

INDEBTEDNESS METHOD OF REGULATING LOCAL GOVERNMENT UNITS IN SELECTED COUNTRIES

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Abstract

The aim of the article is to compare the growth of debt in single countries of European Union, special Slovak and Czech Republic, not only on local government level but also in public sector as such and to offer a suggestion adjustment. The topic of the growth of public debt is being an important part of discussions and summits in coherence with financial crises. We analyzed the debt of Slovak republic as a country, debt of local government and municipalities, too. The same analyze we did for Czech Republic. The last part of article includes comparison of single results of both countries and we are providing some suggestion adjustments for a better financial management of single countries and local units that can be used in the near future.

Keywords

the financial health of public finance, higher territorial units, the public debt, the debt regulation

JEL classification

H61, H63, H68.

1 Introduction

An important part of maintaining the financial health of public finance for the local and regional authorities is an undoubtedly the control of their debts. Due to this fact it is required to regularly publish a database with those information that are concerning their financial health in order to make them more available to the citizens and also in order to allow citizen to compare them according to the key indicators. Based on this, the informed citizen can put a pressure on mayors, supervisors and chairmen of higher territorial units in order to farm responsibly.

In order to evaluate the current status of public finance, it is an important indicator the structural primary balance of public administration that assesses the results of operations of the public sector for the previous period. It represents the value of the budget balance of public administration, adjusted by the economic influence of business entities of the state administration, by the entities of local government and by the National Bank of Slovakia, further the impact of the economic cycle, one-off effects and the costs aimed to manage government debt.(The office of RRZ, 2015)

2 The comparison of the development of regions in SR and CR

As a first indicator that will give us relevant comparison is the development of the structural balance of public administration that is controlled by the independent institution- Council of fiscal responsibility in Slovak Republic. In the Czech Republic, there is a supervising authority the Ministry of Finance of Czech Republic.

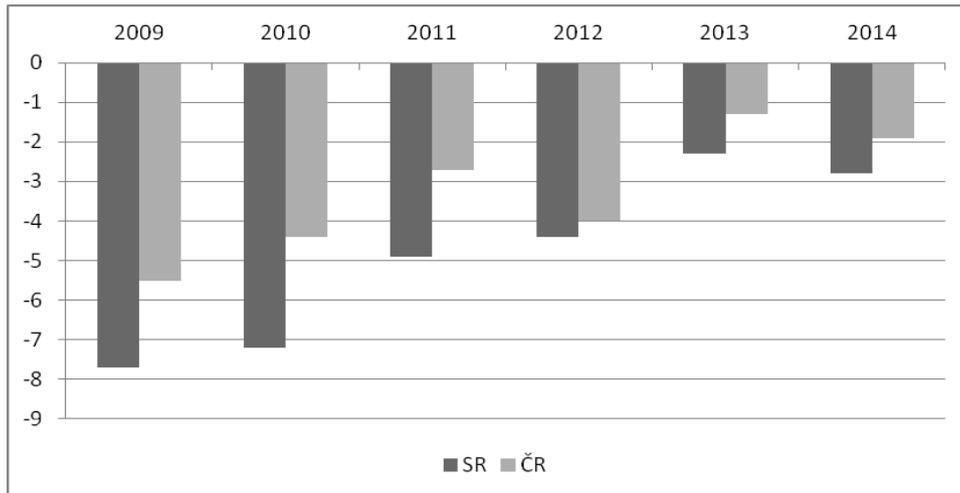


Fig. 1. The comparison of the development of structural balance of the public administration in SR and ČR (%)
 (Source: www.ec.europa.eu)

According to the above-mentioned chart related to the development of structural balance of the public administration, the Slovak Republic has reached higher values in comparison with Czech Republic, for the monitored period. In 2012, the balance has grown in the Czech Republic to the level of 4%. It was due to the fact of lower households expenditures for the final consumption. In recent years, there has decreased also the economic activity of the country, on average there was also a significant reduction in economic performance of many other EU countries. (Czech Confederation of Commerce and Tourism, 2013.) Due to the consolidation, the Slovak republic could significantly reduce the balance of the public administration for years 2011-2013.

