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# Problems of Reforming Local Self-governance: Structural and Financial Aspects

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The paper considers territorial models of local self-governance that had emerged in Russian regions prior to the reform and their impact on various aspects of municipal establishments' activities. The authors evaluate the regional law in the area of local self-governance and interbudgetary relations and consider issues associated with the rise and emergence of territorial foundations of the institute in question until 2003. The authors also analyze reforms undertaken in RF regions in 2004 that addressed the problem of a new territorial structure of local self-governance. Individual chapters highlight on international experiences in the area of organization and financing of local administrations.

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**Part 1. Local Self-governance in Russia:  
Structural and Financial Aspects**

## Introduction

The urgency of challenges that local self-governance presently faces can hardly be overestimated. The country is on the threshold of a large-scale reform that provides for considerable modifications of mechanisms of functioning of all levels of power, including, particularly, the municipal authorities. The new wording of the 2003 law “On general principles of organization of local self-governance in the Russian Federation” suggests large-scale transformations, which should embrace practically all aspects of municipal entities’ functioning, including the territorial and financial fundamentals of local self-governance, powers and functions exercised by municipal authorities, forms of realization of local self-governance by the population, the system of local governments, public control over the municipal authorities’ operations, etc. The new law will fully become effective since January 1, 2006, while until then individual articles of the law, such as Chapter 12 “Transitional provisions”, are in effect.

The fundamental reform concept implies a clear and unequivocal articulation in the law of the structure and responsibilities of municipal entities, identification on this basis their spending powers, and fixing with them, on a regular basis, revenue sources. The major reform avenues are as follows:

- introduction of a two-tier basic model of local self-governance nationwide. The model will secure the formation of municipal entities at the level of settlements and municipal districts. In addition provides for establishment of urban okrugs – one-tier municipalities that exercise functions of both settlements and districts;
- the list of issues of local significance is reduced considerably vis-à-vis the prior version of the Law, while all the municipal entities’ powers are divided between the settlement and district levels, with districts dealing with local issues in inter-locality territories, as well as exercising many key functions in the territory of localities (in particular, those associated with organization of education and health care);
- the law introduces a clearer regulation of delegation of individual government mandates to the local level and provision of their funding from higher-tier budgets;

- the law introduces a more distinct regulation and ensures more substantial guarantees to exercising the direct democracy on a local level; the legal base of the territorial community-based self-governance is formulated in a greater detail than in its previous version;
- legislatively set requirements to local governments are tightened: in particular, it is provided that every municipality is bound to have a representative body, a head and a local administration; it is generally prohibited to combine the posts of head of the administration and head of the representative body, the number of deputies of the local council is strictly controlled etc.;
- the law limits the list of assets which municipalities are allowed to own; objects that fail to fall under legislatively set restrictions are subject to re-profiling or alienation;
- revenue sources are fixed with municipal entities on a regular basis, principles and mechanisms of granting financial aid to municipalities are rigidly controlled by the federal legislation (including the possibility for introducing negative transfers for the most financially self-sufficient municipal entities);
- the law provides for the possibility for temporary execution by the government bodies of individual powers of local self-governance bodies, including introduction of a temporary financial administration, should a given municipal entity become insolvent.

While it is clear that the reforms provided for by the new legislation cover practically all aspects of the municipal entity's activities, the most radical changes concern the territorial and financial fundamentals of local self-governance. The above issues were considered in the research project entitled "Problems of the local self-governance reform: structural and financial aspects". The project was implemented in 2003–2004 within the framework of the Russian-Canadian Consortium for Applied Economic Research. The project framework allowed an evaluation of territorial models of local self-governance in existence in the RF regions prior to the reform and their impact on various aspects of municipal entities' activity, primarily those concerned with organization of municipal services.

At first sight, the not-so-distant prospect for such large-scale transformations in many respects depreciates the importance of the analysis of existing territorial models and makes it a subject of a purely historical interest. However, such a simplification is fundamentally wrong, for such an analysis undoubtedly appears timely, because of the following reasons:

First, while the new legislation provides for rather a uniform regulation of local self-governance throughout the country, there still exists an opportunity for taking flexible decisions that provide for picking a certain option from the respective list of them. Thus, at the regional level, there emerges a new territorial structure of local self-governance and crystallizes the correlation between the two-tier (municipal district-settlement) and one-tier (urban okrug) models. The law keeps untouched the possibility to form administrative bodies of municipal districts (on the basis of general elections or settlement representation) in different ways. The mutual delegation of mandates can affect the distribution of responsibilities between settlement and district levels. An analysis of solutions to these problems within the frame of the existing territorial structure models allows assessing a comparative efficiency of different approaches and identification of the respective threats, which forms a necessary base for selecting optimal options.

Second, regions have accumulated diverse and in many respects unique experiences of organization of local self-governance that display substantial positive characteristics. It is important to identify positive aspects of the current organization of local self-governance, analyze conditions that encouraged their blossoming, and to try not to “lose” them in the course of the reform process.

Third, the methodology of the analysis of the existing models of local self-governance can become instrumental in developing a methodology of monitoring and assessing the local self-governance reform outputs as per the new version of the Law “On general principles of organization of local self-governance in the Russian Federation”, and establishing an adequate information base and organizational mechanisms of such monitoring.

Finally, fourth, not all local self-governance reform elements have been completely identified as yet. The new version of the Law “On general principles of organization of local self-governance in the Russian

Federation” was repetitiously amended which was mitigating the strictness of its genuine provisions. Perhaps, this process will continue further on. The existing practice of municipal organization forms a necessary basis of developing this particular array of issues, while the information available on various aspects of the functioning of the local self-governance system allows to this or that degree forecasting the reform outcomes and attempts to avoid well beforehand the most significant threats.

Thus, it appears that the analysis of functioning of local self-governance within the framework of the existing models of territorial structure constitutes a necessary stage of preparations for the transformations provided for by the new legislation on local self-governance. Such an analysis can become very instrumental in organizing the reform implementation process.

Meanwhile, since the second stage of the project research fell on 2004, which was the time of a rapid rise of a new territorial structure in the regions and their identification of some other parameters of the municipal organization the noted aspects were inevitably included in the set of issues worth analysis, which forms a separate chapter of the present paper.

# Chapter 1. Territorial Organization of Municipal Power: Theoretical Aspect

## 1.1. Territorial Organization – Factors Determining the Choice

Debates on territorial organization of municipal power, the models and variants used in this sphere have been a typical phenomenon in many countries in different periods of their existence. In practice, it is generally admitted that there is no single solution of this problem suitable for all times and conditions. There are different factors affecting the choice of the model<sup>1</sup>, major of them may be grouped into four clusters<sup>2</sup>:

- factors that affect the efficiency and quality of municipal services;
- factors associated with creation of conditions for participation of the population in governance of a municipal entity;
- factors that affect the financial stability of municipal entity, as well as fair allocation of funds;
- factors relating to strategic development at the municipal level.

Efficiency and Quality of Municipal Service. The size of the municipal entity affects a whole set of factors associated with efficiency and quality of municipal service. The key issue in this context is the role played by economies of scale as a factor that determines efficiency of municipal service. At the beginning of 20th century, the economies of scale was an objective of the movement in the USA that called for a local self-governance reform through consolidation of municipalities. It was be-

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<sup>1</sup> In the framework of the project aimed at an analysis of factors affecting the choice of the territorial model of the municipal structures, Enid Slack wrote a special paper “Models of Government Structure at the Local Level.” However, in this chapter we also have to focus on this issue, since our further analysis is to a large extent based on the studying of the factors under observation with respect to Russian realities. The authors tried not to repeat, where possible, reasoning given in this paper, though they could not avoid it in a number of cases.

<sup>2</sup> The focus of the discussion on those four aspects had already been marked in scientific literature. Accordingly, Keating singled out the following main questions touched upon in discussions about the optimal size of municipal entities: economic efficiency, democracy, distributional aspects and development (*Keating, 1995*).

lieved that economies of scale were typical for many municipal services, and consolidation of municipalities was regarded as a method to enhance the efficiency of their activities<sup>3</sup>.

However, later a number of researchers have radically changed their views on the matter. Advocates of the public choice theory suggested an alternative approach. Robert Bish notes, for example, in his publications that, along with economies of scale, a reverse process – diseconomies of scale – is characteristic of many municipal services. Economies of scale are typical of services, which are capital intensive, easily measurable, and not regularly in demand, whereas for labor intensive, hard to measure and regularly provided services more typical is the absence of economies and even losses incurred as the scale increases (*Bish, 2001, p. 11*). Some researches conducted in the U.S. and Canada show that the lowest per capita costs of provision of services are characteristic of towns, where the populations make from with 2500 to 5000 residents. It should be noted that costs grow both in the case the population of a town is above and below these figures (*Bish, 1999b, p. 9*). According to other estimates, in municipal entities with populations above 10 to 20 thousand residents, 80 per cent of municipal services generate no economies of scale (*Bish, 2001, p. 14*)<sup>4</sup>.

It is clear, though, that the absence of economies of scale is not the only factor that determines rises in costs as the sizes of municipal enti-

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<sup>3</sup> This approach was concisely enunciated, for example, in Anderson W. *American City Government*. – New York, 1925.

<sup>4</sup> There are virtually no such researches focusing on Russia. The only such observation may be found in the paper by V. Glazychev, who noted that in the course of an analysis of fiscal capacity “it should be noted that there exist two threshold values, associated with the number of cities’ inhabitants. For towns with populations of about 100 thousand, the specific per capita value of Rb 2 500 is the minimal and critical one, since the increase in the complexity of urban infrastructure results in an abrupt rise in its maintenance costs. Approximately the same specific value is the minimal and critical one as concerns towns and settlements with populations of less than 10 thousand, although for another reason – small number of inhabitants does not allow to concentrate sufficient means for the support of even a rather modest infrastructure. Therefore, at the budget of Rb 2 000 in per capita terms, the conditions of functioning of a municipal entity may be regarded satisfactory only for towns with populations of about 30 to 50 thousand (*Glazychev, 2003, p. 49*, the author uses here the 2001 budget data).

ties increase. One should bear in mind, also, that large urban municipalities deliver a much wider spectrum of services, and not only to their residents, but also to visitors. The quality of services also varies substantially. These factors significantly complicate researching of an impact of economies of scale as it has been mentioned, for example, in the course of the analysis of this problem in post-communist states of the Central and Eastern Europe. As it has been found out, lower spending per unit is very often due to lower quality and performance level, which in turn is due to insufficient financial capacity of the smaller governments (*Swianiewicz, 2002b, p. 305*).

Yet another specific feature of municipal services is that different types of activities generate different economies of scale within the same type of service. The most illustrative example is waste disposal: waste disposal produces virtually no economies of scale (and may even generate diseconomies of scale), while in the case of utilization of domestic solid waste the economies of scale are quite considerable. According to some Polish studies, the economy of scale for this service is not achieved if the market serves less than approximately 100 thousand residents. (*Swianiewicz, 2002b, p. 312*). Another example concerns the law enforcement activity: patrolling streets does not require large-scale organization, while maintenance of a forensic laboratory is a typical activity characterized by economies of scale. Annex 1 presents characteristics of different factors that have an impact on the economies of scale with regard to individual municipal services.

The size of municipal entities defines yet another important aspect associated with quality of municipal services. Municipal entities of larger size are better suited to provide services, which meet minimal quality standards. By contrast, in smaller municipalities it is easier to take into account local preferences, what results in greater satisfaction of residents with the price-quality ratio. Followers of the public choice theory also believe that competition among smaller municipalities facilitates the improvement of quality and efficiency of municipal services. For instance, such a competition creates incentives to use the labor of volunteers and overcome the limitations relating to the inadequacy of



scale by signing agreements with outside organizations (private firms or larger municipalities)<sup>5</sup>.

Participation in Governance. As concerns the problems associated with various forms of residents' participation in governance of municipal entities, the most popular viewpoint is that small settlement-type municipalities provide best conditions for that. In this case, the authorities are more accessible for people and more accountable. Studies show that turnout for elections and other forms of expression of people's will is higher in smaller municipalities, while residents of such municipalities have more confidence in the authorities (*Bish, 2001, p. 7–8; Swianiewicz, 2002b, p. 310–312*). In addition, the population itself proves to be more homogenous in such municipalities, with the power to have a greater possibility to express objectively its interests. Less probable here, also, that big lobbyists will bring the power under their control.

Still, contrary arguments also exist, though they are not so popular. Thus, there is a belief that a larger municipality usually provide a wider spectrum of services, and play a greater part for its residents by that. The above raises the residents' interest to participate in governance, as well as attracts more qualified candidates for local election (*Dahl, Tufte, 1973; Goldsmith, Rose, 2000*). The experience of the countries of Central and Eastern Europe partly confirms this approach. Thus, in Poland, the number of candidates in local elections sharply increases in larger municipalities. Both Polish and Hungarian studies suggest that there are more NGOs and local newspapers in bigger local governments. However, as it has turned out, the influence of these factors does not lead to greater citizens trust in local authorities or interest in participation in local politics (*Swianiewicz, 2002b, p. 311*).

Financial Stability and Fairness. By and large, larger municipalities ensure greater financial stability due to the fact that within a municipal entity funds may be redistributed between its richer and poorer territories. At the same time, such redistribution violates, to a certain extent, the basic principle that underlies the structure of municipal finances in a

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<sup>5</sup>The Tiebout model, describing the consequences of competition between municipal entities, has been analyzed, in detail, in Enid Slack's paper, prepared within the frame of this project. See also *Boyne, 1992; Bish, 2001*.

liberal economy: those who benefit from local public services should pay for them<sup>6</sup>. Hence, it is considered that large municipal entities may cover their losses by means of redistribution and therefore less actively search for cost saving methods. For example, they are less inclined to cooperation, decentralization of the mechanisms of service delivery, as well as attraction of outside organizations (*Bish, 2001, p. 20*).

However, small municipalities also can not completely ensure fairness as concerns the financing of municipal services. Essential factor here is the so-called spillover effects occurring in the cases where the residents of one municipal entity make use of services provided by another municipal entity<sup>7</sup>. Such a situation is typical, for example, of suburbs, where separate municipalities exist, but suburb residents actively use the central urban infrastructure. Municipal entities of larger size can substantially alleviate the problem by attempting to absorb the maximum number of such localities. However, there exist alternative methods to solve this problem, either via transfers from higher authorities, or via inter-municipal agreements<sup>8</sup>. Urgency of this problem substantially depends on the fact whether tax revenues are allocated according to place of residence or according to place of work (*Swianiewicz, 2002a, p. 9*).

Strategic Development. At first glance, large municipalities have overwhelming advantages as concerns ensuring of the interests of stra-

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<sup>6</sup> More closely this question has been analyzed in the paper by Harry Kitchen "Local Taxation in Selected Countries: A Comparative Examination" prepared within the frame of this project.

<sup>7</sup> Spillover effects emerge if services provided in one municipal entity have an impact on the residents of other municipal entity. Positive spillover effects emerge if residents of other municipalities receive a service free of charge or for a charge that does not compensate this service costs. Negative spillover effects emerge when residents of other municipalities bear the costs of services they do not consume or cannot control (*Kitchen 2002, p. 44*).

<sup>8</sup> At the same time experience suggests that it is rather difficult to reach such agreements (see *Swianiewicz, 2002b, p. 312-315; Kitchen, 2002, ch. 12*). Thus, P. Swianiewicz notes: "Experience from Central and Eastern Europe suggests that local governments are not very willing to enter inter-municipal contractual arrangements to buy services from another municipality. Most often, negotiations fail and citizens end up using the services of neighboring authorities as "free riders" (*Swianiewicz, 2002b, p.321*).

tegic development. They are more able to concentrate resources in areas of priority, as well as create the favorable investment environment: develop transport and education, and also ensure public safety. Therefore, large municipal entities create better conditions for stimulation of economic growth and formation of competitive advantages. At the same time, they restrain the competition for investments among individual settlements, which often fails to facilitate efficiency and is merely a “zero-sum game”. However, there also exists contrary evidence. Thus, some researchers claim that there is no direct correlation between the territorial model of municipal governance and economic growth. Moreover, such rapidly growing U.S. territories as Silicon Valley, Boston, Dallas, Seattle-King county (where Microsoft and The Boeing Company are located) belong to the most fragmented municipal structures (*Bish, 2001, p. 20*).

In contrast to other countries, in particular, Canada, where the problem of factors affecting the choice of territorial structure of municipal entities is a subject of serious scientific research, in Russia this problem has been primarily associated with practicalities rather than with theoretical research. As a rule, at the regional and municipal levels there exists a system of arguments substantiating the territorial model in existence in the region. Debates about the comparative advantages and disadvantages of large and small municipal entities boil down to discussions concerning the choice between the district and settlement models of municipal governance. The comparison of such arguments put forward in several regions analyzed within the frame of this project, may illustrate both general characteristics of the discussion in question, and the specifics of the Russian approach to evaluation of the territorial structure of municipal entities.

The main advantage of large municipalities is usually seen in their capability to re-allocate financial resources within their own structure, thus compensating for the unequal distribution of the tax base. For instance, in the Novgorod oblast this argument was put forward as the most fundamental substantiation of the choice of the district model. According to the available information, only a quarter of settlements in the Novgorod oblast dispose of sufficient economic bases, while one

third to half of them have no such bases at all. Therefore, in the framework of the settlement model many municipalities would be deprived of own revenue sources, what might aggravate the problem of municipal service delivery, speed up fading of unviable localities, and facilitate outflow of population. However, in other regions there have been put forward contrary arguments: large municipalities will have no time and wish to deal with small and distant localities, therefore, the latter will be neglected, and the problem of small villages will aggravate; in the framework of the district model liquidation of localities will go faster than in the framework of the settlement model.

Yet another aspect of equalization is related not to revenues, but expenditures for delivery of municipal services, which also may be evened at the district level. Thus, high costs of heat supply, explained by inefficient functioning of the boiler house that considerably exceeds the needs of the locality in the framework of the settlement model are laid exclusively on the shoulders of residents of this locality. Such a situation results in extremely high tariffs on the heating service. In the framework of the district model, such costs are included in the overall heating costs and have only an insignificant effect on the general level of tariffs.

Another positive factor, mentioned in relation to large municipal entities, is associated with the creating of conditions for attainment of long-term objectives. Consolidation of funds at the district level permits to increase capital investments, in particular, in the housing and utility infrastructure. Larger municipalities have greater possibilities for attraction of investors and establishment of interregional relations, thus creating more favorable prerequisites for acceleration of the economic growth and raising of the quality of municipal services.

