

## **LOCAL BUDGETING IN THE CZECH AND SLOVAK REPUBLICS**

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### **Abstract**

A discussion of the importance of local budgeting in transition countries and the significance of a comparison of the Czech and Slovak Republics begins the paper. A simple theory of local budgeting is then presented, in which a modified Leontief model is used. Local revenues are considered as financial inputs and local expenditures as financial outputs. A method of measuring the degree of local autonomy as a part of the budgeting process is a part of this model. An attempt is made to determine how local budgeting in the Czech and Slovak Republics functions in practice. A questionnaire is presented which is designed to reveal the perceptions of Czech and Slovak local government officials about their financial relations with the central government. More importantly, questions directly pertaining to the local budgeting process are a part of the survey. The survey was presented to mayors, city managers and financial officers in the spring of 2005. An analysis of the responses to the survey will be made when the questionnaires have been completed. At that point we shall draw some conclusions about the implications of those responses.

# LOCAL BUDGETING IN THE CZECH AND SLOVAK REPUBLICS

## Chapter I. Introduction

Because of the importance of fiscal decentralization in the local finance systems of transition countries, it is of significant interest to discover how decisions are made in the process of preparing municipal budgets. Planning for effective allocation of whatever revenues a city may anticipate, whether that city be rather large or quite small, will have common aspects everywhere. At the same time, in cities where an effort is underway to overcome the excessive centralization of a central planning legacy, there will be some unique characteristics associated with the process. This is the case for the Czech and Slovak Republics, both of which have spent a decade and a half attempting to establish anew the principle of local government autonomy.

Under the regime of central planning associated with Marxist-Leninist socialism, all governance decisions were made by the party at the center for the cities and towns. Peripheral local governments had only one role to play, which was to carry out delegated tasks (*přenesené působnosti*) of “state administration” (*státní správa*) assigned to them by the central government. The point of fiscal decentralization is to achieve local self-government (*samospráva*) on the basis of autonomy.

The present paper will review the process of local budgeting in the Czech and Slovak Republics, which are ideally suited to supply us with a comparative study. The two republics were paternalistically joined in a federation under communism. When the Velvet Revolution came in 1989, the two countries began their joint transition to a democratic market orientation by modifying their fiscal systems to provide for greater local autonomy. They established joint legislation and institutions for their financial systems which were in place when the Velvet Divorce set them on separate paths in 1993. For some time they retained the legislation and institutions with which they began the transition, but before joining the EU in 2004, they each pursued reforms of public administration as a part of the accession process. With these reforms they began their first substantive diversion from their common beginnings. The deviation from the common path was undertaken primarily by the Republic of Slovakia, which initiated reforms in local finance that will produce divergent financial outcomes beginning with the year 2005. At the end of the common transition era, then, we will evaluate Czech/Slovak local budgeting for the last time in which the historic similarities will have been so great.

A simple theory of local budgeting will be presented in Section II, where a modified Leontief model is used to consider local revenues as financial inputs and local expenditures as financial outputs. A method of measuring the degree of local autonomy as a part of the budgeting process is a part of this model. In section III an attempt will be made to determine how local budgeting in the Czech and Slovak Republics actually functions. A questionnaire will be presented which is designed to reveal the perceptions of Czech and Slovak local government officials about their financial relations with the central government. More importantly, questions directly pertaining to the local budgeting process are a part of the survey, which was presented to mayors, city managers and financial officers in the spring of 2005. Section IV will provide an analysis of the responses to the questionnaires and draw some conclusions about the implications of those responses.

## **Chapter II. A Leontief Model of Local Budgeting**

Municipal budgets consist of diverse receipts and expenditures. Because not all revenue sources are “own revenue” sources, the municipality are bound to accept the strings-attached revenues (SARS) with a commitment to honor the specified expenditure obligations to which grants and some transfers commit local officials. This model is designed to show the sources of revenues and measure the extent to which municipal budget officers are constrained to expend transferred budget funds or grants in specific ways, although it may appear to them that those funds could be better used for other functions.