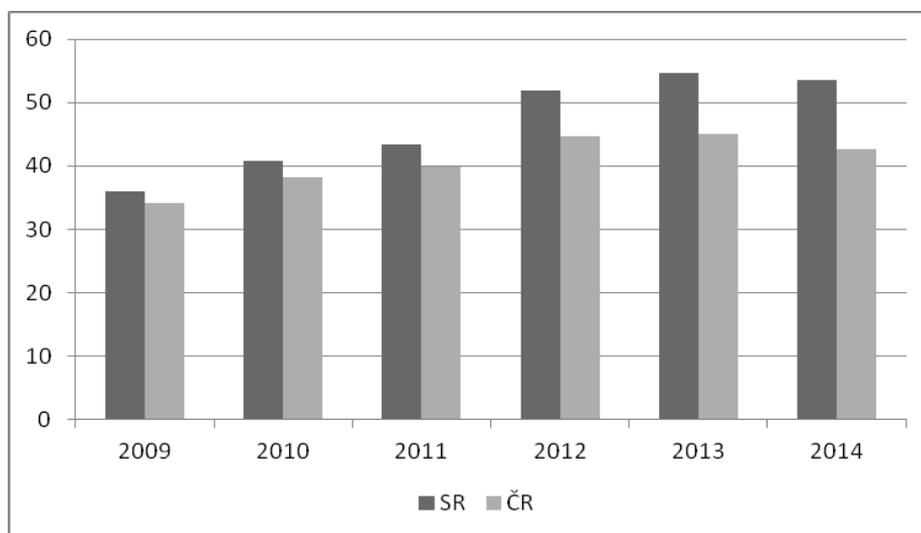


Fig. 2. The comparison of the development of public debts in SR and CR (%)
 (Source: www.ec.europa.eu)

In terms of debt limits we can evaluate the development of the public debt in Czech Republic as a sustainable to the maximum limit of 50%, the highest value was reached in 2013 at a level of 45.12% of GDP. On the contrary, the Slovak Republic has exceeded the level of 50% from 2012 and thus has revised down to the level of the third sanction band in 2014. Already in 2013, after reaching the second sanction zone, there was sent a letter by the minister of finance, to the National Council referring the reasoning the levels of debt. In 2014, there has decreased the debt to the level of the second zone (53-55%) due to the new methodology ESA2010. (Fisher, R. 2016.)

In order to the international comparability of the fiscal position we can use an indicator – the gross public debt that represents the obligations of individual countries in relation to the creditors. In the chart we can see that, for the period of the first three years, there was approximately the same increase in gross debt, but in 2012 there was slightly higher increase in Slovak Republic compared to our neighborhoods. (Pollitt, Ch., Bouckaert, G. 2011) The reason could be the upcoming parliamentary elections, as we have already previously mentioned. Its growth in SR has further continued again, in contrast with the Czech Republic, that has entered downward trend, especially in 2014. Since 2013, there is the Stabilization plan of the government debt in Czech Republic, which is lead under the auspices of the Ministry of Finance of the Czech Republic, associated with the effective involvement of the available liquidity of the Czech state treasury together with the budget surplus of the Czech Republic. (MFČR. 2014) In 2014, there was a decrease of the Slovak debt due to the enacted one-off measures that should be supportive to reduce debt also in the future. (Ochotnický, P. 2012)

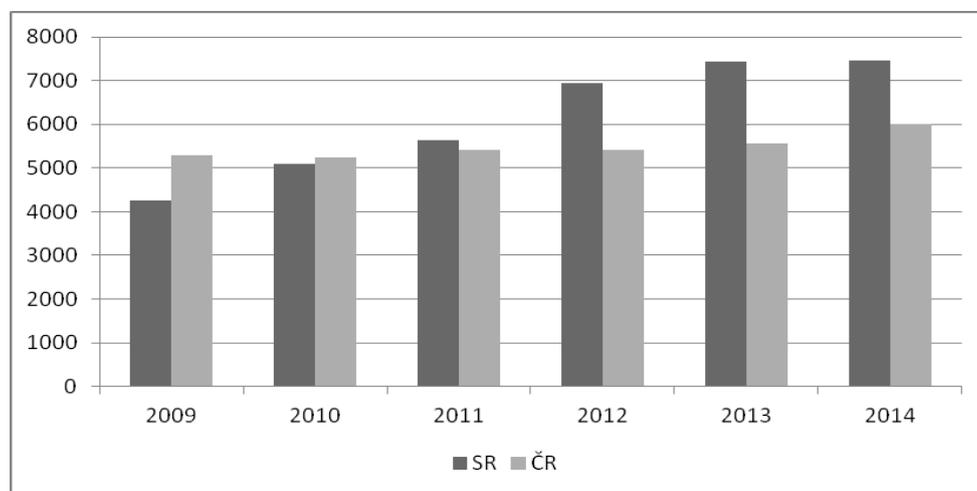


Fig. 3. The comparison of the development of the debt per capita in SR and CR (in Eur)
(Source: www.ec.europa.eu)