Major negative trends in large municipal entities are primarily determined by a gap between the authorities and the population and growing bureaucratization of the authorities. At the level of districts, figures "overshadow people." In addition, in some cases it has been pointed out that the switching from the settlement to district model resulted in a growth in subjectivism with respect to allocation of the financial resources (in a district headed by a Tartar the funds are allocated predominantly to Tartar villages).

As concerns small settlement municipalities, the most considerable advantages were associated with closeness of the authorities to residents and their greater responsiveness to the people's needs. It has been also argued that smaller municipalities have better possibilities for organization of registration of taxpayers, the tax base, etc. Main disadvantages of the settlement model have been primarily associated with overstaffing of the administration and shortage of qualified managers. Basically, this relates to the heads of settlement municipalities, since there the probability of election of an undereducated unqualified person is higher than in districts. However, difficulties arise also in relation to the administrative staff. For instance, if a settlement accountant resigns, it is almost impossible to quickly find a substitute. There has been also noted the problem of diffusion of funds, which has been characterized as intolerable waste under hard budget constraints. There have been noted practically insurmountable problems associated with the voluntary cooperation between the small municipal entities unwilling to join forces for solving common problems even in spite of the fact that this unwillingness could considerably affect the quality of services delivered to the population. At last, great difficulty in carrying out the necessary, but unpopular structural reform of the municipal service (HUS reform, restructuring of the network of budgetary institutions, etc.) has been also put forward as yet another argument against the settlement model.

One of the objectives of this research was to find out the extent, to which those arguments were confirmed by real trends. However, at this stage of the study it seems interesting to compare the main avenues of argumentation used in international practices and in Russian conditions. It is obvious that in many aspects Russian discussions follow the findings of the international research. Thus, the capability of large municipal entities to carry out, to a certain extent, financial equalization and also their prevailing orientation towards strategic objectives have been noted among their advantages, while the central advantage of smaller municipalities is the closeness of the authorities to the population.

It should be noted that some issues actively discussed in foreign papers on this subject were not so fully reflected in the Russian discussions on the territorial organization. It concerned, for instance, problems of economies of scale and spillover effects. Both problems were mentioned in the course of discussions about different territorial models, but were not considered as critically important with respect to the choice of the variant of territorial organization. It should be noted that the problem of economies of scale was in practice reduced to the discussion of the size of the administrative staff, what in foreign papers was considered as only a minor aspect of this problem<sup>9</sup>. It appears that this fact can be explained by the Russian specifics of organization of municipal finances, when municipal entities' budgets primarily reflect not their revenue generating capacities, but evaluation of their spending needs. However, in the case mechanisms regulating municipal finances are transformed<sup>10</sup>, this situation may radically change.

At the same time, some problems, which are not fully reflected in foreign discussions become actual under Russian conditions. Primarily it concerns the issue of the shortage of qualified staff, which is characteristic of settlement municipalities. That is not to say that no attention is paid to this problem outside of Russia. For instance, in Canadian province Ontario in the course of substantiation of the avenues of restructuring of municipalities primarily associated with their consolidation, there was set the objective to ensure a possibility to attract and keep at the municipal service highly qualified staff (*Kitchen, 2002, p. 302*). It is clear, though, that compared with Russia, this problem is not so acute in the developed countries.

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<sup>9</sup> Western researchers point out that administrative expenditures usually constitute no more than 5 per cent of municipal costs, and therefore an analysis thereof is not of much significance (*Bish, 1999b, p. 1*). However, the situation in the countries of Central and Eastern Europe, where administrative expenditures dominate in the budgets of small municipal entities, is quite different. In Hungary, for example, municipal entities of smaller size spend on administration over 20 per cent of their budgets. In Slovakia, expenditures for administration in villages with populations of less than 500 residents amounted to about half of the total budget expenditures (*Swianiewicz, 2002b, p. 307–308*).

<sup>10</sup> To a certain degree, such changes are envisaged in amendments to the Tax and the Budget Codes.

On the whole, the discussions on the factors that determine the territorial organization of local governments have demonstrated different positions and not only differing, but often contrary interpretations of the consequences of the use of different models. It should be noted that arguments from real practice do not always confirm the theoretical approaches. Plus, the practice itself is non-homogeneous, since the same decisions may lead to contrary outcomes.

## **1.2. New Legislation on Territorial Fundamentals of Local Self-Governance in the Context of International Experience**

The new version of the law “On general principles of organization of local self-governance in the Russian Federation” (Law No.131-FZ) envisages the introduction of the uniform territorial structure of municipal governance nationwide. It is envisaged that the two-tier model (settlement – municipal district) should be introduced as the basic structure. Besides, on the basis of urban settlements it is possible to establish urban okrugs, which represent the one-level model of municipal entity combining the functions of both settlement and municipal district.

Assessment of the Two-Tier Model. The two-tier model is widespread enough in international practice. Indeed, it permits to moderate, to some extent, the conflict between the factors facilitating the choice in favor of large or small municipal entities. As it is widely believed, the settlement model associated with the existence of municipal entities at the settlement level makes possible to ensure accessibility and accountability of municipal authorities to the population and to adapt services to local needs; while larger structures permit to use economies of scale, mitigate spillover effects, carry out financial equalization, and to create favorable conditions for strategic development. At the same time “in pursuance of interests of the population of a smaller-size entity that forms its territorial component, a larger municipal entity deals with the issues that the former cannot resolve, or which cannot be resolved effectively enough at its level” (*Markvart, 2002, p.27*).

At the same time, in some cases the two tier model is rather seriously criticized. Some researchers even draw the conclusion that the “two-tier systems are the most conflict-prone system of local-self-

governance, and, currently, it is negatively appraised by many officials and local self-governance specialists” (*Bish, 1999a, p. 6*). There may be singled out the following disadvantages inherent in this model.

First, to all intents and purposes the economies of scale can not be fully used in the framework of the two-tier system, since there is usually perceptible the trend towards the assignment of each local function to only one level of local government. However, as Annex 1 demonstrates, in the framework of each of them individual types of activities presuppose various scales of organization of work. Therefore, the two-tier model does not completely preclude losses associated with both inadequate and excessive scale of activities, while attempts to clearly distribute functions by levels results in constantly reproduced conflicts (*Sankton, 2002*).

Second, the two-tier system involves additional losses associated with overstaffing of the administrations, inevitable duplication of functions and complications in coordination of activities of the two levels of governance. Moreover, in the situation where the municipal authorities are formed on both levels of municipal entities on the basis of direct elections, it is highly probable that competition and conflicts may arise between the two levels of municipal authority, what results in inefficiency of decision making mechanisms (*Kitchen, 2002, p. 312*). Such evident frictions between the two levels of authorities may worsen the reputation of the two-tier system regardless of the real results of its functioning (*Bish, 1999a*). On the other hand, if the authorities of the higher level municipalities are formed basing on representation of the lower level municipalities, the problem is in that deputies “prove to be too much focused on the interests of lower level municipalities” (*Tindal, Tindal, 2004, p. 150*). Besides, in the case the authorities of higher level municipalities are not elected they become less accountable to population (*ibidem, p. 90–91*).

And finally, third, this system is not transparent and clear for taxpayers, who are in serious difficulty to make out which level of the local government is responsible for what functions (*Kitchen, 2002, p. 311–312; Tindal, Tindal, 2004, p. 149*). At the same time, this system is also not too favorable for businesses, since it facilitates the growth in the



number of bureaucratic levels and complexity of the decision making mechanisms, procedures governing the issue of permits, etc. (Byrne, 1999).

Admitting disadvantages of the two-tier system, different specialists have different opinions about its perspectives. Some of them believe that the advantages of the system outweigh its disadvantages, while others propose to reject the two-tier system in favor of the one-tier structure. For instance, the municipal authorities of Canadian state Ontario (Kitchen, 2003) have taken many such decisions in the course of reorganization of municipal structures.

The issue of where the two-tier model can be employed most efficiently is also not unambiguous. As some of specialists believe, the model is primarily suitable for the following specific Russian conditions (Markvart, 2002, p. 31):

- a) large settlement areas,
- b) low density of the population,
- c) considerable degree of concentration of economy and social sphere in certain "points" (settlements),
- d) insufficient and inadequate routes of communications (roads, communications, etc.)".

In such a situation, this model permits, on the one hand, to ensure the closeness of the authorities to residents, and on the other hand, the necessary concentration of resources. Such a combination creates the conditions for delegation of a considerable set of functions to the local level, and raises its political and social significance.

However, other specialists consider this model to be most suitable for urban conglomerates and losing its advantages in the situation of long distances between the localities. First and foremost, this is explained by the fact that exactly in big metropolises, where individual localities are immediately adjacent, such factors as economies of scale and spillover effects are especially effective. At the same time, they lose their importance in of the situations, where small isolated localities are situated at considerable distances from one another (Kitchen, 2002, p. 312). Studies carried out in Central and Eastern Europe also confirm that the impact of a weak infrastructure in some cases makes the bene-

fits of larger scale, especially in rural areas, questionable. For example, although it is true that larger schools may provide better quality education, very poor or non-existent transportation connections may raise additional problems which can overshadow the potential benefits (*Swianiewicz, 2002a, p. 19*).

Regulation of Settlement Size. The new legislation on local self-governance provides constraints on the size of the basic municipal level – a settlement. It is provided that the size of the settlement territory should be established taking into account the number of its residents. As a rule, the lowest limit is set at 1000 residents, and for territories with high population densities this limit is at 3000 residents.

In principle, such a regulation, which in many cases results in forced consolidation of municipal entities, is in line with the municipal reform implemented over the last few decades. As a consequence, in the countries of Western Europe engaged in these reforms, less than 5 per cent of municipal entities are populated by less than 1000 residents (Horvath, 2000, p. 42). At the same time, the general picture remains mixed. In Italy, for example, 24 per cent of municipal entities are populated by less than 1000 residents, in Spain – 61 per cent, in France – 77 per cent. Post-communist countries have also chosen principally different models of reforms. While in Bulgaria and Poland the basic level municipalities are rather large, in Hungary, the Czech Republic, and Slovakia from 54 per cent to 80 per cent of municipal entities are populated by less than 1000 residents (*Swianiewicz, 2002a p.6–8*). It is believed that smaller municipalities are characteristic of the countries, where the values of local democracy and self-governance prevail, while larger municipalities are associated with focusing on the efficiency of municipal service (*Swianiewicz, 2002b, p. 297*).

Evidence suggests that territorial fragmentation of municipal entities would cause a lot of problems as concerns the possibility to ensure efficient governance and provision of municipal services<sup>11</sup>. Realizing this, the countries of Central and Eastern Europe, which formed municipali-

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<sup>11</sup> However, these problems are most typical in municipal entities, where the number of residents is below 100. In the Czech Republic, for example, there are 547 such municipalities (*Swianiewicz, 2002b p.301*).

ties within the borders of individual localities, imposed specific restrictions on the minimal number of residents required for the establishment of new municipal entities. Such restrictions vary from 3000 residents in the Czech Republic to 300 residents in Hungary. Nonetheless, general amalgamation is usually rejected as unrealistic and undemocratic, but individual countries concentrate on other solutions (*Swianiewicz, 2002b*).

Allocation of Functions in the Framework of the Two-Tier Model. Two principally different approaches to the allocation of functions in the framework of the two-tier model are known in international practice. In accordance with one of these approaches there should be introduced strict division of functions between the two levels of municipal authorities. The allocation criteria are primarily technocratic, oriented towards the maximization of the effect of economies of scale and neutralization of the spillover effects. As a result, a rather large set of powers, comparable with a range of issues handled at the basic level, is assigned to the higher level. The table presented in E. Slack's paper (which primarily reflects the Ontario province practice) is an example of such allocation of functions between the two levels of local government. Only a limited set of powers is delegated, in this case, to the basic level: the lower level municipalities are responsible for local roads and bridges, street lighting, parks and leisure areas, libraries, and also for the provision of urban amenities, ensuring of fire safety, and land use planning. All social functions, as well as the organization of utility services are concentrated at the higher level of municipal governance.

Another, more moderate approach, envisages concentration of basic functions and powers at the lower basic level of local self-governance. Such a model is implemented, for example, in some post-communist countries of Central and Eastern Europe, where the higher level (if any) has been traditionally weak. Even if the basic municipal level is rather fragmented (as was the case, for example, in Hungary), nevertheless it is responsible for resolving of the overwhelming majority of local issues.

Delegation of fundamental powers to the lower basic level is logically associated with the absolutely different vision of the role and place of

the higher level of municipal governance. This level is considered primarily as an instrument stimulating the coordination and cooperation of activities carried out by the basic level municipalities, and also as a forum, within the framework of which these municipalities may consider and resolve common problems. Therefore, the originally established competence of the higher level is rather limited. Generally, municipalities are free to determine, which powers and in what amount they are ready to delegate to the higher level. Due to these specifics, this model sometimes is viewed not as a variant of the two-tier structure, but as a form of voluntary cooperation of municipal entities.

This philosophy has accounted, for example, for the establishment of the regional level of municipal governance in British Columbia, among the key functions of which there was the creation of the political and administrative framework for inter-municipal cooperation for organization of delivery of services. However, research findings show that while the regional level reduces the agreements-related costs, the problem of conflict resolution remains pressing. It should be noted however that in the framework of this model there has been accumulated a rather interesting experience as concerns different aspects of inter-municipal cooperation. Thus, there have been used different methods of cost allocation among municipalities participating in agreements for joint delivery of municipal services. The key methods are: allocation in proportion to the value of real estate, in proportion to the population, in proportion to the scope of work carried out over the preceding period, in proportion to land area, and also allocation based on instruments' readings (*Bish, 1999a*).

As concerns the Russian legislation, it used the first, more rigid approach to the formation of the two-tier model. In the framework of this approach, broad powers not limited to the handling of issues of local importance in inter-locality territories, but also including such important spheres of municipal competence as organization of the protection of public order, delivery of health care and education services (to the extent these functions were assigned to the local level) have been initially vested in the district level. However, the technocratic criteria have not been fully observed in the course of allocation of powers between the

two levels. For instance, the issues of heat- and water-supply, which have (as it is generally agreed) a considerable potential of economies of scale, were delegated to the settlement level. By contrast, the issue of garbage and domestic waste was resolved more competently. Organization of collection and removal of domestic waste and garbage is in competence of settlements, while the functions of organization of utilization and recycling of domestic and industrial waste (where the role of economies of scale is really essential) are delegated to the district level.

On the whole, the approach to the allocation of functions between the two levels of municipal governance is close to some of the models implemented in Europe, in particular, in Germany (*Berr, 2002*). However, the Russian legislation does not use such an advantage of the German approach as division of the functions at every level into compulsory and voluntary ones, what facilitates the flexibility of municipalities' functioning. At the same time, the Russian legislation sets an option to delegate functions from districts to settlements and vice versa on the basis of agreements, what enhances the adaptive capacity of the system, but, on the other hand, increases the risks of political pressure and forcible infringement on the interests of one of the municipal levels (most probably – the settlement level)<sup>12</sup>.

As concerns state powers, the legislation provides that they may be delegated to the municipal level, and such powers are assigned primarily to municipal districts and urban okrugs. Although in the majority of countries the functions, which are more or less regulated by the state, are assigned, to a certain degree, to the higher level of municipal governance, the thoroughness and scope of such regulation differ significantly from country to country. At the same time, the optimality of the concentration of all state powers at the higher level of municipal governance is not evident, since in that case these powers turn out to be “separated” from the residents of municipal entities. Thus, in Germany, for example, the powers are delegated to both the community and dis-

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<sup>12</sup> These practices were typical, in particular, in the two-tier municipalities of the Kaluga oblast, where districts, in fact, forced settlements to register in their fixed assets the most cost-intensive municipal institutions, for maintenance of which they had not enough funds.

trict level. As concerns communities, they perform such important functions as the registration of births, marriages, and deaths, registration of residents, etc. (*Berr, 2002, p. 17*).

The Organization of Local Authorities in the Two-Tier Model. In the new legislation on local self-governance one of the most debated issues pertaining to the organization of municipal authorities concerns the establishment of representative bodies of municipal districts. The law envisages two possible models:

The representative body of the municipal district may be formed by representatives (heads and deputies) of settlements included in it;

The representative body of the municipal district may be elected at municipal elections based on universal suffrage, equal franchise and secret vote procedures.

It should be noted that no unambiguous solution of this question has been found in the international practice. Some experts insist that the higher municipal level must directly express the interests of its residents and offer them a certain set of municipal services. The authorities at that level must be directly accountable to the population without interference of representative bodies of lower level municipalities in the relations between the electorate and the higher level authorities. Therefore, direct elections is the most preferable option (*Kitchen, 2002, p. 310*).

Adherents of the contrary concept state that if the representative bodies of both levels of municipal entities are elected at municipal elections basing on universal and direct suffrage, rivalry and “tug of war” will inevitably arise between those bodies. They will be unable to cooperate, and additional costs, conflicts, as well as delays in making the decisions important for voters may take place as a result. They believe that the only stable system of the two-tier municipal governance is the representation of the municipalities of the lower level in the governing bodies of the higher level (*Bish, 1999a*). It would be logical to assume that direct elections should be more typical of the rigid variant of the two-tier system, while representation of the municipalities of basic level is in the framework of a more moderate version. However, it is not apparent that such a logical division is always implemented in practice.

As concerns the organization of municipal authorities, there exists yet another important issue pertaining to the search for methods of organization of the administration permitting to ensure its efficiency and optimization of costs. As it has been pointed out above, the two-tier model tends to increase administrative costs. It can also suffer from shortage of qualified staff at the lower level of municipal governance. The way out of this situation may be found in organization of inter-municipal cooperation permitting to more efficiently resolve administrative problems. For instance, in Bavaria (Germany) there exist 2031 communities with populations ranging from 1000 to 2000 residents. However, in only half of them there exist administrations. 1021 communities established 325 administrative unions implying joint administrations (*Berr, 2002, p. 15*).

It should be noted that the new Russian legislation fails to provide an option to ensure higher efficiency of administrative activities by such methods, since it envisages that every municipal entity should have a representative body, head of municipal entity, and local administration. This fact will facilitate the aggravation of the problem of growth of the administrative staff and related expenditures, as well as an increase in losses associated with the impossibility to ensure the necessary qualification of this staff. At the same time, such an approach to a certain extent permits to make use of the advantages associated with cooperation in the sphere of some specialized technical functions not related to political decision-making (even in this case local administrations exercising at least some powers, is bound to be retained in every municipal entity).