We assume two categories of budget receipts:

- 1) those from various tax revenue transfers or grants from the center,  $Y_n$ , and
- 2) those from “own revenues,”  $OR_n$ . For purposes of illustration, let us assume that own revenues consist of property tax revenues, user fees and sales revenues from privatized municipal properties and assets.

Expenditure types are A, B, C, D, and O, “other.” A may be expenditures for education, B expenditures for public health, C for roads, D for general government administration and O for such things as police protection, public transport, and water and sewage.

Let  $\alpha$  be the coefficient representing the share of a given total revenue source assigned or specified by either the central government or national law that must be spent for a given activity. So  $\alpha$  is an assigned value (AV) or budgeted amount to be spent on a particular activity expressed as a percent of a total revenue

source. The municipality may, for example, plan to spend 40 per cent of the total amount of personal income tax revenues transferred to it by the center for elementary education, so that  $\alpha(Y1) = 40,000$  SKK, where  $\alpha = .4$  and  $Y1 = 100,000$  SKK.

Let  $\beta$  be the coefficient representing the share of the revenue source actually spent by the municipality for a given activity. It is the chosen expenditure (CE) level of the municipality, and may deviate from the AV or  $\alpha$ . The actual  $\beta$  will reflect, though not necessarily with precision, the preferences of the municipal authorities.

We can thus construct a matrix of local expenditures with budget receipts listed horizontally across the top and with expenditures listed vertically down the left-hand side of the matrix. Reading downward in columns we have the expenditures funded from the revenue source listed at the top of the column. Reading along any given row horizontally we have the funds spent on a particular public service from various revenue sources, appearing as below. Here, we have the matrix as planned by the central government, the coefficients being the  $\alpha$  or assigned values (AVs).

	Y1	Y2	Y3	Y4	OR1	OR2
A	$\alpha Y1 = 0.3Y1$			$0.3Y4$		
B	$0.7Y1$	$0.6Y2$	$0.2Y3$			
C			$0.2Y3$			
D			$0.6Y3$	$0.5Y4$		
O		$0.4Y2$		$0.2Y4$		

The matrix can also be shown with the coefficients showing  $|\alpha - \beta|$ , the differences between mandated spending and the level of expenditures actually chosen. This adds the  $\beta$  values to Figure 1, showing the difference between mandated allocations and the municipality's chosen expenditures level.

If we had perfect knowledge of local “revealed” preferences ( $\alpha'$ ) for expenditures on a given task of public service provision, we could calculate the following values based on  $\alpha$ ,  $\beta$ , and  $\alpha'$ .

A coefficient of conflict,  $CT = |\alpha - \alpha'|$

A coefficient of compliance:  $CC = 1 - |\alpha - \beta|$ , and

A coefficient of autonomy,  $CA = 1 - |\beta - \alpha'|$

Assume three different municipal administrations characterized as Milquetoste, Intrepid and Median. All have the same preferences in the face of a particular  $\alpha$  mandate from the center, but the first conforms perfectly to the mandate, the second is at complete defiance, and the third is between the two extremes. The coefficients use absolute values because the local administration may want to spend either more or less from a particular revenue source than the center mandates, as can be seen by the following simple example.

	$\alpha$	$\beta$	$\alpha'$	CT	CC	CA
Milquetoste	0.4	0.4	0.1	0.3	1.0	0.7
Intrepid 0.4	0.1	0.1	0.3	0.7	1.0	
Median	0.4	.25	0.1	0.3	.85	.85

We would get the same results, of course, if we had values reflecting municipal preferences to spend more on a public service than the center mandates, as seen below.