With the increase of Slovak public debt since 2012, there is also increasing the debt per capita that is comparatively higher than in the Czech Republic. Even according to the chart we can see, that in 2009 the debt has exceeded the level of 5.000 Euros and in 2010 the level of the debt per capita in the Czech Republic is only slightly higher than in our country, in amount of 5.233 Euros. It represents a slight decrease compared with the previous year. In 2014, the amount of debt per capita has reached the maximum value in Slovak Republic on the level of 7.460 Euros, in the conditions of Czech Republic in amount of 6.007 Euros per capita, while the debt has been slightly increasing over the past three years. (Greene, J. 2012)

In order to compare the development of regions in SR and CR we can use the indicators of the development related to the debt service and the regions debt per capita. In Czech republic, we have chosen 8 regions; in Slovak republic were selected 8 higher territorial units.

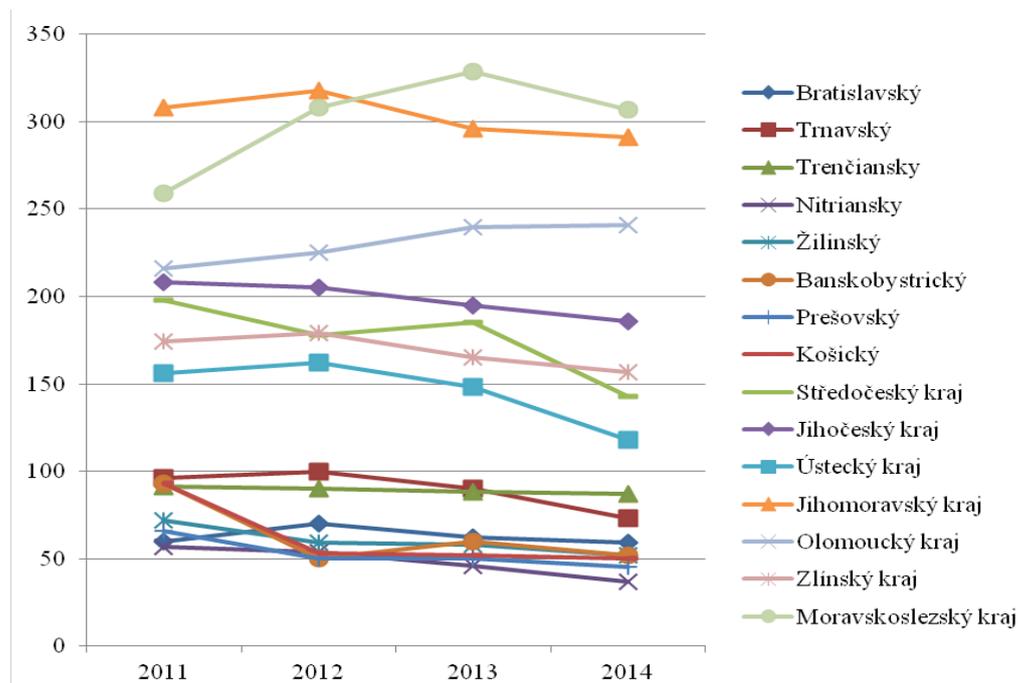


Fig. 4. The comparison of the development of the debt service in SR and CR (in Eur)
 (Source: MFSR, MFCR)

The amount of expenses associated with the servicing of debt could be shown by the values in the chart related to the development of debt service. In Slovakia, there are reached the highest values in Trnava, Trenčín and Žilina region in 2013. The lowest figures are reached in Prešov region and also in Bratislava region. In the Czech Republic, there are reached the highest amounts in Stredočeský (Central Bohemian) region and Ústecký region and the lowest amounts are reached in Jihomoravský region (South Moravia).