### **1.3. Basic Hypotheses and Methods of Research**

The discussion of merits and flaws of different models of territorial organization of local authorities, identification of issues most urgent from the point of view of the prospects of implementation of the new version of the law “On general principles of organization of local self-governance in the Russian Federation”, and an analysis of available sources of information permitted to single out a number of hypotheses,

the testing of which was the objective of this research. There were formulated the following basic hypotheses:

The choice of territorial structure in different regions is determined by both objective and subjective factors.

Territorial structure affects the development of mechanisms of self-governance: organization of municipal entities at the settlement level, which is most close to its residents, creates maximally favorable conditions for participation of residents in the governance.

Territorial structure affects the size of the administration and related expenditures: establishment of municipalities at the settlement level results in increasing administrative expenditures, since economies of scale are in effect in this sphere.

Territorial structure affects the scope of powers vested in municipal entities: at the settlement level the scope of powers is less than at the district level.

Territorial structure affects the capacity of the authorities to influence economic development: in this regard the district model has a greater potential.

Territorial structure affects the mechanisms and quality of municipal service delivery: while it is preferable to provide some services at the district level, other services could be better provided at the level of settlements.

Territorial structure affects the rates of implementation of structural reforms at the municipal level: larger municipalities create better prerequisites for implementation of reforms.

The authors employed two groups of methods to test the hypotheses advanced above. Qualitative methods were used in the cases, where it was possible and necessary to reveal relationships on the basis of large arrays of information. It should be noted that the possibilities to use quantitative methods were rather limited due to insignificant amount of the available information pertaining to municipal entities.

In the cases, where it was impossible or unfeasible to employ quantitative methods, and also in addition to them, there was conducted a detailed analysis of the functioning of municipal entities in the framework of different territorial structures in selected regions.



Since the study has been carried out for two years (2003 through 2004), during each year there was analyzed situation in three different regions. In 2003, there were analyzed:

Tyumen oblast. Prior to 2001, the settlement model dominated in the greater part of the oblast territory. In 2001, there was carried out a massive transition to the district model of organization of municipal governance. At the same time, the settlement model was retained in the Tyumen district, what provided a good base for comparison.

Kaluga oblast. Alongside with the district model, settlement-type municipalities were established in some territories of the Kaluga oblast, as a result the two-tier system of local self-governance had formed in certain districts. This situation permits to compare both the functioning of the settlement and district models and the districts with the two-tier structures and the usual district model.

Novgorod oblast. This region made its choice in favor of the district model. However, in the framework of this model there existed a thoroughly elaborated and efficient mechanism, which ensured independence of the lower levels of government and active participation of the population in governance.

In 2004 the analysis was conducted in the following regions:

Leningrad oblast. The district model dominated in the oblast, however, a considerable part of urban municipal entities was independent and was not included in districts. This model permits to reveal the merits and weaknesses of separation of urban settlements and separate functioning of a ring shaped district an urban center.

Astrakhan oblast. This region is one of few examples of full-fledged two-level structures in Russia, where local elections, as well as local budgets, existed at two levels of local self-governance. Its analysis is of special interest, because exactly the model implemented in this region is envisaged by the new legislation for introduction in the whole territory of the Russian Federation.

Tver oblast. The district model dominates in the oblast. However, in contradistinction to the Novgorod oblast, some urban settlements are independent and some are included in the composition of districts.

The research of the territorial organization of local self-governance in 2004 could not ignore the starting process of transformation of the territorial structure in accordance with the new version of the law “On general principles of organization of local self-governance in the Russian Federation”. In the majority of regions under observation, this process had clear specific features permitting to characterize the major approaches to the reform of the territorial organization of local self-governance, typical of regions of the Russian Federation as a whole. In the course of the study there were observed examples of both negative and positive practices. From this point of view, the experience of the Tyumen, Kaluga, Tver, and Leningrad oblasts is of special interest.

The combination of the quantitative research methods with a detailed analysis of the situation (case-studies) conducted in six regions permits to discuss various aspects of municipal entities’ functioning in the framework of alternative variants of the territorial structure and identify the relationships between the territorial organization of local self-governance and various aspects of municipal entities’ functioning, primarily, organization of the delivery of municipal services. Although the informational base of the quantitative methods of research is rather limited, and the sample for case studies included less than 7 per cent of the Russian regions, the analyzed materials permit to put forward a rather wide spectrum of arguments in favor or against the hypotheses advanced above.

## **Annex 1.1. Requirements to Organization of Municipal Services that Affect Generation of Economies of Scale<sup>13</sup>**

### **Services Not Requiring Specialized Equipment and Heavy Investment**

- generate diseconomies of scale;
- are labor intensive;
- require direct contact between the service providers and the population;

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<sup>13</sup> This Annex has been composed on the basis of a Robert Bish article (*Bish, 1999b, annex B*).

- input-output ratio is hard to measure;
- are most efficiently provided by relatively small organizations, where managers can keep a tight rein on activities of their employees.

**Services Requiring Specialized Equipment and/or Specially Trained Staff**

- do not require direct contact between service providers and the population;
- volume of output is easy to measure;
- are efficiently provided by both the specialized units of large municipalities governing bodies and specialized organizations operating under contracts with several small municipalities.

**Investment Intensive Services**

- generate economies of scale;
- the size of organization that provide services is of no importance.

*Table 1.1*

<b>Classification of Municipal Services</b>			
<b>Sphere of activity</b>	<b>Services Not Requiring Specialized Equipment and Heavy Investment</b>	<b>Services Requiring Specialized Equipment and/or Specially Trained Staff</b>	<b>Investment Intensive Services</b>
Law Enforcement	Administering of law enforcement bodies	Technical support of communication facilities and computer systems of law enforcement agencies	Maintenance of prisons and police stations
	Supplying foodstuff to prisons, organization of cleaning of prison wards and territories	Organization and servicing of target ranges	
	Organization of patrolling (except for helicopter patrolling)	Personnel training Organization of helicopter patrolling	

<b>Sphere of activity</b>	<b>Services Not Requiring Specialized Equipment and Heavy Investment</b>	<b>Services Requiring Specialized Equipment and/or Specially Trained Staff</b>	<b>Investment Intensive Services</b>
	<p>Conduct of investigative actions (robberies, family quarrels, road traffic accidents)</p> <p>Provision of public services by law enforcement agencies (prevention of juvenile delinquency, traffic safety committee, etc.)</p>	<p>Conduct of investigative actions (forensic laboratory, murders, narcotics, DNA and fingerprint identification)</p> <p>Provision of public services by law enforcement agencies (family dispute resolution committee, rehabilitation centers for victims of family violence, etc.)</p>	
Fire Safety	<p>Basic training of recruits and nursing staff</p> <p>Organization of fire prevention programs, fire inspections, control over observation of fire regulations</p> <p>Rescue and evacuation operations</p>	<p>Organization of refresher courses</p> <p>Maintenance of equipment and fire alarm systems</p> <p>Investigation of the cause of fire</p>	
Engineering Services: roads and parking lots	<p>Installation and maintenance of street lighting and road signs</p> <p>Planning, construction and maintenance of boulevards</p>	<p>Installation and maintenance of traffic lights</p> <p>Laying of road markings</p>	

<b>Sphere of activity</b>	<b>Services Not Requiring Specialized Equipment and Heavy Investment</b>	<b>Services Requiring Specialized Equipment and/or Specially Trained Staff</b>	<b>Investment Intensive Services</b>
	<p>Planning, construction and maintenance of parking lots</p> <p>Installation, maintenance and collection of money from parking meters</p> <p>Cleaning of streets and removal of snow</p> <p>Maintenance of roads and elevated roads</p> <p>Construction and maintenance of pavements and road sides</p>	<p>Asphalt production</p> <p>Design and construction of roads and elevated roads</p> <p>Design, construction and maintenance of bridges</p>	
Engineering Services: water supply	<p>Maintenance of water intake facilities and storage reservoirs</p> <p>Maintenance of waste water treatment facilities, water-pumping and decompression stations</p> <p>Maintenance of water supply systems</p> <p>Maintenance of water chlorination stations</p>	<p>Design and construction of water intake facilities and storage reservoirs</p> <p>Design and construction of waste water treatment facilities, water-pumping and decompression stations</p> <p>Laying of water supply systems</p>	<p>Financing of the construction of water intake facilities and storage reservoirs</p>

<b>Sphere of activity</b>	<b>Services Not Requiring Specialized Equipment and Heavy Investment</b>	<b>Services Requiring Specialized Equipment and/or Specially Trained Staff</b>	<b>Investment Intensive Services</b>
Engineering services: sewerage	Maintenance of main collectors of sewerage systems, treatment and sewage facilities  Maintenance of drainage systems	Design and construction of main collectors of sewerage systems, treatment and sewage facilities  Design and construction of drainage systems	Financing of construction of main collectors of sewerage systems, treatment and sewage facilities
Other selected public services	Organization and maintenance of kindergartens Organization and maintenance of Alcoholic and Drug Addicts Rehabilitation Centers, mental health clinics  Maintenance of burial sites  Maintenance of residential homes for the elderly people	Design and construction of library buildings  Provision of special transport services	Financing of libraries  Organization of transport services for the population (maintenance of bus networks)

## **Chapter 2. An Empirical Analysis of the Territorial Structure of Municipal Entities**

### **2.1. Constraints to the Conducted Analysis and Description of Database**

The framework of the present paper employed empirical analysis to research into two main issues: which factors influence selection of a territorial structure of municipal entities in this or that region and on which parameters the territorial structure impacts itself. The identification of these particular factors appears of a special interest to a researcher, as it allows separation of general trends from a specificity of individual Subjects of the Federation, which is impossible to do in the course of an in-depth research into specific regions. Plus, such an analysis allows drawing distinction between truly significant specifics of individual territories and a subjective justification for making these or those decisions in the municipal structure area, i.e. proving or uncrowning myths existing in this particular area.

The research was undertaken to the extent allowed by constraints imposed by the existing informational base. The constraints in question proved to be fairly substantial – the available statistical information that should enable one to track down the respective correlations appeared rather poor, while its structure was not suitable for such kind of research. The identified constraints not only considerably affected the intensity and results of the quantitative analysis in the present paper, but they can also exert a substantial influence on an assessment of effects of a large-scale reform of the structure of local self-governance as per the new version of law 131 FZ “On general principles of organization of local self-governance in RF”. That is why ensuring the availability of adequate information that would allow monitoring the progress in, and results of the reforming process should form an integral part of the transformations in question.

To conduct the research, all the regions were broken into five categories:

- 1) regions with the rayon structure of municipal entities;
- 2) regions with the settlement structure of municipal entities;

- 3) regions with a two-level structure of municipal entities, with budget present on the settlement level;
- 4) regions with a two-level structure of municipal entities, with budget present on both the district and settlement levels;
- 5) regions in which the identification of a territorial structure of municipal entities for the purpose of given computations is complicated.

The last category comprises a collage of regions, namely:

- regions with a mixed structure of municipal entities (several models exist and play a significant role in the frame of a single Subject of the Federation);
- regions with substantial constraints to development of local self-governance;
- regions on which reliable information is unavailable (or, drawn from different sources, it appears substantially conflicting);
- regions in which the number of cities is comparable to the number of other kinds of municipalities, thus the data on them substantially affect results of computations.

Underlying the classification is information of the Center of Fiscal Policy, data of Analytical Newsletter of the State Duma Committee on self-governance issues No.13 “Issues of legislative provision of territorial organization of local self-governance”, part 2, and the authors’ research findings. Results of the division of regions into five categories on the basis of the 2000–2003 data are given in *Table 2.1*. For the sake of the subsequent analysis the regions that fall under the first four categories were labeled as regions with the net structure. At this point, it is worth noting that the territorial structure of the regions that fall under the third category holds an intermediate position between the structures that fall under the first and fourth categories, respectively. On the one hand, in the situation when under the two-tier structure the settlement – level municipalities do not have their own budgets, their actual independence does not differ radically from that settlements and village councils enjoy in the district structure frame, while the existence of elected bodies on the settlement level draws this particular structure together with a full-fledged two-tier one.

Obviously the structure of the integrity in question per se complicates quantitative analysis, for it displays a considerable asymmetry. As



the data of *Table 2.1* show, the overwhelming majority of regions fall under the first and third categories, while the sample by the second and fourth categories that appear of the greatest interest to a researcher is fairly small. That is why specifics of every given region in the sample substantially affect final results. These complexities were taken into account while opting for the quantitative analysis methodology.

*Table 2.1*

**Results of Division of Regions into Five Categories on the Basis of the 2000–03 Data**

	Regions with the district structure of local self-governance	Regions with the settlement structure of local self-governance	Regions with the two-tier structure of local self-governance		Regions in which identification of the territorial structure of municipal entities is complicated
			Without budgets on the settlement level	With budgets on the level of districts and settlements	
	1	2	3	4	5
2000	38	6	10	2	30
2001	38	5	10	3	30
2002	39	4	10	3	30
2003	39	4	10	3	30

**2.2. The Data Employed**

The quantitative analysis centered on identification of correlations between the choice in favor of a certain option of the territorial organization of local self-governance and various parameters of their functioning. *Table 2.2* contains the list of indicators employed for the sake of empirical analysis. Two groups of indicators were selected as parameters to be examined: namely, indicators that characterize expenditures on administering municipal entities (1–2) and those characterizing the division of functions between a Subject of the Federation and municipal entities (3–6), while indicators of the financial state of municipal entities (7–11) and demographic indicators (12–13) formed explanatory variables. In addition, the analysis employed dummies that characterize existence in a region of this or that territorial organization model of the local self-governance, while nominal

of the local self-governance, while nominal variable<sup>14</sup> was used to analyze factors that impact the selection of a given territorial structure.

The choice of indicators that characterize expenditures on administration and division of functions and power between the regional level and municipal one as explained variables in the course of the analysis of the impact of the territorial structure on the organization of municipal entities' functioning was determined by the absence of a statistical base that would otherwise allow a more conceptual research, for instance, the analysis of a correlation of this or that territorial structure and the quality of provision of public services.

In the present research, to characterize expenditures on administration, the first group of explained variables was complemented by indicators of the proportion of expenditures under the item "public administration and local self-governance" in expenditures of consolidated regional budgets and consolidated local ones. The need to analyze the proportion of the noted item in expenditures of the consolidated regional budget in the course of the study of the territorial structure is explained by the fact that in the conditions of the settlement model, on the district level there usually emerges a government body whose operations are funded out of the regional budget. Whereas this body chiefly, to this or that extent, assumes the functions usually exercised by the district-level municipalities in the conditions of other models of organization of local self-governance, the restriction of the analysis with just the structure of the consolidated municipal budget can provide only one-sided results.

As concerns the allocation of functions and powers between the regional level and municipal one, in this particular case the analysis was conducted with respect to the three most significant spheres of municipal operations and municipal expenditures – that is, the housing and communal sector, education, and healthcare. The indicators that characterize the given division of functions and powers were represented by shares of the respective expenditures of the consolidated local budget in consolidated expenditures of the regional one. As well, the authors built an integral indicator of decentralization of municipal expenditures that accounted expenditures by the three noted items. The decentrali-

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<sup>14</sup> The description of the dummies and nominal variable is given in Section 2.3. "*The Methodology of Quantitative Analysis*".

zation coefficient was computed as an aggregate of products of shares of expenditures of consolidated regional budgets on the housing and communal sector, education and healthcare funded out of local budgets by shares of the respective expenditure items in overall expenditures of municipal budgets weighted by the share of the noted items in local budgets. In other words, the decentralization index was computed according to the following formula:

$$DC = \frac{D_{MB}^{(GKH)} \times D_{StrMB}^{(GKH)} + D_{MB}^{(Ed)} \times \overline{D}_{StrMB}^{(Ed)} + D_{MB}^{(MA)} \times D_{StrMB}^{(MA)}}{D_{StrMB}^{(GKH)} + D_{StrMB}^{(Ed)} + \overline{D}_{StrMB}^{(MA)}},$$

$D_{StrMB}^{(GKH)}$ ,  $D_{StrMB}^{(Ed)}$ ,  $D_{StrMB}^{(MA)}$  – where  $D$  stands for decentralization index,  $D_{MB}^{(GKH)}$ ,  $D_{MB}^{(Ed)}$ ,  $D_{MB}^{(MA)}$  – shares of expenditures on the housing and communal sector, education and healthcare funded from local budgets;  $\overline{D}_{StrMB}^{(GKH)}$ ,  $\overline{D}_{StrMB}^{(Ed)}$ ,  $\overline{D}_{StrMB}^{(MA)}$  – shares of expenditures on the housing and communal sector, education and healthcare in overall expenditures of municipal budgets.

An indirect indicator of the decentralization of expenditures can also be formed by a share of the consolidated local budget in the consolidated regional one. This indicator appears more general than the previous one, as it is not limited by the three key powers and characterizes the whole complex of municipal functions. However, its value finds itself under a substantial impact of the volume of expenditures on exercising specific regional functions that are not associated with municipalities' obligations, which is why this particular indicator cannot be recognized as fully adequate to the objectives of the present analysis.

While studying into factors that affect selection of a territorial structure, we analyzed such indicators as population density, budgetary sufficiency of the consolidated regional budget in terms of its own revenues and the share of financial assistance in the consolidated regional budget revenues. However, it should be taken into account that these parameters were examined by a Subject as a whole, without singling out large cities, the population density and financial sufficiency indicators by which can differ substantially from the situation in the rest of the Subject's territory and thus somewhat distort the respective results. The intensity of this problem was partly mitigated by including the re-

gions a substantial number of municipal entities of which are attributed to cities in the fifth category and thus excluding regions with a net structure from the analysis.

