu gospodarki lokalnej. Występuje model „mieszany”. Rozszerzone zostały granice decentralizacji w dziedzinie prawno-majątkowej i planistycznej. Nie została natomiast zrealizowana decentralizacja w zakresie zwiększenia źródeł dochodów własnych rad narodowych.