In the chart, there are presented the data related to the amount of debt per capita of the relevant region, where we can see in average the difference of double amount of the debt in Czech regions than in the Slovak regions. This result can be evaluated also from the positive angle; the Slovak regional centres are not so heavily indebted concerning the number of population living in cities than in a case of Czech cities, where the debt was significantly higher. According to the previous analysis, in the chapter five, we know that the Czech regions have been investing into the development of infrastructure in recent years, further into the reconstruction of hospitals, modernization of sports facilities, improving of education. Typically, the Czech regions are increasing their debts over years. For this purpose they spare money in order to reduce this overall debt due to the one-time pay in a certain time period (of about 10 years) and thus to reduce expenses associated with the servicing of the debt. (Gruber, J. 2011.)

Due to the indicators related to the basic balance, to the total debt, to the debt service and to the amount of debt per capita we can compare the development of the debt in regional cities during the monitored period in Slovakia and the Czech Republic. (Kušnírová, J. – Válek, J., 2014)

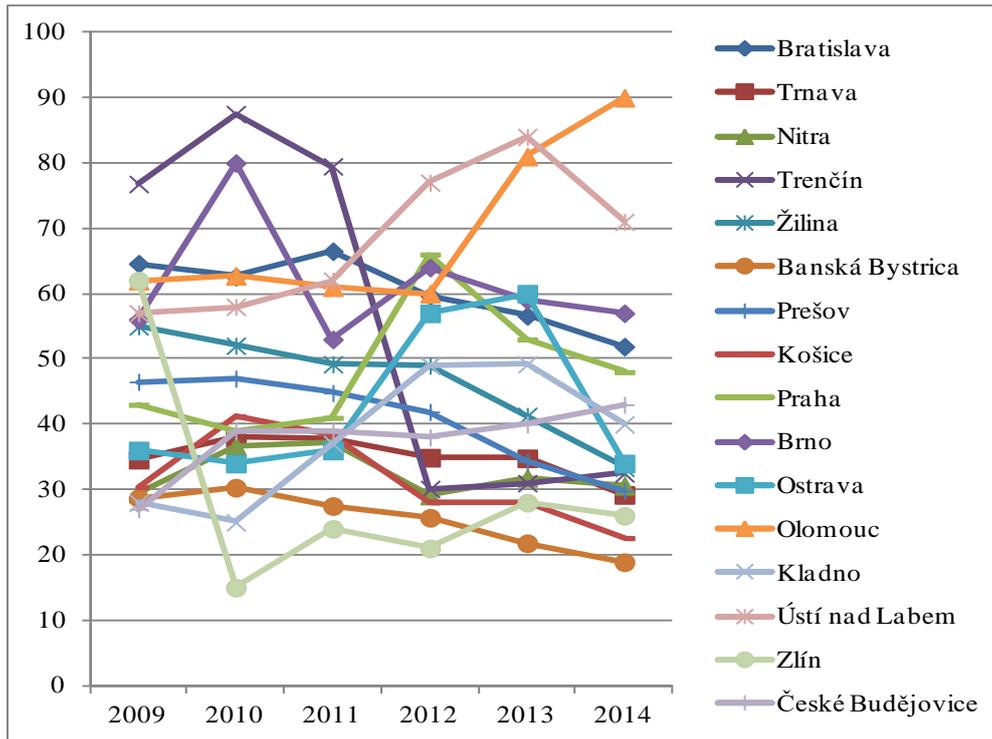


Fig. 5. The comparison of the development of the total debt of cities in SR and CR (in %) (Source: MFSR, MFČR)

Comparing the evolution of total debt in the regional cities in Slovakia and in the Czech Republic we can see on the chart, that the lowest amount of the debt relative to the current income for the previous year, are reached, in average, in the regional town Zlín in the Czech Republic and in Banská Bystrica in Slovakia. On the contrary, the highest amount of the debt is reached by the cities of Olomouc and Bratislava.