*Table 2.2*

**Indicators Employed in the Course Empirical Analysis**

<b>№</b>	<b>Indicator</b>	<b>Legend</b>	<b>Unit</b>
1.	The share of expenditures under the item “ Public administration and local self-governance” in the consolidated regional budget	KRB	%
2.	The share of expenditures under the item “ Public administration and local self-governance” in the consolidated local budget	MB	%
3.	The share of expenditures from the consolidated regional budget on the housing and communal sector funded out of the consolidated local budget	GKH	%
4.	The share of expenditures from the consolidated regional budget on education funded out of the consolidated local budget	ED	%
5.	The share of expenditures from the consolidated regional budget on health care funded out of the consolidated local budget	MA	%
6.	The coefficient of decentralization of municipal expenditures	DC	%
7.	The share of financial assistance in revenues to the consolidated regional budget	FAR	%
8.	The share of financial assistance in revenues to the consolidated local budget	FAL	%
9.	Budget sufficiency in terms of tax and non-tax revenues to the consolidated regional budget with account of the amount of subsistence minimum in a region	RAR_1	Rb
10.	Budget sufficiency in terms of tax and non-tax revenues to the consolidated local budget with account of the amount of subsistence minimum in a region	RAL_1	Rb
11.	The share of expenditures of the consolidated local budget in the consolidated regional budget	MB_RRB	%
12.	Population density rate	Density	Individuals per km.l
13.	Population per municipal entity in a region, on average	AP_1	Individuals

For the case of regions with the two-tier structure of local self-governance, the index of population per municipal entity across the re-

gions on average, which is computed as the population in the region to the number of municipal entities ratio, was initially computed for municipal entities of both levels. However, while assessing regressions, the authors failed to identify the impact of the population of settlement municipal entities on any of the factors in question. That is why the consequent analysis was dealing only with the population indicator in the district-level municipalities.

The computations are based on the data of the RF Ministry of Finance of execution of consolidated budgets of the RF Subjects between 2000 and 2003 and the Goskomstat data on the population numbers and density in regions. It was not accidental that the noted period was selected for the purpose of the present research.

First, the classification of the RF regions by types of models of organization of local self-governance was based on research dated back to 2001–2003. Accordingly, one cannot confidently argue that the classification is equally applicable to the earlier stages of the development of local self-governance. Tumen and Orenburg oblast that have recently undergone the replacement of the settlement model with the district one prove the above assumption.

Second, the year 2000 saw the beginning of the period of a relative financial stabilization of local budgets. By contrast to the prior years, the specificity of that particular period lay in a considerable part of municipal entities experiencing some improvement of their financial situation. That manifested itself in the decline of the wages arrears problem in respect to budget employees, fall in the growth rates or even decline of debts accumulated by then, and some rise in capital expenditures. Such positive changes became possible, in particular, thanks to the higher-level budgets more completely funding their obligations to local budgets. As concerns the 1995–99 period, a chronic failure to fully finance critical expenditure items, as well as the execution of a considerable part of budgets in the non-monetary form and scarce accounting data do not allow an adequate assessment of the municipal entities' financial state.

### **2.3. The Quantitative Analysis Methodology**

The quantitative analysis was held in two stages. **At the first stage,** we computed mean values of such values as the consolidated regional

budget and regional and local budget expenditures on public administration staff under various models of territorial organization of local self-governance, as well as the proportion of expenditure on the housing and communal sector, education, healthcare, decentralization coefficient, and the proportion of local budget expenditures in the consolidated regional budget. These indicators were computed by four groups of regions, by the sample as a whole, and across the integrity of the RF Subjects. The work at that stage focused on identification of the most visible correlations between expenditures on public administration in budgets of all levels and allocation of functions between the state power and municipal authorities and the selected model of territorial organization of local self-governance.

**At the second stage**, we attempted to find linear correlations that determined the impact of the type of the territorial structure on various parameters of the municipal entities' operations, as well as to reveal factors that exerted influence on the selection of a type of the territorial structure. The analysis covered a sample of 56 regions ( $N=56$ ) with the net structure over four years (2000–03) ( $T=4$ ). To do the first sum, we assessed regressions on two-way error components with fixed effect models:

$$y_{it} = \alpha + \mu_i + \lambda_t + \beta' x_{it} + v_{it} \tag{2.1},$$

where  $y_{it}$  – dependent variable in moment of time  $t$  for region  $i$ ,  $x_{it}$  – explaining variable,  $\mu_i$  – individual term of  $i$ - region,  $\lambda_t$  – time term for time period  $t$ ,  $v_{it}$  – random component. It is assumed that random components are not correlated with regressors and appear independent equally distributed values with zero mean (By agreement,  $(N-1)$  individual terms and  $(T-1)$  time terms were introduced into the equation, while general constant  $\alpha$  was kept therein). In this case, to account time effects the following dummies were introduced:

Y2001 = 1, if the data falls under 2001,
Y2001 = 0, in other cases
Y2002 = 1, if the data falls under 2002,
Y2002 = 0, in other cases
Y2003 = 1, if the data falls under 2003,
Y2003 = 0, in other cases

The following values formed dummy: the proportion of expenditures on administration, the indicator of decentralization of the local budget expenditures or the proportion of the consolidated budget expenditures by main items funded out of the local budget.

The employment of the panel data allows consideration of individual distinctions existing between economic units and explained by unobserved or not expressed in quantitative form factors. The introduction of time terms to the equation allows consideration of differences in conditions over different time periods, which appears equal for all regions. When regions become subjects of research, a model with *fixed* individual effect is selected, because every region constitutes a unique object, rather than an object picked at random from a great totality of objects (in that case, it would be more appropriate to resort to a random effect model). In this particular case, a consideration of dynamic models does not appear urgent, as we examine a short time period ( $T=4$ ), while a more detailed description of the method can be found in *Greene, 1997*.

Equation (2.1) is estimated by means of Ordinary Least Squares after application of the within transformation, which essentially diminishes the volume of computations and provides the same values of parameters  $\beta$ . Asymptotic normality of within estimators<sup>15</sup>  $\beta$  allows examination of significance of coefficients using regular *t*-tests.

The significance of the regression as a whole was examined by means of *F*-test, with  $R^2_{\text{within}}$  as a possible adjustment quality measure. The justification for the introduction of the time series into the model was examined by means of testing hypotheses of time effects equaling zero with the use of *F*-test. If the hypothesis is not rejected, one can proceed to the fixed effect model:

$$y_{it} = \alpha + \mu_i + \beta^1 x_{it} + v_{it} ,$$

which does not include time terms. The hypothesis of the absence of individual effects, i.e. of all the individual terms equaling zero is also tested with the use of *F*-test. If the hypothesis is not rejected, one should proceed to the pooled model:

$$y_{it} = \alpha + \beta^1 x_{it} + v_{it} ,$$

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<sup>15</sup> The estimators are also known as fixed effect estimators or Least Squares Dummy Variable (LSDV) estimator.

i.e. in the course of examination of this particular case the panel structure of the data does not provide any advantages.

Should the group of regressors include the ones whose value does not change for each subject over time, the model with fixed individual effects does not allow identification of coefficients that match given variables. This is associated with the fact that unchanged factors cannot be separated from an individual effect. Because of this particular constraint, in the course of the regression analysis regions with the two-tier structure of local self-governance were put together into the same group. Should one consider regions with the two-tier structures with settlement-level budgets and regions with the two-tier structure exclusive of settlement-level budgets, the value of the dummy that corresponds to the latter group would remain unchanged for all the regions through the whole period of observations and it would not be possible to estimate the effect from this particular type of structure. Hence, to analyze the impact of the territorial structure on various parameters of municipal entities' operations, the following dummies were introduced:

STRUCT\_1 = 1, if the region has the district structure of self-governance,  
 STRUCT\_1 = 0, in other cases

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STRUCT\_2 = 1, if the region has the settlement structure of local self-governance,  
 STRUCT\_2 = 0, in other cases

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STRUCT\_3 = 1, if the region has the two-tier structure of local self-governance,  
 STRUCT\_3 = 0, in other cases

The correlations between the type of territorial structures and different factors were assessed within the multinomial logit model, for in this case the dependent variable appears nominal (has several values that cannot be regulated). The model framework allows the assumption that the probability of dependent variable  $Y$  taking value  $j$  is described by the formula:

$$Prob\{Y = j\} = \frac{\exp(\beta'_j x)}{\sum_{k=0}^J \exp(\beta'_k x)},$$



where the number of alternatives equal  $(J+1)$ ,  $J$ - the alternative number (starting from zero),  $\beta_j$ - column of coefficients in the equation for a  $j$  alternative,  $x$  – matrix of explanatory variables. To eliminate the uncertainty associated with the possibility to increase all  $\beta$  coefficients by the same number which would not change the value of the probability, normalization  $\beta_0 = 0$  is used. The variable “type of territorial structure” consequently takes 4 values that are numbered as follows:

- STRUCTURE = 0 if the region has the district structure of self-governance

---

- STRUCTURE = 1, if the region has the settlement structure of local self-governance

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- STRUCTURE = 2, if the region has the two-tier structure of local self-governance exclusive of budgets on the settlement level

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- STRUCTURE = 3, if the region has the two-tier structure of local self-governance inclusive of budgets on the settlement level

That is to say, in this case it is assumed that

$$Prob\{STRUCTURE = j\} = \frac{\exp(\beta'_j x)}{1 + \sum_{k=1}^3 \exp(\beta'_k x)}, \text{ for } j = 1, 2, 3, \text{ and}$$

$$Prob\{STRUCTURE = 0\} = \frac{1}{1 + \sum_{k=1}^3 \exp(\beta'_k x)}, \text{ for } j = 0.$$

Estimating coefficients  $\beta_j$  is conducted by means of Maximum Likelihood Estimation. At this point, it should be noted that coefficients  $\beta_j$  cannot be interpreted as easily as in the case of continuous dependent variables. This method is described in a greater detail in *Greene, 1997*. The significance of the regression as a whole is found by means of the Likelihood Ratio (LR) test.

## 2.4. Results of Quantitative Analysis

The analyzed above approaches to application of quantitative analysis and the existing informational constraints allow employment of the given methods to test a series of hypotheses formulated in Chapter 1 – that is, to identify:

- correlation between objective and subjective factors in the course of selection of a territorial structure model (hypothesis 1);
- effect the selected model of territorial structure has on administrative costs (hypothesis 3);
- effect the selected model of territorial structure has on the allocation of functions and powers between the regional level and municipal one (hypothesis 4).

The analysis of the correlation between objective and objective factors in the course of selection of a territorial structure model required an assessment of the correlation between variables that characterize the type of territorial structure and such variables as the budget sufficiency of the consolidated regional budget in terms of tax and non-tax revenues; the proportion of financial assistance in revenues to the consolidated regional budget and the average population density. No significant correlations have been found, which allows to assume that the given objective factors do not play a substantial role in selecting a territorial structure. The selection is most likely to be driven by subjective factors and peculiarities of the political process in a given region.

The analysis of the proportion of expenditures on administration has brought about more conceptual findings. *Table 2.3* contains averaged over the four years (2000–03) values of the indicators of the share of expenditures under the item “public administration and local self-governance” in the consolidated municipal and consolidated regional budgets for regions with each of the four models of territorial structure.

The share of expenditures on administration in the regions with the district, settlement, as well as two-tier structure without budgets on the settlement level evidently appears fairly similar and roughly equal to the average one nationwide. By contrast, in the case of regions with the two-tier structure and budgets existing on both tiers of municipal entities this share is substantially greater and accounts for 130% of the average indicator nationwide. As concerns expenditures on administration in the consolidated regional budgets, the distinctions are not so drastic there. This indicator appears slightly greater in the regions with the settlement structure (which, in all likelihood, is determined by territorial public administration structures in existence on the district level, as well as a greater volume of functions exercised on the regional level and in the regions with the two-tier structure with budgets existing on both

levels (because municipal budgets having greater expenditures on this item). The excess of the value of the indicator in these groups of regions, nonetheless, does not appear extremely drastic vis-à-vis the average one nationwide and accounts for 13.6%.

Table 2.3

**The Proportion of Expenditures on Public Administration and Local Self-Governance in Expenditures of the Consolidated Regional and Local Budgets in 2000–2003 Averaged by the Sample of Regions, as %**

Regions with different structures of organization of local self-governance	The proportion of expenditures on public administration and local self-governance in:	
	Consolidated regional budgets	Consolidated local budgets
District	6.5	7.5
Settlement	7.4	8.1
Two-tier (without budgets)	6.3	7.8
Two-tier (with budgets)	7.2	9.7
By sample on the whole	6.6	7.7
By all the RF regions	6.4	7.5

Source: the data of the RF Ministry of Finance on execution of consolidated budgets of the RF Subjects, 2000–03

Results of computations of panel regressions allowed broader and more comprehensive information of factors that affect administrative expenditures. The results of the regression analysis are given in *Tables 2.4–2.5*. These tables, coupled with *Tables 2.7–2.9*, display only statistically significant coefficients, the value of standard bias for these coefficients, t-statistics values and the probability of this coefficient being equal zero. As well, the Tables provide results of the testing of hypotheses on significance of the regression on the whole, on individual effects equaling zero, and time effects equaling zero (in the cases the time effects have proved to be significant).

Table 2.4

**The Correlation between the Proportion of Expenditures under the Item “Public Administration and Local Self-Governance” in Overall Expenditures of the Consolidated Regional Budgets and Budget Sufficiency in Terms of Own Revenues, Proportion of Expenditures of Local Budgets in the Consolidated Regional Budget and Time Factors (224 Observations)**

Dependent variable: KRB				
Explanatory variables	Coefficient	Standard bias	t-statistics	Probability
RAR_1	-0.000092	0.000024	-3.88	0.000
MB_RRB	0.085	0.008	10.1	0.000
Y2001	0.34	0.15	2.32	0.021
Y2003	0.56	0.18	3.06	0.003
Const	2.3	0.5	4.6	0.000

*Testing the significance the regression on the whole:  $F(4, 164) = 43.02, P = 0.0000$*

$R^2_{within} = 0.51$

*Testing the hypothesis of individual effects equaling zero:  $F(55, 164) = 7.49, P = 0.0000$*

*The proportion of the explained dispersion due to individual effects:  $\rho = 0.72$*

*Testing the hypothesis of time effects equaling zero:  $F(2, 164) = 6.23, P = 0.0025$*

As shown by Table 2.4, the proportion of expenditures on administration in the consolidated regional budget finds itself negatively correlated with budget sufficiency and positively correlated with the share of local budget expenditures in the consolidated regional budget. Besides, regardless of these factors, the proportion of the expenditures on administration in 2001 and 2003 was greater than in 2000 and 2002. The authors have failed to find a correlation between the proportion of expenditures on administration and the type of territorial structure, share of financial assistance in revenues to the consolidated regional budget, the average population density and average population per municipal establishment.

An analogous trend was revealed while assessing the correlation between the proportion of expenditures on administration in the consolidated local budget and explanatory variables. As Table 2.5 shows, this particular variable finds itself negatively correlated with budget sufficiency and positively correlated with the share of local budget expenditures in the consolidated regional budget, albeit in this particular case

the latter correlation appears fairly loose<sup>16</sup>. In addition, regardless of the noted factors, the 2001 and 2002 proportion of expenditures on administration grew vs. 2000, while in 2003- vs. 2002. The coefficients under other explanatory variables (the type of territorial structure, share of financial assistance in revenues to the consolidated local budget, the average population density and average population per municipal entity) proved to be insignificant.

Table 2.5

**The Correlation between the Proportion of Expenditures under the Item ‘Public Administration and Local Self-Governance’ in Overall Expenditures of the Consolidated Local Budgets and Budget Sufficiency in Terms of Own Revenues, Proportion of Expenditures of Local Budgets in the Consolidated Regional Budget and Time Factors (224 Observations)**

Dependent variable: MB				
Explanatory variables	Coefficient	Standard bias	t-statistics	Probability
RAL_1	-0.00038	0.00010	-3.76	0.000
MB_RRB	0.0297	0.0152	1.96	0.052
Y2001	0.56	0.20	2.75	0.007
Y2002	1.01	0.34	3.01	0.003
Y2003	1.8	0.40	4.57	0.000
Const	6.31	0.90	7.00	0.000

*Testing the significance the regression on the whole:  $F(5, 163) = 5.34, P = 0.0001$*   
 $R^2_{within} = 0.14$   
*Testing the hypothesis of individual effects equaling zero:  $F(55, 163) = 9.71, P = 0.0000$*   
*Testing the hypothesis of time effects equaling zero:  $F(3, 163) = 7.96, P = 0.0001$*   
*Testing the hypothesis of equality of time effects in 2001, 2002 and 2003:  $F(2, 163) = 9.46, P = 0.0001$*   
*Testing the hypothesis of equality of time effects in 2001 and 2002:  $F(1, 163) = 2.79, P = 0.0966$*   
*Testing the hypothesis of equality of time effects in 2002 and 2003:  $F(1, 163) = 14.71, P = 0.0002$*   
*The proportion of the explained dispersion due to individual effects:  $\rho = 0.74$*

<sup>16</sup> Under the 5% level of significance the coefficient under the share of local budget expenditures in the consolidated regional one appears insignificant ( $P=0.052$ ). Should this variable be excluded from the equation, it would lead to the model losing its substance, which is why the variable has been kept as one of the regressors, given, furthermore, the excess over the 5% barrier was not big.

The analysis of correlations between the proportion of expenditures on administration and the explanatory variables allows some conclusions:

First, it is worth noting a negative correlation between the proportion of expenditures on administration and budget sufficiency. Such a situation demonstrates that, on the one hand, wealthier regions do not have a possibility or do not consider it necessary to transform an additional financial capacity into the respective increase in administration costs (i.e. the ideology of lowering expenditures on administrators appears a universal one), while poor regions, on the other hand, do not spend their resources in a rational fashion – they overstaff their administrative agencies at the expense of cutting down expenditures on provision of budget services to the population. This correlation can also indirectly evidence that so far poor regions have failed to fully implement economies of scale in the administration area, but this hypothesis demands additional testing.

Second, the conclusion on the absence of a correlation between administrative expenditures and the type of territorial structure may appear paradoxical at the first glance. However, one should take into account that for the sake of the analysis the authors were compelled to put the regions with the two-tier structure without budgets and those with budgets existing on the lower level in the same group. With account of the fact that the totality of the regions without budgets on the lower level is far greater than the number of regions with budgets existing on both levels of the municipal structure, such a combination could not help introducing distortions in the analysis outcomes. So, the given empirical correlation does not form a basis for the conclusion that expenditures on administration do not tend to grow in the frame of a valuable two-tier structure vs. other models of the territorial structure. More specifically, the noted correlation does not provide a possibility for the forecast that the introduction of the territorial structure as per law 131-FZ "On general principles..." will not be accompanied by a considerable rise in expenditures on administration.