	$\alpha$	$\beta$	$\alpha'$
Milquetoste	0.2	0.2	0.5
Intrepid 0.2	0.5	0.5	
Median	0.2	.35	0.5

In the absence of revealed local preferences, we can gain less detailed but nevertheless helpful information simply by looking at the Coefficient of Compliance for the various categories of local public expenditures. We observe that in instances where the center transfers untied or non-mandated funds, the center is essentially adopting local preferences in the action, so that  $\alpha$  is assumed to be the same as  $\beta$  and the  $CC = 1.0$ . Across all expenditure categories, this will raise the average  $CC$ .

In general, this simple methodology is interested in finding a matrix of the absolute values of the differences between coefficients of assigned values and chosen expenditures,  $|\alpha - \beta|$ . The absolute values of these differences,  $|\gamma| = \Sigma(AV-CE) + \Sigma(CE-AV)$  declines as autonomy increases. We have no measurement of the Coefficient of Autonomy as defined above, but can only measure differences as expressed in the Coefficient of Compliance.

In summary, we have  $[\alpha_{ij}] - [\beta_{ij}] = [\gamma_{ij}]$  where  $[\alpha_{ij}]$  is a matrix of the coefficients of spending mandates. These are rules for the use of transferred funds or state grants. The matrix represents available, constrained funds designated for essential spending programs or projects. Planned spending is represented here as a share of a total expenditures budget, which could also be viewed as an average of spending among similar communities.  $[\beta_{ij}]$  is a matrix of actual municipal spending choices. It represents the actual sum spent for a program or project.  $[\gamma_{ij}]$  is a matrix of differences between mandated and actual expenditures.

### Chapter III. An Investigation of Local Budgeting Processes

Originally interested in the perceptions of local government officials regarding the interaction between the central and municipal governance levels, we developed a questionnaire to learn how they perceived the situation and outcomes of local budgeting. As we developed interest in the actual decision processes involved, we added questions about that aspect of budgeting. We present below the questionnaire developed to pursue these issues.

#### QUESTIONNAIRE FOR MAYORS, CITY MANAGERS, AND FINANCIAL MANAGERS

For each question, circle the response with which you agree

SA: I strongly agree      A: I agree      U: I am undecided, unsure, or uninformed  
D: I disagree      SD: I strongly disagree

**At the end of the survey you will be given the opportunity to comment and to give examples of the things you have responded to in the survey question if you wish to clarify or elaborate.**

1. Although our municipality receives most of our revenues from the central government, we operate with complete autonomy.

SA      A      U      D      SD

2. Our municipality could operate with much greater independence if we were not so dependent upon financial transfers from the central government to fund our activities.

SA      A      U      D      SD

3. Our municipality always has sufficient funds to accomplish the tasks expected of us.

SA      A      U      D      SD

4. From all financial resources, we receive at least enough revenue to cover our annual operating costs.

SA    A    U    D    SD

5. In the past ten years, funds we have received from all sources have permitted us to make investments in capital facilities that will enable us to provide necessary functions such as schools, social services, and garbage collection, at a satisfactory level in the future.

SA    A    U    D    SD

6. In my experience, no mandates from the central government have been given unless public moneys were transferred to fund them. (This question does not refer to tasks of state administration.)

SA    A    U    D    SD

7. The debt burden of our local self-government is appropriate and payments of principal and interest during the repayment period do not cause significant problems with fulfillment of financial obligations which accrue to us by extant legal norms.

SA    A    U    D    SD

8. My local government never supplies services that would be better supplied by the central or regional government. (This question does not include tasks of state administration.)

SA    A    U    D    SD

9. The central and/or regional governments supply *no* public services that would be better to supply through independent, local governments.

SA    A    U    D    SD

10. Although we face many required expenditures, we still have enough funds to make me feel that we have budget autonomy and discretion.

SA    A    U    D    SD

11. It seems logical to me that, as in England or the United States, a real estate tax, effectively designed and administered, could be a source of considerable revenue for local governments.

SA    A    U    D    SD

12. If we had a real estate tax similar to that in England or the United States, it should be administered by  
local government    regional government    central government

13. Roughly, \_\_\_\_\_ per cent of all our municipality's revenues come from the central government as tax revenues or shared taxes. From those shared and transferred taxes we can spend about \_\_\_\_\_ per cent for whatever purposes we choose.