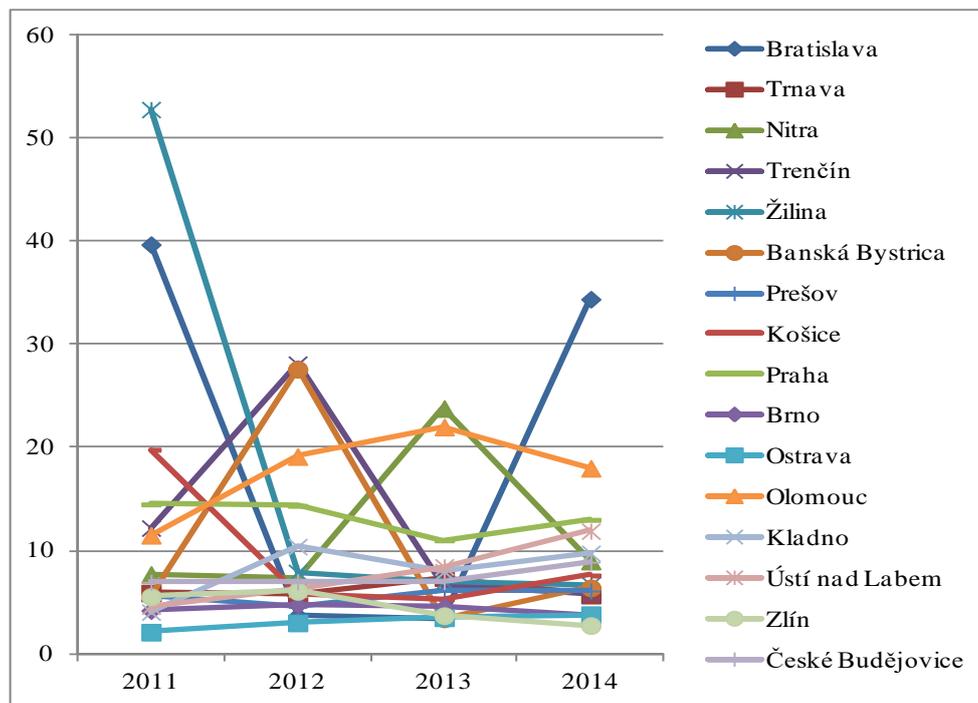


Fig. 6. The comparison of the development of the debt service of the cities in SR and CR (in %) (Source: MFSR, MFČR)

For the next indicator related to the development of the debt service we could only compare the data from 2011, as there does not exist any longer period related to the Czech regional cities. It should be emphasized, that some of the figures that are visible in the previous year, might be caused by the inclusion of all repayment of early lump debts that should not be counted as expenditures for the repayment of principal and interest payments. Following this fact, this indicator is not entirely credible, due to the fluctuations that are shown on the Slovak and also on the Czech side. Resulting from the chart data, we can see, that the highest level of expenses associated with the servicing of the debt is reached by the regional city of Olomouc and Bratislava.

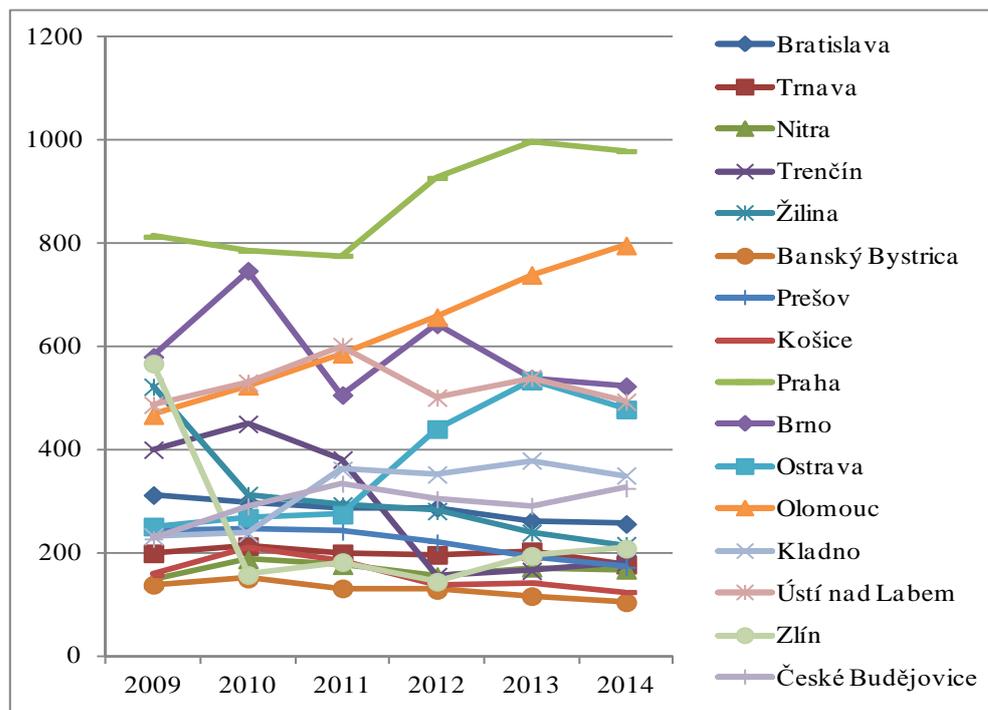


Fig. 7. The comparison of the debt per capita in SR and CR (in Eur)
 (Source: MFSR, MFČR)