Third, a positive correlation between the proportion of expenditures on administration not only in the consolidated municipal budgets, but even to a greater extent, in consolidated regional budgets, and the proportion of local budget expenditures in the consolidated regional

budget may have two possible explanations. On the one hand, it can be assumed that the allocation of powers between the regional and municipal levels has not been optimal, with the functions that could not be implemented fully efficiently (for instance, those by which economies of scale were not ensured) being assigned to the municipal level. On the other hand, perhaps, the delegation of a part of extra expenditure mandates to the municipal level has enabled regions to extend their powers, which required limited budget resources, but extra administrative staff, in the areas that did not fall under municipalities' purview.

Table 2.6 provides average indicators over years 2000–03 that characterize the allocation of powers between the regional and municipal levels. In addition to the share of expenditures on the housing and communal sector, education and health care funded out of local budgets, the Table also provides the decentralization index and the share of the consolidated municipal budget in the consolidated regional one.

Table 2.6

**Indicators Characterizing Allocation of Powers between Municipal and Regional Levels in 2000-2003, Averaged across the Sample of Regions, as %**

Regions with different structures of organization of local self-governance	Decentralization index	Expenditures funded from local budgets, on			The proportion of local budget expenditures in the consolidated regional budget
		HCS	Education	Healthcare	
District	83.2	90.4	85.4	61.6	54.1
Settlement	68.9	77.6	68.6	42.4	43
Two-tier (without budgets)	84.5	93.9	87.6	63.5	57
Two-tier (with budgets)	79.8	90.7	81.6	63.8	46.4
By sample as a whole	82	90	84.2	60.4	53.5
By all RF regions	80.4	87.4	82.8	57.7	51.1

Source: the data of the RF MinFin on execution of consolidated budgets of the RF Subjects, 2000–2003.

As evidenced by the decentralization index, it is municipalities based on the settlement level that exercise the smallest volume of powers, while the greatest level of decentralization is displayed by the district structure and the two-tier structure without budgets on the settlement level, which, as noted above, appears in many ways analogue to the district model. Interestingly, in the frame of the two-tier structure with budgets existing on both levels the degree of decentralization in such critical areas as the housing and communal sector and education is slightly lower (which, as noted above, is accompanied by greater expenditures on administration).

As concerns the proportion held by the consolidated municipal budget in the consolidated regional one, this particular indicator appears the greatest one in the district model frame, while the other structures display roughly the same level of the indicator, albeit substantially lower than that of the district model.

Notably, the dynamics of decentralization indices by key municipal powers differ greatly from the dynamics of the proportion of local budget expenditures in the consolidated regional budget. While between 2000 and 2002 the proportion of local budgets in the consolidated regional one had been tending to fall steadily, in 2002–03 it became relatively stable by practically all the regions in question. By contrast, decentralization indices by key municipal powers were relatively stable in 2000–02, and, in some cases, even showed a slight rise in 2003. It can be assumed that the centralization affected other municipal functions, while regional expenditures not associated with municipal powers could be growing at a higher pace than ever. The information of annual values of the indicators that characterize the allocation of functions and powers between the regional and municipal levels is given in *Annex 2.2*.

Results of the assessment of the correlation between the decentralization coefficient and various parameters by means of regression analysis are given in *Table 2.7*.



Table 2.7

**Correlation between the Coefficient of Decentralization of Municipal expenditures and the Type of Territorial Structure and Budget Sufficiency of Consolidated Municipal Budgets in Terms of Their Own Revenues (224 Observations)**

Dependant variable: DC				
Explanatory variables	Coefficient	Standard bias	t-statistics	Probability
STRUCT_1	–			
STRUCT_2	–13.0	2.9	–4.4	0.000
STRUCT_3	–			
RAL_1	0.00066	0.00026	2.57	0.011
Const	81.3	0.8	98	0.000

**Testing significance of the regression on the whole:  $F(2, 166) = 14.30, P = 0.0000$**   
 $F^2_{within} = 0.15$   
*Testing the hypothesis of individual effects equaling zero:*  
 $F(55, 166) = 9.68, P = 0.0000$   
*The proportion of the explained dispersion due to individual effects:  $\rho = 0.71$*

As evidenced by the Table, the coefficient of decentralization of municipal expenditures depends on the type of territorial structure – the decentralization coefficient is sliding from the district model to the settlement structure and remains stable, as long as the transition from the district model to a two-level one is concerned. Plus, the decentralization coefficient finds itself positively correlated with budget sufficiency. The authors failed to find a correlation between the decentralization coefficient and the share of financial assistance in revenues to the consolidated local budget, the average population density and average population per municipal entity.

Tables 2.8–2.9 provide results of the assessment of the effect from territorial structure, indicators of financial state of local budgets and demographic factors on the proportion of expenditures from the consolidated regional budget on the housing and communal sector and education funded out of the local budget.

The Table above shows that the proportion of expenditures on the housing and communal sector funded out of local budgets finds itself correlated with budget sufficiency and the type of the territorial structure. Once delegated to the local level, the proportion of expenditures on the housing and communal sector decreases in the event of the settlement model vis-à-vis the district model, while it remains unchanged

for both the district and two-tier models. The authors have failed to find a correlation between the delegated to the local level proportion of expenditures on the housing and communal sector and the share of financial assistance in revenues to the consolidated local budget, the average population density and average population per municipal entity.

Table 2.8

**Correlation between the Proportion of Expenditures on the Housing and Communal Sector Funded from Local Budgets in the Aggregate Expenditures of the Consolidated Regional Budget on the Housing and Communal Sector from the Type of Territorial Structure and Budget Sufficiency of Consolidated Regional Budgets by Their Own Revenues (224 Observations)**

Dependent variable: GKH				
Explanatory variables	Coefficient	Standard bias	t-statistics	Probability
STRUCT_1	–			
STRUCT_2	–15.9	6.0	–2.65	0.009
STRUCT_3	–			
RAL_1	0.00207	0.00054	3.94	0.000
Const	85.5	1.7	50.5	0.000

**Testing significance of the regression on the whole:  $F(2, 166) = 12.37, P = 0.0000$**   
 $R^2_{within} = 0.13$   
*Testing the hypothesis of individual effects equaling zero:*  
 $F(55, 166) = 9.24, P = 0.0000$   
*The proportion of the explained dispersion due to individual effects:  $\rho = 0.70$*

Table 2.9

**Correlation between the Proportion of Expenditures on Education Funded out of Local Budgets in Aggregate Expenditures on Education of the Consolidated Regional Budget and the Type of the Territorial Structure (224 Observations)**

Dependent variable: ED				
Explanatory variables	Coefficient	Standard bias	t-statistics	Probability
STRUCT_1	–			
STRUCT_2	–17.0	3.2	–5.2	0.000
STRUCT_3	–			
Const	85.6	0.40	216	0.000

**Testing significance of the regression on the whole:  $F(1, 167) = 27.49, P = 0.0000$**   
 $R^2_{within} = 0.14$   
*Testing the hypothesis of individual effects equaling zero:*  
 $F(55, 167) = 14.37, P = 0.0000$   
*The proportion of the explained dispersion due to individual effects:  $\rho = 0.78$*

As concerns educational expenditures, their proportion funded from the local budget is correlated solely with the type of the territorial structure. Under the settlement model it is less vis-à-vis the district model, while remains unchanged for both the district and two-tier models. There have been noted no correlations between this variable and other factors.

The present research also focused on estimating the proportion of health care expenditures funded out of local budgets, but failed to find any correlation. This is surprising, as health care is financed from two sources- that is, budget funds and the compulsory medical insurance funds, and an analysis of correlations characteristic of only either of them would not help imagine a complete picture in this particular sector.

So, by contrast with expenditure on administration, in this particular case we have revealed a clear correlation between the level of decentralization and the type of the territorial structure, with the centralization of functions on the regional level being the greatest one under the settlement level, while the other cases displayed no substantial differences. There also exists yet another factor on which the decentralization level depends: namely, budget sufficiency, for given other conditions being equal, its greater level suggests a greater decentralization of expenditures.

## **2.5. Main Conclusions**

As noted above, results of the conducted quantitative analysis found themselves under the impact of challenges and constraints associated with the accessibility and structure of the information available. That is why it did not become possible to draw unambiguous conclusions by all the tested hypotheses. A number of results appear trustworthy nevertheless, which allows progress with the analysis of the earlier formulated hypotheses.

The most visible correlations were identified in the course of the analysis of the impact the territorial structure of local self-governance had on allocation of powers between the regional and municipal levels. All the employed research methods showed that the higher degree of decentralization is characteristic of the settlement level, while the others displayed no substantial distinctions.

By contrast, results of the analysis of the impact of the territorial structure on the degree of administrative expenditures did not appear equally unambiguous. The analysis of the average level of the noted kind of expenditures by each model of the territorial structure allows assumption of a considerably greater proportion of expenditures on administration being characteristic of a valuable two-tier model (the one with budgets existing on both levels of local self-governance). However, the regression analysis failed to prove these conclusions or reject them, for while conducting it, the authors were compelled to combine the two-tier model with budgets with the one without budgets on the settlement level into the same group. With such a grouping of regions, the authors failed to identify significant correlations between the proportion of administrative expenditures and the type of the territorial structure.

Finally, the authors equally failed to find a correlation between a type of the territorial structure and considered in the analysis objective demographic and financial characteristic of a region, which allows to assume that the selection of a given structure was dictated primarily by subjective and political factors.

Notably, in addition to the territorial structure, there existed yet another factor that proved to be significant under the analysis of a number of considered correlations (the proportion of expenditures on administration, level of decentralization) – that is, budget sufficiency of the consolidated regional and consolidated local budgets in terms of tax and non-tax revenues (without regard to financial assistance).

## **Annex 2.1. Classification of Regions**

<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>
<b><i>Regions with the district structure of local self-governance</i></b>			
Arkhangelsk oblast	Arkhangelsk oblast	Arkhangelsk oblast	Arkhangelsk oblast
Belgorod oblast	Belgorod oblast	Belgorod oblast	Belgorod oblast
Volgograd oblast	Volgograd oblast	Volgograd oblast	Volgograd oblast
Vologda oblast	Vologda oblast	Vologda oblast	Vologda oblast
Ivanovo oblast	Ivanovo oblast	Ivanovo oblast	Ivanovo oblast

1	2	3	4
Irkutsk oblast	Irkutsk oblast	Irkutsk oblast	Irkutsk oblast
Kaliningrad oblast	Kaliningrad oblast	Kaliningrad oblast	Kaliningrad oblast
Kamchatka oblast	Kamchatka oblast	Kamchatka oblast	Kamchatka oblast
Kirov oblast	Kirov oblast	Kirov oblast	Kirov oblast
Kostroma oblast	Kostroma oblast	Kostroma oblast	Kostroma oblast
Krasnodar krai	Krasnodar krai	Krasnodar krai	Krasnodar krai
Moscow oblast	Moscow oblast	Moscow oblast	Moscow oblast
Novgorod oblast	Novgorod oblast	Novgorod oblast	Novgorod oblast
Omsk oblast	Omsk oblast	Omsk oblast	Omsk oblast
Primorsky krai	Orenburg oblast	Orenburg oblast	Orenburg oblast
Pskov oblast	Primorsky krai	Primorsky krai	Primorsky krai
Republic Of Altay	Pskov oblast	Pskov oblast	Pskov oblast
Republic Of Buryatia	Republic Of Altay	Republic Of Altay	Republic Of Altay
Republic Of Karelia	Republic Of Buryatia	Republic Of Buryatia	Republic Of Buryatia
Republic Of Komi	Republic Of Karelia	Republic Of Karelia	Republic Of Karelia
Republic Of Mary-El	Republic Of Komi	Republic Of Komi	Republic Of Komi
Rostov oblast	Republic Of Mary-El	Republic Of Mary-El	Republic Of Mary-El
Ryazan oblast	Rostov oblast	Rostov oblast	Rostov oblast
Samara oblast	Ryazan oblast	Ryazan oblast	Ryazan oblast
Saratov oblast	Samara oblast	Samara oblast	Samara oblast
Sakhalin oblast	Saratov oblast	Saratov oblast	Saratov oblast
Sverdlovsk oblast	Sakhalin oblast	Sakhalin oblast	Sakhalin oblast
Smolensk oblast	Sverdlovsk oblast	Sverdlovsk oblast	Sverdlovsk oblast
Tver oblast	Smolensk oblast	Smolensk oblast	Smolensk oblast
Tomsk oblast	Tver oblast	Tver oblast	Tver oblast
Tula oblast	Tomsk oblast	Tomsk oblast	Tomsk oblast
Udmurt Republic	Tula oblast	Tula oblast	Tula oblast
Ulyanovsk oblast	Udmurt Republic	Tyumen oblast	Tyumen oblast
Ust-Ordynsky Buryatsky autonomous okrug	Ulyanovsk oblast	Udmurt Republic	Udmurt Republic
Chita oblast	Ust-Ordynsky Buryatsky autonomous okrug	Ulyanovsk oblast	Ulyanovsk oblast
Chukotka autonomous okrug	Chita oblast	Ust-Ordynsky Buryatsky autonomous okrug	Ust-Ordynsky Buryatsky autonomous okrug

1	2	3	4
Yaroslavl oblast	Chukotka autonomous okrug Yaroslavl oblast	Chita oblast Chukotka autonomous okrug Yaroslavl oblast	Chita oblast Chukotka autonomous okrug Yaroslavl oblast
<b>Regions with the settlement structure of local self-governance</b>			
Nenetsky autonomous okrug	Nenetsky autonomous okrug	Nenetsky autonomous okrug	Nenetsky autonomous okrug
Penza oblast	Penza oblast	Penza oblast	Penza oblast
Republic Of Khakassia	Republic Of Khakassia	Republic Of Khakassia	Republic Of Khakassia
Stavropol krai	Stavropol krai	Stavropol krai	Stavropol krai
Orenburg oblast	Tyumen oblast		
Tyumen oblast			
<b>Regions with the two-tier structure of local self-governance exclusive of budgets on the settlement level</b>			
Altay krai	Altay krai	Altay krai	Altay krai
Amur oblast	Amur oblast	Amur oblast	Amur oblast
Voronezh oblast	Voronezh oblast	Voronezh oblast	Voronezh oblast
Krasnoyarsk krai	Krasnoyarsk krai	Krasnoyarsk krai	Krasnoyarsk krai
Kurgansk oblast	Kurgansk oblast	Kurgansk oblast	Kurgansk oblast
Lipetsk oblast	Lipetsk oblast	Lipetsk oblast	Lipetsk oblast
Magadan oblast	Magadan oblast	Magadan oblast	Magadan oblast
Nizhny Novgorod oblast	Nizhny Novgorod oblast	Nizhny Novgorod oblast	Nizhny Novgorod oblast
Tambov oblast	Tambov oblast	Tambov oblast	Tambov oblast
Khabarovsk krai	Khabarovsk krai	Khabarovsk krai	Khabarovsk krai
<b>Regions with the two-tier structure of local self-governance inclusive of budgets on the settlement level</b>			
Astrakhan oblast	Astrakhan oblast	Astrakhan oblast	Astrakhan oblast
Orel oblast	Orel oblast	Orel oblast	Orel oblast
Republic Of Mordovia	Republic Of Mordovia	Republic Of Mordovia	Republic Of Mordovia
<b>Regions with the two-tier structure of local self-governance inclusive of budgets on the district and settlement level</b>			
Aginsky Buryatsky autonomous okrug	Aginsky Buryatsky autonomous okrug	Aginsky Buryatsky autonomous okrug	Aginsky Buryatsky autonomous okrug

1	2	3	4
Bryansk oblast	Bryansk oblast	Bryansk oblast	Bryansk oblast
Vladimir oblast	Vladimir oblast	Vladimir oblast	Vladimir oblast
Jewish autonomous oblast	Jewish autonomous oblast	Jewish autonomous oblast	Jewish autonomous oblast
Kabardino-Balkar Republic	Kabardino-Balkar Republic	Kabardino-Balkar Republic	Kabardino-Balkar Republic
Kaluga oblast	Kaluga oblast	Kaluga oblast	Kaluga oblast
Karachay-Cherkes Republic	Karachay-Cherkes Republic	Karachay-Cherkes Republic	Karachay-Cherkes Republic
Kemerovo oblast	Kemerovo oblast	Kemerovo oblast	Kemerovo oblast
Komi- Permyatsky autonomous okrug	Komi-Permyatsky autonomous okrug	Komi- Permyatsky autonomous okrug	Komi- Permyatsky autonomous okrug
Koryaksky autonomous okrug	Koryaksky autonomous okrug	Koryaksky autonomous okrug	Koryaksky autonomous okrug
Kursk oblast	Kursk oblast	Kursk oblast	Kursk oblast
Leningrad oblast	Leningrad oblast	Leningrad oblast	Leningrad oblast
Murmansk oblast	Murmansk oblast	Murmansk oblast	Murmansk oblast
Novosibirsk oblast	Novosibirsk oblast	Novosibirsk oblast	Novosibirsk oblast
Perm oblast	Perm oblast	Perm oblast	Perm oblast
Republic Of Adygeya	Republic Of Adygeya	Republic Of Adygeya	Republic Of Adygeya
Republic Of Bashkortostan	Republic Of Bashkortostan	Republic Of Bashkortostan	Republic Of Bashkortostan
<b><i>Regions where the identification of territorial structures of municipal entities is complicated</i></b>			
City of Moscow	City of Moscow	City of Moscow	City of Moscow
Republic Of Dagestan	Republic Of Dagestan	Republic Of Dagestan	Republic Of Dagestan
Republic Of Ingushetia	Republic Of Ingushetia	Republic Of Ingushetia	Republic Of Ingushetia
Republic Of Kalmykia	Republic Of Kalmykia	Republic Of Kalmykia	Republic Of Kalmykia
Republic Of Sakha (Yakutia)	Republic Of Sakha (Yakutia)	Republic Of Sakha (Yakutia)	Republic Of Sakha (Yakutia)
Republic Of North Ossetia-Alania	Republic Of North Ossetia-Alania	Republic Of North Ossetia-Alania	Republic Of North Ossetia-Alania
Republic Of Tatarstan	Republic Of Tatarstan	Republic Of Tatarstan	Republic Of Tatarstan
Republic Of Tyva	Republic Of Tyva	Republic Of Tyva	Republic Of Tyva
Saint Petersburg	Saint Petersburg	Saint Petersburg	Saint Petersburg

1	2	3	4
Taymyrsky (Dolgano-Nenetsky) autonomous okrug	Taymyrsky (Dolgano-Nenetsky) autonomous okrug	Taymyrsky (Dolgano-Nenetsky) autonomous okrug	Taymyrsky (Dolgano-Nenetsky) autonomous okrug
Khanty-Mansy autonomous okrug	Khanty-Mansy autonomous okrug	Khanty-Mansy autonomous okrug	Khanty-Mansy autonomous okrug
Chelyabinsk oblast	Chelyabinsk oblast	Chelyabinsk oblast	Chelyabinsk oblast
Chechen Republic	Chechen Republic	Chechen Republic	Chechen Republic
Republic of Chuvashia	Republic of Chuvashia	Republic of Chuvashia	Republic of Chuvashia
Evenk autonomous okrug	Evenk autonomous okrug	Evenk autonomous okrug	Evenk autonomous okrug
Yamal-Nenetsky autonomous okrug	Yamal-Nenetsky autonomous okrug	Yamal-Nenetsky autonomous okrug	Yamal-Nenetsky autonomous okrug

Source: The Center for Fiscal Policy; Analitichesky vestnik No. 13 of State Duma Committee for Local Self-Governance Issues «Voprosy zakonodatel'nogo obespecheniya territorional'noy organizatsii mestnogo samoupravleniya», part 2.