14. Revenues from a property tax planned and designed by local self-governments would have a higher value to us than the same amount of revenues offered from the central government in the form of shared taxes.

SA    A    U    D    SD

15. If expenses for one function, *e.g.*, social care, increased rapidly, we could meet those costs by spending less for one or more other functions, *e.g.*, education, sport, culture or transportation, according to our own preferences.

SA    A    U    D    SD

16. In making budgetary decisions, we pool all revenue sources to determine the total amount available for all expenditures, and then we spend the entire pool on activities and projects according to our own discretion.

SA    A    U    D    SD

17. Examples of some general expenditures your municipality makes are listed below. From the revenue sources listed at the right, choose those sources which have been used in your municipality to fund the different activities and functions on the left. For example, if you use own-revenues (SP) and state grants (DV) to fund health care, you would write SP, DV on the line by Health Care.

<b>Expenditures: (Revised)</b>	<b>Sources of Funds, Revenues</b>
Education grades 1 through 6 _____	State Grants, DV
Education grades 6 through ? _____	Shared revenues/ Transferred Taxes
University Education _____	Own-Revenues (e.g., sales of
Health care _____	property, poplatky, etc.), SP
Social care _____	Bonds, debt, D
Sport, Culture _____	Accepted credits and returnable
General government Administration _____	financial aid, A
Roads and Streets _____	
Public Transportation _____	
Communication _____	
Fire protection _____	
Police protection _____	
Garbage _____	
Water and sewage _____	
Other public works _____	
Government employee wages and salaries _____	

18. In your budget do you use the same funding sources to finance particular expenditures each year?

Yes

No

If you wish, please explain

19. The anticipated receipts of our municipality this year will be approximately \_\_\_\_\_ Kč.

Last year's receipts were \_\_\_\_\_ Kč.

20. My position in our municipality is:

Mayor

City Manager

Financial Manager

Other \_\_\_\_\_

21. Our *obci* has a population of \_\_\_\_\_ inhabitants.

This survey was ready for distribution by email in April, 2005 to municipalities in the Czech and Slovak Republics. Questions 15 through 17 of the survey are directly related to the actual process of budgetary decision making. In Figure 1 below the on-line version of question 17 is reproduced from the Czech questionnaire; the Slovak counterpart has, of course, the same appearance. In question 17 budgeting is presented in the input-output fashion with the vertical entries in columns being the budgetary expenditures financed by various "inputs."


**Figure 1**

17. Z jakých zdrojů jsou financovány některé působnosti ve vaší obci. Ze zdrojů prostředků v pravém sloupci označte ty, které byly použity ve vaší obci na financování úkolů uvedených v levém sloupci. Pokud je používáno více zdrojů, označte všechny používané zdroje.

**Finanční zdroje**

	Dotace ze státního nebo krajského rozpočtu	Sdílené dani (RUD)	Vlastní příjmy (z prodeje a pronájmu majetku, daň z nemovitostí, místní poplatky, apod.)	Dluhopisy, úvěry, pohledávky, atd.
<b>Náklady:</b>				
vzdělávání, základní	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
zdravotnictví	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
sociální péče	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
sport, kultura	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
všeobecná správa	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
údržba a výstavba místních komunikací	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
místní hromadná doprava	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
telekomunikace	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
požární ochrana	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Policie	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
odpadové hospodářství	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
voda a kanalizace	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

ostatní veřejné služby	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
platy zaměstnanců obce	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



The horizontally presented data of the rows represents the financial sources used to finance individual projects or public services. The more liberally local authorities can draw from various financial sources for whatever expenditures they wish to make, the greater we assume financial autonomy to be. Where the financial sources come with specified and limiting mandates about the expenditures they are to support, the less the individual municipality's financial autonomy.

The results of the survey will be analyzed for insights into the way local budgeting decisions can be made. They will be written up on the basis of the results of the survey.