The lowest amount of the debt per capita is reached in Slovakia in 2013 in the city Banská Bystrica- in amount of 116 Eur, in the Czech republic it is reached in the regional city Zlín, where the amount of the debt per capita in 2012 was reached in the amount of 144 Eur. The highest level is reached in Slovakia in amount of 522 Eur- in the regional city Žilina in 2009, in the Czech republic in 2014 (excluding Prague) was the highest amount of the debt per capita reached in Olomouc (in amount of 796 Eur), that is hardly struggling with their debt.

3 Possibilities of the debt regulation

There are many ways, how to regulate the debt of countries, particularly the setting of the effective fiscal policy. It should concern especially budgets, in that the total amount of expenses should be not exceeding the total amount of revenue. During the implementation of the budget, there may occur some unexpected deviations, to which respond the government. In case of the positive effects, the government may use the additional resources in order to reduce deficit and debt (acceleration of consolidation) or the new measures worsening the budget balance, particularly through the higher expenditures and risk coverage of the budget. Conversely, in case of some unpredicted negative effects, the government may either adopt some additional measures to comply with the budgetary objectives or it may translate these influences into the deterioration in the budget balance. In most cases, the final result consists in a combination of the unpredicted effects, the risks coverage and also of some relevant measures of the government. (Hyman, N. 2011)

It is necessary to pay a relevant attention to the current level of indebtedness and to strive for its gradual reduction or its single repayment, due to the recoverable financial payment or due to more preferable loans that would ultimately represent lower burden for the economy. Certainly, it is important to not borrow even more than it is really necessary. The implications of the present actions will be bear by the future generations as their burden, even without their any intervention. In terms of the potential impacts on the economic growth, there are very important some relevant presumptions related to the disbursement of EU funds, beside the management of public finance and also in addition with the established budget targets.

In a case of the fiscal responsibility policy, there should be established more strictly rules for its compliance, such as a reduction of penalty bands to the level of 40-45%, only from this point the government representatives would be forced to think more in deep how to set up the budget for the following period in order to meet this threshold and to not exceed it. Slovakia and also the Czech Republic could be thus inspired in relation to the compliance of the stabilization of the state debt ratio for the last two years, where they are successful, even though the rules of the fiscal responsibility are sill not anchored in the Constitution.

3.1 Possibilities of the debt regulation in the Czech Republic

The municipalities and regions in the Czech Republic can obtain some forms of subsidies that are paid based on the comprehensive financial relationship of the state budget to the local budgets, based to the grant from the chapter of general public treasury administration, further based to the subsidies of the chapters of individual ministries, state extra-budgetary funds to the EU funds. Municipalities also receive subsidies from the regional budgets. The most of the grants are given for the specific purpose and they are liable to the accountancy. Their nature is in a form of ordinary or capital subsidies. Difficulties in obtaining grants for the villages consist in the excessive complexity and in the lack of transparency of the system and also in a long-term continuing lack of rules by its provision. Generally, in the Czech Republic, there is too high proportion of special-purposed subsidies; typically they represent up to two thirds of the total amount of subsidies given for the specific purpose. The main sources of income in the Czech Republic regions are the subsidies from the state budget. In particular, it is more-less the contribution that serves for the state administration. Local government entities may also use the financial funds from the structural funds of EÚ. (Provazníková, R. 2015.) However, the state is not liable for the way of farming the villages and regions

The reasons of debt increase in the Czech Republic on the basis of the analysis:

- non-profit projects (their implementation does not bring any additional financial funds in order to reduce debt by its repayment),
- allocation of grants and criteria for allocation of investment subsidies,
- implementation of the EU structural funds (it requires some mutual participation in relation to the project financing),
- easy access of villages to obtain loans (they represent the low-risk clients),
- lack of regulation of property rights, the sanction mechanisms (relevant settlement of the debt limits in regions - villages, the Act related to the management of local authorities can limit it only indirectly, there is an absence of a forced administration)
- introduction of a ban on the speculative investments for the local authorities (they have the opportunity to execute a business also on the capital market)
- there is missing some agency or a monitoring body that would monitor and take control over debts and would analyse the credit risks (there are only two private agencies providing a credit rating)

- a transparent reporting of finance in communities (villages) / regions (to not hide and to not keep the amount of debt as a secret).