## Annex 2.2. Indicators that Characterize Division of Powers between the Municipal and Regional Levels, 2000–2003, averaged by the sample of regions, as %

Regions with different structures of organization of local self-governance	Decentralization index				The proportion of local budget expenditures in the consolidated regional budget			
	2000	2001	2002	2003	2000	2001	2002	2003
District	82.5	83.2	83.9	83.1	64.3	59.2	47.7	47.2
Settlement	69.5	69.7	65.0	71.1	48.3	47.6	38.3	39.8
Two-tier (less budgets on the settlement level)	85.1	84.6	84.9	83.5	66.2	62.9	50.4	48.7
Two-tier (inclusive of budgets on the settlement level)	78.3	76.1	82.9	82.1	49.6	49.4	43.0	43.6
Across the sample on the whole	81.4	81.9	82.7	82.2	62.1	58.1	46.9	46.8
Across all the RF regions	80.5	80.0	80.5	80.7	60.2	55.6	44.5	44.1



## **Chapter 3. Regional Legislative Framework in the Sphere of Local Self-governance**

### **3.1. General Description of the Legal Framework**

The process of development of local self-governance in Russia has been evolving for more than 10 years. Over that time, in the subjects of the Russian Federation there was developed a substantial legislative framework in this sphere. In the monitored regions, this framework included from 17 (in the Novgorod and Kaluga oblasts) to 61 (the Tyumen oblast) regional laws. Although the initial conditions for formation of local self-governance had been equal in the whole territory of Russia, each region chose its model of development of this authority institution and, accordingly, focused its efforts on more detailed development of a legislative framework in the respective areas.

In the Novgorod oblast, there was chosen the district model of organization of local self-governance, which significantly simplified the regulation of territorial principles of local self-governance; issues relating to the distribution of property among municipal entities; issues concerning the establishment and transformation of municipal entities, etc. However, a flaw of this model was that local governments were rather remote from the population. In order to solve this problem and put local governments into closer contact with the population, the major legislative efforts in the oblast were aimed at the creation of a legal framework, in which local governments could function at the sub-municipal level. As a result, there was elaborated the regional law "On territorial community-based self-governance," which set up legal and organizational basis of this type of public self-governance.

In the Tver oblast, where there also was chosen the district model of organization of local self-governance, the respective legislation failed to pay sufficient attention to the regulation of issues relating to the organization of administration of territories at the level below districts. A rather detailed regulation of issues relating to the legal status and social guarantees of elected officials of local governments and deputies of representative bodies may be seen as a specific feature of the oblast legislation. There was also introduced the procedure governing the recall of elected officials.

In the Kaluga oblast, the regional legislation permitted to form municipal entities both at the level of districts and oblast towns, and at the level of settlements, rural councils, and volosts. In this region, legislators had paid special attention to the determination of territorial principles of local self-governance, establishment of methods permitting to learn about public opinion as concerned the issues of transformation of municipal entities, as well as determination of the frames of reference of local governments in municipal entities of different types.

In the Leningrad oblast, similarly to the Kaluga oblast, the legislation envisaged the option to organize municipal entities at the settlement level. However, this right had been exercised only in three settlements and one volost. At the same time, in the oblast there was widespread the practice of making towns into separate entities by withdrawing them from the composition of district municipalities. In the process, a serious attention was paid to the normative and legal regulation of the issues relating to the sharing of municipal property among municipalities in the cases where such municipalities coexisted in the same territory. In the oblast, there were also adopted separate laws concerning the delegation of certain state powers to local governments of different levels.

In the Tyumen oblast, two stages were observed as concerns the development of the organizational and legal framework of local self-governance. At the first stage (in 1994 through 2001), in the oblast there was formed the settlement based model of organization of local self-governance. In order to enable this model to function successfully, in the oblast there were adopted laws setting the borders of municipal entities; it was envisaged organization of consolidated municipal entities as a form of inter-municipal cooperation; there were set up procedures governing the establishment and reorganization of municipal entities. The fact of creation of the legal framework of establishment and functioning of consolidated municipal entities permitted to use the existing legislation to switch to the settlement based model of organization of local self-governance in the majority of the oblast's districts in 2002. The implementation of this reform also required Tyumen legislators to adopt a number of laws on the fixation of borders of new municipal entities and delegation of certain state powers to such entities.

In the Astrakhan oblast, there was envisaged the establishment of a two-tier system of local self-governance, where both settlements (rural

councils, settlements), and towns and districts. The legislation also set up the option of voluntary consolidation of rural councils in a single municipal entity at the district level.

Prior to the implementation of the reform, in all pilot regions *oblast charters and regional laws on local self-governance* had been the key laws, which had formed the legal framework of local self-governance. At the same time, the sets of norms determined by these laws in each individual region were different.

The Charter of the Novgorod oblast (approved by regional law No. 2-OZ of September 3, 1994, as amended on March 4, 1997) set up the guarantees of local self-governance and responsibilities of the regional state authorities with respect to assurance of necessary legal, organizational, material, and financial conditions for the establishment and development of local self-governance.

In the Leningrad oblast, the regional Charter (law of the Leningrad oblast No. 6-OZ of October 27, 1994) recognized and guaranteed the population's right of self-governance, stipulated that the procedures governing the establishment, transformation, and liquidation of municipal entities, the procedures of conduct of local self-governance, the issues in the competence of municipal entities, and the procedures governing delegation of certain state powers to local governments should be set up by regional laws. It was also stipulated that local governments should be outside the system of state authorities in the oblast.

The Charter of the Kaluga oblast (approved by Resolution of the Legislative Assembly No. 473 of March 27, 1996) included, alongside with the provisions mentioned above, the list of forms of local self-governance and the provision that local governments should be not included in the system of state authorities. Besides, the Charter set up a mandatory requirement that there should be representative bodies of local self-governance, as well as envisaged the option that municipal entities could introduce the office of the head of municipal entity and other elected officials of local governments.

The largest list of norms was set up by Charters of the Astrakhan, Tyumen, and Tver oblasts. For instance, the Charter of the Astrakhan oblast (approved on March 28, 1997) set up the list of territories, in the territories of which local self-governance could be exercised. Besides, the oblast Charter outlined financial, economic, and legal basis of local

self-governance, as well as legal guarantees of this institution of power. The Charter of the Tyumen oblast (approved by the Tyumen Oblast Duma on June 30, 1995) also determined the relations between the state authorities and local governments, as well as the procedures governing the settlement of disputes between them. The Charter of the Tver oblast (approved by Resolution of the oblast Legislative Assembly No. 436 of November 5, 1996) stipulated that local self-governance should be exercised across the whole territory of the oblast with the borders of municipal entities. The Charter determined that the issues pertaining to education, liquidation of municipal entities and transformation thereof, definition of issues of local importance, and delegation of certain state powers to municipal entities should be regulated by federal and regional laws. This law also contained the provisions concerning responsibilities of local governments and officials thereof, etc.

Regional laws "On local self-governance..." established general principles of organization of the system of local self-governance in the respective RF subjects, determined the legal, territorial, and economic principles of its functioning, regulated the rights, competence, and responsibilities of local governments. Some articles of these laws virtually cited the federal law "On general principles of organization of local self-governance in the RF." In particular it concerns the articles assigning to municipal entities the rights to create associations, unions, the articles containing the requirements regulating the structure of local governments, etc. However, all reviewed oblast laws on local self-governance contained also a number of unique articles. First of all, it concerns the articles setting the territorial organization of local self-governance, determining the issues of local importance, and powers of local governments. These stipulations will be more thoroughly analyzed in the next sections of this chapter.

*The problem of territorial organization of local self-governance* in all regions under observation was regulated by laws "On local self-governance..." In the Kaluga oblast, there was also introduced law No. 11-OZ of April 20, 1999, "On the procedures governing the establishment, consolidation, transformation, and liquidation of municipal entities in the Kaluga oblast; designation and re-designation of the boundaries and names thereof." This law set up the procedures governing the transformation of municipal entities and changes in their

borders, as well as determined the powers vested in the state authorities and local governments in the framework of this process.

In the Tyumen oblast, there was in force regional law No. 50 of October 28, 1996, "On the approval of borders and composition of territories of municipal entities in the Tyumen oblast." In accordance with the first version of this law, in the oblast there were delimited borders of 301 municipal entities. In relation to the establishment of consolidated municipal entities in the region, which took place in 2001, the law was significantly amended and concerned only the determination of borders of settlement municipalities of the Tyumen district and three towns. The borders and composition of the territories of districts were set up by the laws on the establishment of respective municipal entities.

The issues relating to the territorial organization of local self-governance in the Astrakhan, Tver, and Tyumen oblasts had been also regulated by the laws on the administrative and territorial structure<sup>17</sup>. These laws fixed not only the administrative and territorial structure of oblasts, but also set up the procedures governing the establishment and reorganization of their territorial and administrative units. The same laws determined the procedures of establishment, transformation, and liquidation of municipal entities, regulated the process of delimitation of boundaries between municipalities. It should be noted that these laws had primarily focused on the changes in the administrative and territorial structure of oblasts, while the provisions of these laws concerning the establishment, transformation, and liquidation were not sufficiently elaborated. In this relation, for instance, in the Astrakhan oblast there had been prepared the regional law "On the establishment, transformation, and liquidation of municipal entities"; however, this draft law was not approved.

Certain provisions, similar to those described above, were included in the Leningrad oblast law No. 9-OZ of April 17, 1996, "On the administrative and territorial structure of the Leningrad oblast." At the same time, this law introduced the term "territorial entity," which encom-

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<sup>17</sup> Law of the Tyumen oblast No. 53 of November 4, 1996, "On the administrative and territorial structure of the Tyumen oblast," law of the Astrakhan oblast No. 18 of September 18, 1996, "On the administrative and territorial structure of the Astrakhan oblast," law of the Tver oblast No. 62-OZ 2 of May 27, 1999, "On the administrative and territorial structure of the Tver oblast."

passed the notions of administrative-territorial and municipal entities. The law defined administrative and territorial entities as the territories, where state powers were exercised by territorial state authorities of the Leningrad oblast. The law stipulated that “municipal entities are urban and rural settlements, several settlements within the same territory, a part of the settlement, or other populated territories as defined by the federal law “On general principles of organization of local self-governance in the RF,” where there is exercised local self-governance, exist municipal property, municipal budget, and representative bodies of local self-governance.” The law permitted the identity of boundaries of administrative-territorial and municipal entities.

Alongside with the regional Charters and laws “On local self-governance...” *the problems of organization of administration of municipal entities* were regulated by the laws “On municipal service...,” which determined the legal statuses of municipal officials in the regions, and set up the procedures governing the organization and performance of municipal service in all monitored oblasts. Law of the Tyumen oblast No. 69 February 5, 1997, “On the principles of municipal service in the Tyumen oblast” had also approved the register of municipal offices and determined the terms of remuneration of labor of officials of local governments. In the Novgorod, Kaluga, Leningrad, and Tver oblasts, these issues were regulated by separate regulatory acts:

- Law of the Kaluga oblast No. 50 OZ of December 31, 1999, “On the single register of municipal offices and the terms of remuneration of labor of officials of local governments of the Kaluga oblast”;
- Laws of the Novgorod oblast of February 10, 1998, “On the register of municipal offices in the Novgorod oblast” and of December 25, 2000, “On salaries of officials of the state authorities and local governments of the Novgorod oblast”;
- Laws of the Leningrad oblast No. 27-OZ of July 29, 1998, “On the register of municipal offices of the Leningrad oblast” and No. 30 oz of September 18, 1995, “On the register of offices of municipal officials in Leningrad oblast”;
- Law of the Tver oblast No. 28-OZ-2 of July 30, 1998, “On the register of municipal offices of the municipal service in the Tver oblast.”

In the regions under observation, there were also adopted separate laws establishing the procedures governing the calculation of the length of municipal service<sup>18</sup>.

In the Astrakhan oblast, the single register of municipal offices was approved by law No. 28 of August 15, 1997, "On municipal service in the Astrakhan oblast", while the classification of municipal offices of municipal service, i.e. the division of such offices in groups (supreme, chief, leading, senior, junior) was regulated by oblast law No. 8/99-OZ of February 5, 1999, "On classification of municipal offices of municipal service of the Astrakhan oblast." The same law set up the classification of municipal offices of municipal service depending on the size of the population in respective municipal entities. At the same time, the same offices of municipal service were placed in different groups in municipalities of different levels. For instance, the offices of the deputy heads of municipal entities

- In the city of Astrakhan were defined as the supreme offices of municipal service;
- In districts and other towns of the oblast they were defined as chief offices;
- In municipal entities, where the size of the population made from 6000 to 20000 residents, the same offices were defined as leading posts;
- In municipal entities, where the population was below 6000 residents, these offices were defined as posts of the senior group.

The law "On municipal service in the Astrakhan oblast" also regulated the salaries of municipal officials, for instance, there was set up the caps on the salaries paid to the heads of municipal entities (in terms of the minimum amount of pay (MAP)) for municipalities with different

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<sup>18</sup> Law of the Novgorod oblast No. 11-OZ of February 10, 1998, "On calculation of the length of state service of regional public officials and the length of municipal service of municipal officials in the Novgorod oblast"; law of the Kaluga oblast No. 44-OZ of September 29, 2000, "On the length of state and municipal service in the Kaluga oblast"; law of the Tyumen oblast No. 92 of March 22, 1999, "On the length of municipal service in the Tyumen oblast"; law of the Leningrad oblast No. 18-OZ of June 6, 2002, "On the procedures governing the calculation and determination of the length of state and municipal service."

sizes of the population<sup>19</sup>. As concerned other offices of the municipal service, the salaries were set up in per cent of the salary of the head of the municipal entity. In 2004, there was issued the Resolution of the oblast Governor “On the regulation of the remuneration of labor of municipal officials of the Astrakhan oblast” (No. 754-r of August 13, 2004), which determined the recommended amounts of salaries for all offices of municipal service in municipal entities with different sizes of population. The salaries were set up in per cent of the salary paid to the head of the municipal entity in terms of MAPs. The same Resolution had determined the size of the MAP to be used for the calculation of salaries (Rub. 600).

The length of municipal service of a municipal official in the Astrakhan oblast was defined as equal to the length of service of a state official and was calculated in accordance with the procedure and on term set up by regional law No. 32 of November 10, 1996, “On the municipal service of the Astrakhan oblast.”

In the Kaluga, Astrakhan, Leningrad, and Tver oblasts, the laws “On municipal service...” did not cover deputies of representative bodies of local self-governance, elected officials, and members of other elected bodies of local governments. The legal basis of the status of such persons were set up by the following laws:

- Law of the Kaluga oblast No. 28 OZ of November 30, 1998, “On the status of elected officials of local governments in the Kaluga oblast”;
- Law of the Astrakhan oblast No. 29 of August 15, 1997, “On the status of deputies of representative bodies of local self-governance of the Astrakhan oblast”;
- Law of the Leningrad oblast No. 59 oz of December 22, 1997, “On the status of deputies, members of representative bodies of local self-governance, elected officials of local self-governance of the Leningrad oblast”;
- Laws of the Tver oblast No. 49 of January 30, 1997, “On the status of deputies of representative bodies of local self-governance in the Tver oblast” and No. 54 of February 27, 1997, “On the specifics of

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<sup>19</sup> Since in small municipal entities this approach had not always been adequate to the financial possibilities of municipalities, in different municipal entities there had been used different (i.e. set at different times) levels of MAP: from Rub. 300 to Rub. 600.



the legal status of and social guarantees for persons holding municipal offices of municipal entities of the Tver oblast (municipal offices of “A” category).”

Law of the Kaluga oblast No. 12 of June 25, 1995, “On the regulatory and legal acts of state authorities and local governments of the Kaluga oblast” fixed the system and status of regulatory and legal acts approved by state authorities and law-making bodies of local governments of the Kaluga oblast, the procedures governing the elaboration, approval, enactment, and abolishment of such acts.

In contradistinction to other four regions, in the Tver and Tyumen oblasts the procedures governing the recall of elected officials of local self-governance was fixed legislatively. Laws of these regions<sup>20</sup> set up the procedures governing the initiation, elaboration and conduct of this action for municipal entities. The same laws determined the sources of financing of the recall actions. Similarly to the law mentioned above, the law “On the procedures governing the exercise of the right of legislative initiative of the representative bodies of local self-governance in the Tyumen Oblast Duma” had no analogs in the legislations of the Novgorod and Kaluga oblasts. In accordance with this law, representative bodies of local self-governance had the right of legislative initiative in the oblast Duma with respect to all issues under the jurisdiction of the Tyumen oblast and those under the joint jurisdiction of the Russian Federation and the Tyumen oblast within the scope of competence of the Tyumen oblast. Similar laws were adopted in the Astrakhan and Leningrad oblasts<sup>21</sup>.

As a rule, alongside with the laws “On local self-governance...,” *the issue of delegation of state powers to local governments* had been regulated by special laws. The only exceptions were the Astrakhan and Tver oblasts, where the regulatory documents determining the proce-

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<sup>20</sup> Law of the Tyumen oblast No. 93 of March 22, 1999, “On the procedures governing the recall of elected officials of local governments in the Tyumen oblast,” law of the Tver oblast No. 78 of September 17, 1997, “On the procedures governing the recall of deputies, heads of municipal entities, and other elected officials of local governments.”