The risk of repayment of debts exists rather in smaller municipalities where they have not sufficient administrative background and qualifications. The view on the indebtedness of municipalities / provinces should be judged on the base of the purpose for the village indebtedness, of the size of assets concerning the overall economic situation of the territorial unit.

The preventive measures of the regions should consist in the use of external resources to finance capital expenditures and not to finance current ordinary expenditures. There should be essential to implement relevant legislation in a case of bankruptcy that would further define the procedures and steps to be taken in a case of region- and municipalities- insolvency. Further, to set up some agency as an independent institution that would regularly monitor the size of indebtedness of municipalities / regions, to introduce a scale of regular management ratings. At a present, the Ministry of Finance of the Czech Republic is the monitoring body, but it serves rather to the general overview. It operates only formally; its disadvantage is also the lack of the legal regulation that would deal more in deep with the debt limits and with the manners how to post-pone highly indebted municipalities, i.e. a recovery mode and a forced administration, as it is already implemented for example in Slovakia. The main reason for it is a reliable and accurate display of a settlement of the municipalities and regions, based on that is further derived an overall evaluation of management methods and a possible regulation in debt.

3.2 Possibilities of the debt regulation in the Slovak Republic

The Council of a Fiscal Responsibility in the Slovak Republic (The office of RRZ, 2015.) refers to a number of risks associated with the implementation of national fiscal responsibility rules for the Slovak Republic in the future. On one hand, there is positively evaluated that the government continues to present its intention to achieve the approximately balanced budget in 2017. Due to the compliance with this commitment at the European level, there can be enhanced the credibility of Slovakia, in the eyes of investors. On the other hand, the intended aim to achieve the medium-term objective brings several risks. The inadequate performance measures of the government debt reduction beyond sanctioning zones are considered as the potential risks. It is required to create a sufficient scope for the fiscal policy, especially in in good times, when the economy produces higher tax revenues and lower expenses. The government has missed a number of positive effects related to the acceleration of consolidation; on the other hand, there have increased the aimed levels of the budgetary deficits by the actualization of the three-years budget. According to the Council of a Fiscal Responsibility, the introduction of expenditure limits, which are assumed by the constitutional law, could greatly help to the consolidation in good times.

The Council of a Fiscal Responsibility has identified the overestimation of non-tax revenues, the low level of expenditures in the health sector and in the local government the saving measurements without their further explanation. The decrease in debt, due to the permanent measures of the government, should occur from 2016 for the first time. It is due to the planned reduction in the deficit and the increase of the economic growth. Despite the fact that the disposable income in years 2014 to 2015 have contributed to the reduction of the gross debt, it is not sufficient to reduce sanctions outside the zones until 2018, even the government has met all the aimed targets in the consolidation macroeconomic scenario of the Ministry of Finance. In such a case, the debt would reach the level of 49.2% of GDP. So far, there is only one identified risk coverage in 2016. It is the potential savings resulting from the co-financing that is resulting from lower spending of EU funds, but this may be partly offset towards less favourable macroeconomic developments due to

slower spending. Despite to the budgets draft, there were not created any reserves related to the possible deterioration in the economic development and to the failure to meet budgetary targets.

From the long-term sustainability of the planned improvement in the structural balance of the debt reduction in 2016, there is more favourable starting position. If these objectives are fulfilled, the long-term sustainability of public finances in comparison to its level in 2015 will improve. Meeting this objective in 2016 will depend on the priorities of the new government, further on the continuity of transferring the control over the budget, including also its early awareness with the possible positive and negative budgetary risks. The advantage for the fulfilment of the objective may be that if the new government identifies with the settled goals but the risks of the budget are confirmed, the government will have enough time to react by the adoption of the additional measures.

In case of local territorial units, the budget proposal assumes a relatively high volume of budget surpluses resulting from the rapid annual growth in tax revenue, from the assumption of limitation of the operating expenditure, especially in villages, and from the maintenance of a low level of own investment expenditure. Taking into account the actual development of operating expenses in the past, an accelerated rise of the long-term low capital expenditure and the estimated risk projected for 2015, it may result in worsening of the economic activity of government by the amount of 100 million EUR in 2016. It is due to the actual development of expenditures of local territorial units in the first half of the year 2015. The law on the budgetary rules of the public sector enables to shift the unused capital expenditures into the next year. In case of a positive impact on the deficit in 2015 (it means until 2016, there will be transferred higher amount of the unused expenses than it was in 2015), increase the risk of their use in the coming years. Therefore, the potential risk for 2016 depends on the outcome in 2015. Furthermore, since 2015, there is an effective rule related to the penalization of the local municipalities that are exceeding a specified amount of debt. It will be evaluated during the year 2016 for the first time, on the basis of actual data at the end of 2015. The rule is more strictly as the debt limit for the public administration by the same upper limit of 60%, compared to the proportion of current income of municipalities and not to their economic performance. If the total amount of the debt of the municipality or higher territorial unit reaches 60% of the actual current revenues of the previous financial year and more, the municipality or higher territorial units are obliged to pay the fine imposed by the Ministry of Finance, amounting to the level of 5% of the difference between the total debt and the amount of 60 % of real current incomes of the previous financial year.

The scope for the introduction of measures to control indebtedness in Slovak Republic:

- the undefined approach to the debt reduction,
- the government has still not settled the expenditures limits,
- the overestimation of non-tax revenue in forecast,
- a failure to establish a reserve for a possible deterioration in the economic development,
- more strictly compliance with the financial regulations,
- a need for implementation of the additional measures to meet the budget objectives.

Based on the above-listed issues related to the indebtedness of the Slovak Republic, we can say that the number of all-over measures is not so high, but it is necessary to take into account more rigorous approach in order to solve problems related to the indebtedness. With the entrance of the new government, after this year's parliamentary elections, should relate also additional complementary measures to reduce the potential risks, especially with regard to the future generations that will consequently repay the debts.

4 Conclusion

The maintenance of a human health is so important as the maintenance of the financial health of public finance for the municipalities and regions. Therefore, it is required a regular disclosure of a database with relevant information, related to their financial health, in order to make them more available to all citizens that could use them for the comparison, according to the selected key indicator. Only the informed public sector can put a relevant pressure on mayors, chairmen or directors of higher territorial units in order to execute their “business” more responsibly.

We have the ability to elect deputies to the parliament and to elect the president of the country, as well as we have the option to vote for the mayors of villages or larger cities. In order to answer a question regarding who should be elected for the mayor, there should be helpful to us the financial results of the individual municipalities that were driven by many different mayors. The comparison of the economic results should be available to the general public, according to the law on free access to information due to the official website of the municipalities. As free citizens living in a democracy, we have the opportunity to intervene in a certain decision-making processes, for example during the sessions of the municipal council, which should be accessible to the public in most cases, we have the opportunity to express our opinion in relevant scope. One could perhaps say that it does not make a sense as it is probably not important what the "ordinary" citizen say?! Unfortunately, it is not always this case. If the number of inhabitants do not agree, by the use of some petition or in the form of some complaints, the municipality representatives / regions representatives would have to listen them and adequately reflect to their requirements. Due to higher pressure, such as a protest, it can be achieved the abolishment of the proposed regulation or even more the abolishment of already implemented regulation. It may refer to a solution of elimination of the hidden landfills, of an introduction of parking system or a creation of a special territory for the dog person in the village. However, it is required to be aware of all current events by the citizens, to know when and how to present their opinion, if there is anything in principle against the benefits to the citizens and try to propose a simpler solution to the problem, which could ultimately also spare the financial funds in the budget of the municipality / territorial units and thus could be satisfied both parties.

Due to the analysis of the indebtedness development we have tried to refer to some ways of the indebtedness of public sector in Slovakia and in the Czech Republic due to the local territorial municipalities (regions) and regions cities of the both states. In addition to the obtained data related to the creation of our own database, we came to the result that not all the required data are available to the public, what should people naturally assume in a present time. This fact has caused to us more difficulties in the scope of our deeper investigation. Nevertheless, we have tried to analyse the progress of the indebtedness and thus we came to the certain measures that could be used to regulate and to control the issue of indebtedness.

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