<sup>21</sup> Law of the Astrakhan oblast No. 3 of March 18, 1996, “On the procedures governing the exercise of the right of legislative initiative in the oblast representative assembly by local governments of the Astrakhan oblast”; law of the Leningrad oblast No. 38-OZ of December 1, 1995, “On the procedures governing the exercise of the right of legislative initiative by local governments in the Leningrad oblast.”

dures governing the delegation of state powers to local governments had not been approved. However, in the legislative framework of the Tver oblast there were laws delegating certain state powers to the municipal level. No such documents were found in the legislation of the Astrakhan oblast.

In the Kaluga, Novgorod, and Leningrad oblasts, laws “On the procedures governing the delegation of certain state powers to local governments”<sup>22</sup> determined the principles of delegation of state powers to local governments, the procedures governing the elaboration of respective laws and requirements thereto, as well as the guarantees of material and financial basis of delegated powers (the respective financial resources should be annually earmarked in the oblast budget).

In the Kaluga oblast, there was also adopted the law “On the delegation of certain state powers to local governments,” which contained the full list of the state powers delegated to the municipal level. In the Novgorod oblast, the state powers concerning the determination of additional privileges related to the payment of the stamp tax with respect to certain payers, licensing of retail trade with alcoholic beverages, and a number of other powers were delegated to local governments by separate laws. In the Tyumen oblast, there was introduced law No. 101 of July 25, 1997, “On the principles of division of powers concerning the issues under the joint jurisdiction of the oblast state authorities and municipal entities, and the procedures governing the delegation of certain state powers to local governments”<sup>23</sup>. Besides, in the process of establishment of consolidated municipal entities of the district type in 2002 there was adopted a number of laws assigning to each district the list of delegated state powers, set up the responsibilities borne by the state

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<sup>22</sup> Law of the Leningrad oblast No. 17-OZ of June 23, 1997, “On the procedures governing the delegation of certain powers vested in the Leningrad oblast to local governments, on the terms and procedures governing the exercise of control over the implementation thereof”; law of the Kaluga oblast No. 235-OZ of July 3, 2003, “On the procedures governing the delegation of certain state powers to local governments of the Kaluga oblast”; law of the Novgorod oblast No. 108-OZ of February 7, 2000, “On the procedures governing the delegation of certain state powers vested in the Novgorod oblast to local governments.”

<sup>23</sup> At present, this law is in force only as concerns the stipulations regulating the procedures of delegation of state powers to municipal entities, since the stipulations of the law concerning the regulation of issues being under the joint jurisdiction of state authorities and municipal entities were suspended by oblast law No. 8 of February 27, 1998.

authorities and local self-governance, the control procedures pertaining to the exercise of these powers, and responsibility for infringement on these laws. In the oblast, there were also in force the laws concerning the delegation of certain state powers in the sphere of the use of forests and notary functions.

In the Leningrad oblast, there was in force law No. 12-OZ of June 3, 1998, "On the procedures governing the transfer of material resources necessary for the exercise of certain powers vested in the Leningrad oblast to local governments," which established the forms and procedures of transfer of material resources to local governments and set up control mechanisms pertaining to the exercise of such powers and responsibility for infringement on the procedures governing the use thereof. Besides, there was adopted a number of laws concerning the delegation of certain state powers to municipal entities of the oblast.

*Forms of direct expression of the citizens' will*

In accordance with the regional Charters, one of the forms of the implementation of local self-governance was the *local referendum*. The key principles determining the conduct of local referendums were set up by the law "On local self-governance..." The process, in the framework of which local referendums should be held, from the stage of preparation thereto to the stage of establishment of the vote results was regulated by special laws in the Astrakhan, Kaluga, Leningrad, Tver, and Tyumen oblast:

- Law of the Kaluga oblast No. 42 of August 27, 1996, "On the local referendum in the Kaluga oblast";
- Law of the Tyumen oblast No. 298 of March 16, 2001, "On the local referendum in the Tyumen oblast";
- Law of the Astrakhan oblast No. 26/2003 OZ of July 8, 2003, "On the local referendum"<sup>24</sup>;
- Law of the Leningrad oblast No. 31 oz of May 24, 2001, "On the local referendum in the Leningrad oblast";
- Law of the Tver oblast No. 2 of September 22, 1994, "On local referendums in the Tver oblast."

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<sup>24</sup> Prior to 2003, in the Astrakhan oblast there was in force law No. 16/2000-OZ of April 7, 2000, "On local referendums in the Astrakhan oblast".

Prior to 2001, a similar law had been in force in the Novgorod oblast; however, it was abolished because of the adoption of oblast law No. 183-OZ of April 6, 2001, "On the abolishment of the oblast law 'On the local referendum.'"

In the Kaluga oblast, there was used yet another form of revealing of the public opinion concerning the issues of local importance – the consultative poll. The procedures governing the preparation, conduct, and establishment of the results of the polls were set up by oblast law No. 18-OZ of May 24, 1999, "On the consultative poll of citizens in municipal entities of the Kaluga oblast."

In the Astrakhan, Leningrad, and Tver oblast, there were adopted special laws<sup>25</sup> setting up the competence of the meetings (gatherings) of citizens, the procedures governing the convocation and holding thereof, as well as the adoption and amendment of the decisions taken by such meetings.

*The mechanisms of preparation and holding of elections of the bodies and officials of local self-governance* were different in each oblast. In the Tyumen oblast, there was adopted Election Code (law) of the Tyumen oblast No. 140 of November 5, 1999, which regulated the issues pertaining to the preparation and holding of not only municipal elections, but the elections of state authorities as well. In the Kaluga oblast, there was in force law No. 43-OZ of December 17, 1999, "On municipal elections in the Kaluga oblast." The same law stipulated that the procedures governing the formation of other bodies of local self-governance, as well as the procedures of elections of the heads of municipal entities elected by representative bodies of local self-governance should be regulated by Charters of municipal entities. The procedures governing the holding of elections of all elected officials of municipal entities and deputies of local councils in the Leningrad oblast were regulated by law No. 28-OZ of August 24, 2000, "On the elections of deputies of representative bodies of local self-governance and offi-

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<sup>25</sup> Law of the Astrakhan oblast No. 47/99-OZ of December 15, 1999, "On meetings of citizens in municipal entities of the Astrakhan oblast"; law of the Leningrad oblast No. 27 oz of July 20, 2000, "On meetings of citizens in municipal entities of the Leningrad oblast"; the law of the Tver oblast of February 27, 1997, "On meetings of citizens in municipal entities of the Tver oblast."

cials of local self-governance in the Leningrad oblast.” A similar law was adopted in the Tver oblast<sup>26</sup>.

In 2003, in the Astrakhan oblast there was adopted new law “On the elections of deputies of representative bodies of local self-governance and heads of municipal entities in the Astrakhan oblast (No. 23/2003-OZ of June 24, 2003). In contradistinction to the law on elections to bodies of local self-governance of 2000<sup>27</sup>, this law did not grant to local governments the right to independently set up procedures relating elections in the respective municipal entities. The law stipulated that the documents forming the legislative framework of municipal elections should include also the legal and regulatory acts adopted at the federal and regional levels. Besides, this law in detail determined the procedures governing the participation of different actors in the election process, including election blocs and election associations.

In the past few years, in the Novgorod oblast there was in force law No. 63-OZ of July 11, 1996, “On the elections of heads of local governments.” The law “On the elections of deputies of representative bodies of local self-governance...”, which had been in force prior to the adoption of the new law, was abolished in 2003 in connection to the adoption of oblast law No. 100-OZ of January 31, 2003, “On the abolishment of oblast laws.”

The legal frameworks of all monitored regions included documents establishing the procedures governing the *registration of municipal charters*. The documents regulating this issue in the RF subjects under observation significantly differed in terms of their structures and the number of provisions they contained. The broadest scope of issues relating to the registration of municipal charters was regulated by law of the Tyumen oblast No. 86 of December 15, 1999, “On the procedures governing the state registration of charters of municipal entities in the Tyumen oblast.” This law, alongside with the requirements to the content of municipal charters, contained the list of documents necessary for the registration of charters, the procedures governing the submis-

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<sup>26</sup> Law of the Tver oblast No. 103-OZ 2 of May 30, 2000, “On the election of the deputies of representative bodies, heads of municipal entities, and other elected officials of local governments.”

<sup>27</sup> Law of the Astrakhan oblast No. 27/2000-OZ of June 29, 2000, “On the election of the deputies of representative bodies and officials of local governments in the Astrakhan oblast.”

sion of such documents to and examination thereof by the registering authority, the basis for refusal to register charters, the procedures governing the registration of amendments to charters, and a number of other provisions.

In the Kaluga oblast, municipal charters were registered in accordance with the Regulations approved by the Resolution of the oblast Governor. However, no legal act regulating this issue had not been adopted in the region. The Regulations determined the responsibilities of the registering authority (the oblast Administration) with respect to registration of Charters, and determined in detail all stages of the registration process indicating the terms of examination of the respective documents, the list of regulatory acts approved by the registering authority, etc. The requirements pertaining to the contents of municipal charters in the Kaluga oblast were set up by the law "On local self-governance..."

Law of the Astrakhan oblast No. 6 of April 17, 1996, "On the procedures governing the state registration of charters of municipal entities in the Astrakhan oblast" contained both the requirements to the charters of municipal entities, and the procedures governing the submission of documents for registration, the registration procedures, and a number of other provisions. However, all procedures contained in this law were elaborated much less thoroughly than, for instance, in the law of the Tyumen oblast. Thus, as concerned the procedure governing the refusal to accept the registration application, the law of the Astrakhan oblast stipulated the following: "The Administration of the Astrakhan oblast should have the right to reject without consideration the charters of municipal entities submitted in a way infringing upon the respective requirements and procedures set up by this law" (item 1, article 5). At the same time, the law of the Tyumen oblast contained clear stipulations concerning all relevant procedures (the requirement to make the marks indicating the refusal to consider charters in the documents control register, the procedures governing the signing and forwarding of notifications concerning the refusals to consider registration applications). In terms of the degree of comprehensiveness of key stipulations, the law of the Astrakhan oblast was similar to law of the Tver oblast No. 12-OZ of February 18, 2003, "On the procedures governing the state registration of charters of municipal entities of the Tver oblast."

In accordance with law of the Novgorod oblast No. 33-OZ of February 2, 1996, the procedures governing the registration of municipal charters were stipulated rather laconically. The law focused on the requirements to the charters, while the list of these requirements was practically identical to the respective list approved by the federal and regional laws “On local self-governance...” Law of the Leningrad oblast No. 39-OZ of December 1, 1995, “On the procedures governing the registration of charters of municipal entities in the Leningrad oblast” had practically duplicated these provisions.

*Issues of organization of the territorial community-based self-governance* were regulated by the laws “On local self-governance...” In the Novgorod oblast, there was also adopted law No. 36-OZ of September 30, 1998, “On the territorial community-based self-governance in the Novgorod oblast.” This law set up the general principles and organizational forms of the territorial community-based self-governance in the Novgorod oblast and the guarantees of the exercise thereof, determined the place and role of the territorial community-based self-governance in the organizational structure of local self-governance, set basic rights and responsibilities of the population as concerned the exercise of the territorial community-based self-governance. A similar law was adopted in the Leningrad oblast<sup>28</sup>.

### **3.2. Territorial Organization of Local Self-governance**

The issue of the territorial organization of local self-governance had been among the most complicated among the municipal problems. The RF Constitution stated that local self-governance should be exercised in the town and rural settlements, as well as in other territories, while any territorial changes with respect to municipal entities should take into account the opinion of the respective population. The federal law “On general principles of organization of local self-governance in the RF” of 1995 also stipulated that the procedures governing the establishment, consolidation, transformation, or liquidation of municipal entities, as well as the definition or alteration of their boundaries should be set up by laws of RF subjects.

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<sup>28</sup> Law of the Leningrad oblast No. 17-OZ of July 12, 2000, “On the territorial community-based self-governance in the Leningrad oblast.”

In accordance with the requirements set up by the RF Constitution and federal legislation, RF subjects had adopted the laws regulating the territorial organization of self-governance; however, each region under observation had settled this problem in its own way.

### ***Novgorod Oblast***

Article 13 of the oblast law “On local self-governance in the Novgorod oblast” set up the exhaustive list of types of administrative and territorial entities, within the borders of which there could function local governments. Such entities included:

- The territory of the city of Novgorod the Great within the city limits, as well as the territories of workers’ settlements administratively related to the city;
- Territories situated within the boundaries of a single administrative and territorial entity (an urban settlement with the adjacent subordinated district);
- Territories situated within the boundaries of administrative districts.

At the same time, item 2 of the same article stipulated that “the population of urban and rural settlements, notwithstanding its size, can not be deprived of the right to exercise local self-governance.” However, the law has failed to answer the question about the way this right might be enjoyed in the situation, where it was permitted to form municipalities only at the level of administrative districts.

It should be noted that the first versions of the Novgorod law “On local self-governance...” contained the article determining the ways of division of powers vested in municipal entities, municipal property, sources of revenues of local budgets in the cases, where (with the exception of the city of Novgorod) other municipal entities existed in the territory of a municipal entity. This article was excluded from the last version of the law; as a result even a theoretical possibility of the existence of one municipal entity in the territory of another municipal entity was excluded.

As concerned the definition and alteration of the borders of municipal entities, article 13 of the oblast law “On local self-governance...” literally duplicated the provisions set up in the federal legislation (the law of 1995 “On general principles...”). The only difference seemed to be the fact that regional legislators had determined the forms of detection of public opinion. These forms included voting or public opinion



polls held among the citizens of the Russian Federation being the habitual or long-term residents of the municipal entity and vested in the electoral rights. The procedures governing organization and conduct of polls / voting should have been regulated by a separate regulatory legal act of the oblast Duma. However, no such acts had been elaborated and adopted in the oblast.

### ***Tver Oblast***

The Tver oblast law “On local self-governance...” practically failed as concerned the regulation of the issues of territorial organization of this institution. Article 3 of the law defined that the territories of municipal entities in the Tver oblast, where local governance could be exercised, were:

- Territories situated within the boundaries of urban settlements;
- Territories situated within the boundaries of districts as per the current administrative and territorial structure;
- Other populated territories.

At the same time, the law did not contain any provisions defining the types of municipal entities, which could be established in the territory of the oblast, and failed to directly answer the question about the possibility to establish a municipal entity in the territory of another municipal entity. However, the provisions of article 15 of the law, which regulated the issues of consolidation of municipalities and withdrawal of territories from the municipal entities with the purpose to establish a new municipality at the settlement level, might be viewed as the confirmation of the fact that an option to establish settlement municipalities in the territories of districts existed. Nevertheless, in this case the law failed to regulate the issues of division of powers vested in municipalities of different levels, as well as sharing of property, material and financial resources. In practice, no municipalities of the settlement level had been formed in the territory of the oblast.

### ***Kaluga Oblast***

In the Kaluga oblast, there was created the legislative framework of formation of municipal entities of different types. The law “On local self-governance in the Kaluga oblast” permitted to form municipalities both at the level of administrative districts and at the level of settlements. At the same time, the law defined the following territories, where local governance could be exercised:

- districts,
- towns,
- settlements,
- volosts<sup>29</sup> and rural councils.

Alongside with district and settlement municipal entities, in the oblast there was permitted to establish single municipal entities of the “town and district” type in the case only one urban settlement was situated within the borders of a district.

Besides, the oblast legislation permitted voluntary consolidation of municipal entities for the purposes of establishment of a new municipal entity. The mandatory requirements for consolidation of municipal entities were the common border and situation in the territory of the Kaluga oblast. The oblast law “On the procedures governing the establishment, consolidation, transformation, and liquidation of municipal entities” set up the respective procedures.

While legislatively setting up the option of existence of one municipality in the territory of another municipal entity, the law “On local self-governance...” also regulated the methods concerning the definition of territories of municipal entities. In accordance with this law, the territories of volosts and rural councils were defined as the sum of populated localities not constituting independent municipal entities. All lands in actual use of settlements and towns, as well as the reserve lands, which were situated in their territories, with the exception of lands situated in the territories of other municipal entities, constituted the territories of these settlements and towns.

In order to regulate the process of establishment and reorganization of municipal entities in the territory of the oblast, the Legislative Assembly adopted the law “On the procedures governing the establishment, consolidation, transformation, and liquidation of municipal entities in the Kaluga oblast, delimitation and re-delimitation of their boundaries.” In accordance with this law, the establishment or reorganization of municipalities should:

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<sup>29</sup> Volost was defined as a territorial amalgamation of rural settlements, rural councils, and other populated territories having common borders or common interests, including the utility sector infrastructure, pasture lands, watering places, arable lands, etc., where the total size of the population is at or above 2000 residents (the oblast law “On local self-governance...” article 3).

- ensure the territorial integrity of the Kaluga oblast;
- observe the rights of the population to exercise local self-governance, i.e. in the case of reorganization of municipal entities local self-governance in any populated territory of the oblast could not be liquidated;
- take into account the fact if there existed financial and economic situation permitting to exercise the powers of local self-governance;
- combine and guarantee the interests of both local governments, and state authorities;
- base on the choice of optimal territories permitting efficiently carry out functions of local self-governance and exercise delegated state powers;
- base on the primacy of the people's will and take into account the historical and other local traditions, as well as the economic, production, and social relations existing in the respective territory.

Residents of the respective territory, local governments, or state authorities might be the initiators of the establishment, reorganization, alteration of borders or names of municipal entities. Public opinion was taken into account via meetings (conferences) of citizens or consultative polls. The conduct of consultative polls or meetings (conferences) of citizens was mandatory, however, the obtained results, while being nonbinding, should be taken into account in the process of adoption of respective regulatory and legal acts on the part of state authorities.

One of the provisions of the law "On the procedures governing the establishment..." restricted the possibility to alter borders and establish consolidated municipal entities. In accordance with article 8 of the law, any alteration of the borders of territories, in which local self-governance was exercised, could be carried out only within the borders of the territorial and administrative structure of the Kaluga oblast. "Establishment, consolidation, transformation, and liquidation of municipal entities involving territories outside the borders of districts (with the exception of districts in towns) and towns constituting administrative and territorial units should be carried out only after the alteration of the administrative and territorial structure of the Kaluga oblast."

In other words, settlement municipalities could be established, consolidated, or transformed only in the case the whole new municipality

was situated within the territory of an administrative district. This provision was adopted primarily due to the fact that some issues of local importance, for instance, establishment and development of institution providing complete (secondary) education and exercise of state powers in the territories of settlement municipalities was in the competence of district local governments. Therefore, in the case a municipal entity were situated in the territories of two districts, it could present problems concerning the exercise of these powers in the territory of such a municipality. Besides, this article of the law prohibited consolidation of district municipalities without making respective alterations in the administrative and territorial structure of the oblast. Article 9 of the law “On local self-governance...” also stipulated that it was prohibited to establish new municipal entities with participation of not adjacent municipal entities or in the cases where participating municipal entities were situated outside the territory of the oblast.

### ***Tyumen Oblast***

In the Tyumen oblast, in accordance with article 15 of the law “On local self-governance...” territories of municipal entities were defined as:

- territories of towns, settlements, villages, rural councils, rural settlements;
- territories of other municipal entities set by the oblast state authorities with the view to take into account the ways of life, forms of economic activities, historical and national specifics of the population;
- consolidated territories of several municipal entities in the cases of the voluntary consolidation of two or more municipal entities into a single unit;
- territories of intra-town municipal entities in the cases the representative bodies of local self-governance took the respective decisions.

Therefore, the regional legislation defined such localities as towns, settlements, rural councils, and rural settlements as the basic territorial units, within the borders of which there was exercised local self-governance. The law “On local self-governance...” also envisaged the establishment of consolidated municipal entities on the basis of voluntary consolidation of settlement municipalities. Population should independently take decisions concerning the consolidation of municipal entities, while the respective procedures were set up by the regional law “On the administrative and territorial structure of the Tyumen oblast.” At

the same time, the settlement municipal entities could not only consolidate in a single municipal entity, but also withdraw from the composition of such an entity forming an independent municipality. The withdrawal from the composition of a consolidated municipality was permitted only after the end of a financial year, while the delimitation of the territory of the newly established municipal entity, assignment of property to such an entity, and determination of the sources of financing was carried out on the basis of an agreement between the existing and newly established municipal entities.

Yet another specific feature of the regional legislation on local self-governance in the Tyumen oblast was that it included an open list of approved types of municipal entities. Alongside with the municipalities of the settlement type and consolidated municipal entities, the law "On local self-governance" permitted to introduce other types of municipal entities in the cases, where it was needed due to the historical, cultural, and ethnic specifics of the population. New types of municipal entities should be introduced via regional laws.

As concerned the territories of municipal entities, in accordance with the oblast legislation it should include all lands situated within the borders of such an entity notwithstanding the forms of ownership and purposes of use of such lands. The transfer of land in the jurisdiction of municipal entities should be based on the standard size of necessary land resources and planning documents setting mandatory zoning of general use lands, recreation zones, and the lands necessary for future development. The borders and composition of territories of all municipal entities in the oblast were determined by laws. The law "On the approval of borders and composition of territories of municipal entities of the Tyumen oblast" set up the borders and the composition of territories of the city of Tyumen, towns of Ishim, Tobolks, and municipal entities of the settlement type in the Tyumen district. The borders of each municipal entity (district) had been approved by a separate law.

The procedures governing the alteration of the borders of municipal entities, as well as the powers vested in the state authorities and the list of documents necessary for the consideration of the issue by the oblast Duma were set by the law "On the administrative and territorial structure of the Tyumen oblast." The public opinion on the issue was taken into account via organization of local referendums.

### ***Astrakhan Oblast***

Prior to 2003, in the Astrakhan oblast there had been in force article 14 of the law “On local self-governance,” which stipulated that the following types of municipal entities could exist in the Astrakhan oblast:

- towns;
- districts;
- rural councils (rural okrugs);
- urban-type settlements (workers’ settlements);
- villages, other types of settlements;
- closed administrative and territorial entities.

The same article envisaged that residents of several villages and settlements of the oblast having the common border and being constituents of one administrative and territorial entity should have the right to consolidate and create single local governments having the status of subjects of local self-governance. The initiative of such consolidation should be vested in the population and expressed by a resolution of a local referendum (meeting). Due to the fact that in 2003 there was adopted a new federal law on local self-governance, this article was abolished. The law “On local self-governance...” also contained provisions setting up the specifics of organization of local self-governance in individual municipal entities. For instance, the law (article 15) stipulated that the right of the city authorities to organize intra-city municipal entities and administrative districts should be indicated in the Charter of the city of Astrakhan. However, no decisions concerning the establishment of intra-city municipal entities had been adopted.

It was envisaged that in districts there could be set up both one-tier and two-tier system of local self-governance. Single municipal entities at the district level could be established in the case all rural councils and other settlements situated in the respective territory took the decision about the voluntary consolidation. In such a situation, structural units of the district administration should be created at the level of settlements. In the case the decisions about voluntary consolidation were not taken, in districts there should be organized municipal entities both at the district level and the level of settlements.

### ***Leningrad Oblast***

Article 14 of the regional law “On local self-governance...” stipulated that the territories of municipal entities should be defined as the territo-

ries situated within the borders of towns, settlements, villages, and other types of settlements; volosts<sup>30</sup> and districts. At the same time, the law envisaged that local self-governance should be exercised in the territory of a district either in the case of voluntary consolidation of all settlements and volosts situated in its territory into one single municipal entity, or in the case in the territory of the district certain powers relating to issues of local importance were exercised by newly established local government of the district. Thus, similarly to the Astrakhan and Kaluga oblasts, in the Leningrad oblast it was permitted the establishment of both one-tier (district or settlement based) and two-tier models of local self-governance. However, it should be noted that in all three oblasts there were observed different mechanisms of formation of the system of local self-governance. In the Astrakhan oblast, the decision about the establishment of the two-tier system was taken at the superior level, i.e. by the state authorities of the oblast. At the same time, in the Kaluga and Leningrad oblast municipalities of the settlement level could be granted the status of municipal entities only on their own initiative.

At the same time, according to the law “On the administrative and territorial structure...” the settlement-based system of local self-governance took precedence. Article 6 of the law stipulated that municipal entities in the Leningrad oblast should be defined as urban and rural settlements, volosts, which had adopted Charters of municipal entities. Districts and administrative okrugs in the composition of districts were defined as administrative and territorial entities, within the borders of which state administration was carried out by territorial bodies of state administration (district administrations). In the case of consolidation of settlements situated within the borders of a district into a single municipal entity, instead of establishing territorial bodies of state administration the respective powers could be vested in the local government of the district. However, in spite of the fact that the legislation of the Leningrad oblast had been elaborated basing on the settlement model of local self-governance, in practice in the region there had formed the district based model with certain localities (both towns and settlements) being independent municipalities.

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<sup>30</sup> In the Leningrad oblast, former rural councils were redefined as volosts.

### **3.3. Scope of Competence of Local Self-governance**

In accordance with the federal legislation, issues of local importance and certain state powers, which might be delegated to local governments, should be in competence of municipal entities.

#### ***Issues of local importance***

The law “On general principles of organization of local self-governance in the RF” adopted in 1995 defined 30 issues of local importance. At the same time, the list of powers vested in municipal entities remained open. Municipal entities could also deal with other problems defined by laws of RF subjects as issues of local importance, as well as the issues not excluded from their competence and not defined as being in the competence of other municipal entities and state authorities.

The lists of issues of local importance as approved by laws of the ***Novgorod and Leningrad oblasts*** were absolutely similar to the list approved by the federal law. At the same time, similarly to the federal law, the regional laws left these lists open.

In the ***Tver oblast***, the list of issues of local importance was somewhat expanded in comparison with the federal legislation. Alongside with organization and maintenance of municipal archives, the scope of competence of local governments also included the preservation of archives; however, the law had failed to define the respective archives, so it remained unclear if this provision referred only to municipal archives, or both municipal and state archives. Among the issues of local importance, alongside with control over the use of land, there was also listed the control over the land protection issues. The further expansion of this list of issues of local importance was possible only in the case such an expansion was stipulated by regional laws. The Tver oblast legislation did not envisage that municipalities could assume additional powers on their own initiative.

In the ***Tyumen oblast***, alongside with the problems defined as the issues of local importance by the federal law, the scope of competence of municipal entities included the creation of conditions permitting to protect the population from emergencies and the functions pertaining to the sphere of labor relations, employment, and migration at the local level. Similarly to the federal law, the oblast law also envisaged that municipal entities should have the right to assume the power to deal with



other issues not necessarily defined as the issues of local importance by the regional legislation, with the exception of the issues directly under the jurisdiction of state authorities or other municipalities.

The list of issues of local importance approved by the authorities of the **Kaluga oblast** also differed from the list set by the federal legislation. In the Kaluga oblast, such issues as elaboration and approval of municipal charters; ownership, use, and management of municipal property; municipal financial issues and social and economic development of municipal entities were excluded from the list of local issues. At the same time, the same law determining the powers vested in municipal entities of different types defined these problems as the issues of local importance. From the list of issues defined by the Kaluga oblast legislation as issues of local importance there were also excluded the creation of conditions facilitating the carrying out of housing, social, and cultural construction projects, as well as control over the use of lands situated in the territories of municipal entities. More accurately, the latter issue was included in the composition of state powers delegated to municipalities by the same law. However, in this case it concerned only farm lands. In addition to the federal list, the list of issues of local importance included such issues as reporting and control with respect to residential housing, organization of training and further training of municipal employees, organization of legal services rendered to the population, and creation of conditions facilitating the activities of lawyers and notaries.

It should be noted that in the Kaluga oblast the scope of competence varied across municipalities of different types. Certain state powers were vested only in the municipal entities – districts and oblast cities of Kaluga and Obninsk. The list of issues of local importance settled by these municipalities was also somewhat broader than the respective list of settlement-type municipalities. For instance, these municipalities were vested with the struggle against high prices and establishment of municipal wholesale trade organizations.

In the Astrakhan oblast, in addition to the issues of local importance as defined by the federal law, the municipal level was vested with participation in the labor protection and observance of working conditions in the territories of municipal entities; protection of the rights of consumers; and organization of work with young people and teenagers.

The regional law did not stipulate any division of the issues of local importance between the municipalities of different levels.

The above analysis of the regional legislation revealed that in the majority of regions the powers delegated to the municipal level somewhat differed from those set up by the federal legislation. At the same time, in some cases in the lists of issues of local importance there were included state powers (for instance, the creation of conditions ensuring the activities of lawyers and notaries, issues of labor protection and working conditions). In other cases, the responsibilities of local governments included the regulation of such issues, which in the framework of market economy should not be subjects of municipal / state interference (for instance, struggle against high prices).

### ***Delegation of Certain State Powers to Municipal Entities***

The RF Constitution stipulated that municipal entities could be vested with certain state powers. The delegation of state power should be legislatively fixed and accompanied by the simultaneous transfer of financial and material resources necessary for the exercise of such powers. The law "On general principles..." adopted in 1995 also stipulated that the terms and procedures of control over the exercise of the state powers delegated to municipal entities should be regulated by federal laws and laws of RF subjects. In pursuance of the federal law, in the regions there were adapted laws regulating the transfer of state powers to local governments and control over the exercise thereof.

In the ***Novgorod oblast***, this issue was regulated by law No. 108-OZ of February 7, 2000, "On the procedures governing the delegation of certain state powers vested in the Novgorod oblast to local governments." This law stipulated that state powers should be delegated to local governments only in accordance with a regional law and be accompanied by the transfer of respective financial resources. The law also stipulated the procedures governing the elaboration of laws concerning the transfer of powers, setting up of control powers of the state authorities, and contained a number of other provisions.

Alongside with the provisions mentioned above, the law of the Novgorod oblast also envisaged that state powers could be withdrawn. However, the law failed to set up the procedures governing the withdrawal of powers and determine the list of persons and authorities having the right to initiate the process of withdrawal of powers, as well as

specify the cases, where state powers could be withdrawn ahead of time.

In accordance with the law “On the procedures governing the delegation of certain state powers vested in the Novgorod oblast to local governments,” the following state powers were delegated to local governments of the Novgorod oblast:

- determination of additional privileges related to the payment of the stamp tax with respect to certain payers;
- determination of the list of remote and difficult-to-access localities (with the exception of towns, district centers, urban-type settlements), where legal entities and individuals could conduct cash transactions with the population without the use of cash registers;
- licensing of retail trade with alcoholic beverages;
- determination of the share of municipal housing stock available for sale;
- awarding of the “Veteran of Labor” title;
- establishment of the procedures governing the determination of territories, where the retail trade with alcoholic beverages should be restricted;
- organization of state bureaus of medical and social examination.

In the ***Kaluga oblast***, there also was in force the law “On the procedures governing the delegation of certain state powers to local governments of the Kaluga oblast” (regional law No. 235-OZ of July 3, 2003). Similarly to the law of the Novgorod oblast, this law established the procedure governing elaboration of laws concerning the delegation of state powers, set up guarantees of material and financial basis of delegated powers, determined control functions of the state authorities, etc.

However, in contradistinction to the Novgorod oblast law, the law of the Kaluga oblast introduced a closed list of officials and authorities having the right to initiate delegation of certain state powers to local governments. This list included: deputies or groups of deputies of the Legislative Assembly of the Kaluga oblast; committees and commissions of the Legislative Assembly of the Kaluga oblast; the Governor of the Kaluga oblast; the Government of the Kaluga oblast; the Audit and Control Chamber the Kaluga oblast; and representative bodies of local governments. Moreover, the law envisaged that on the initiative of the

state authorities the exercise of certain state powers on the part of local governments could be terminated ahead of time.

Besides, in the Kaluga oblast there was adopted law No. 46–OZ of December 29, 1999, “On the procedures governing the delegation of certain state powers in the sphere of turnover of alcoholic products to local governments of the Kaluga oblast.” In accordance with this law, the powers concerning the licensing of retail trade with alcoholic beverages in the territory of the oblast could be delegated to local governments.

Prior to 2003, the list of state powers had been determined by the law “On local self-governance...” In accordance with that law, the state powers relating to the following activities had been delegated to local governments of the oblast cities of Kaluga and Obninsk, as well as district municipal entities:

- organization, maintenance, and development of municipal establishments providing secondary (complete) education, methodological support of municipal establishments providing basic general education, and control over the content of education;
- provision of housing to employees of the prosecutor’s offices, judges, and employees of internal affairs agencies, payment of benefits set up by federal laws;
- payment of social benefits, target compensations, and subsidies envisaged by federal laws and laws of the Kaluga oblast;
- organization and conduct of registration of births, marriages, and deaths;
- state registration of legal entities until the adoption of a federal law on the registration of legal entities;
- labor protection, including struggle against unemployment, organization of public works, regulation of work at municipal enterprises and organizations;
- civil defense, including struggle against natural catastrophes;
- organization of conscription;
- appraisal of real estate for taxation purposes;
- control over the use of farm lands.

In the course of analysis of the list of state powers delegated to the local level, it should be noted the fact that alongside with the state powers in this list there were also included issues of local importance, for

instance, such as maintenance and development of municipal establishments providing secondary (complete) general education and control over the land use.

In November of 2003, in the oblast there was adopted the law “On the delegation of certain state powers to local governments of the Kaluga oblast,” which had significantly altered the list of powers delegated to municipalities. In accordance with this law, to the municipal level there were delegated powers relating only to the sphere of:

- civil defense;
- guarantees of citizens’ right for free general education;
- maintenance of employees of social protection departments engaged in the calculation of pensions and benefits;
- remuneration of labor of foster parents in accordance with the regional law “On social guarantees for foster families in the Kaluga oblast”;
- maintenance of employees of municipal bodies responsible for the management of education.

At the same time, the law contained the complete list of municipal entities, to which there were delegated state powers. The list included both district and settlement municipalities. It should be noted that earlier state powers had been already delegated to a number of municipal entities by laws on the oblast budget for respective financial years. Since 2003, these powers were delegated to municipalities on the permanent basis. It was envisaged to set the sources and amounts of financing of expenditures borne by local governments in relation to the exercise of delegated state powers via laws on the oblast budget.

In the **Tyumen oblast**, the procedures governing the delegation of certain state powers to local governments were established by the oblast law “On the principles of division of powers concerning the issues under the joint jurisdiction of the oblast state authorities and municipal entities, and the procedures governing the delegation of certain state powers to local governments.”

In accordance with this law, certain state powers could be delegated to local governments both on the initiative of state authorities, and representative bodies of local self-governance. Powers should be delegated via respective oblast laws. Powers could be delegated to all municipalities, municipalities of a certain type, or certain municipalities.

The delegation of powers should be accompanied by the transfer of respective material and financial resources necessary for the exercise thereof. The law also stipulated that in the case the amount of financial resources transferred from the oblast budget was insufficient for the proper exercise of the delegated powers the local government should have the right to apply to the body, which had delegated the respective powers to this local government, for the diminishing of the scope of such powers. In the case of a dispute between the local government and the state authority, the matter in controversy should be settled by a conciliation commission created on the parity principle, or by a court.

In the case the exercise of delegated state powers becomes impossible because of reasons beyond the control of local governments, these powers and material and financial resources transferred for the exercise thereof could be returned ahead of time to the respective state authority. In such case, the state authorities should assume the exercise of returned state powers.

Laws on the delegation of certain state powers to local governments of concrete municipal entities were adopted in the middle of 2002. In accordance with these laws, the following powers were delegated to municipal entities of the district type:

- in the sphere of conservation of natural resources situated in the territory of the district:
  - participation in the preparation and conduct of anti-flood measures in the territories of districts;
  - organization of work aimed at prevention of damage caused by water and liquidation of consequences of floods.
- in the sphere of archive maintenance:
  - maintenance, procurement, registration, and use of archive funds and archive documents being in state ownership of the Tyumen oblast, which were situated in the territory of districts.
- in the sphere of education:
  - licensing of educational institutions with the exception of licensing of the right to conduct educational activities in accordance of programs of professional education.

To all municipal entities of the oblast there were also delegated powers pertaining to the performance of notary functions<sup>31</sup> and a number of powers pertaining to the use of forests (with the exception of municipal entities of the town type)<sup>32</sup>.

The legislation of the **Leningrad oblast**, which regulated the delegation of state powers to local governments, significantly differed from legal and regulatory acts adopted in other regions. First, the provisions concerning the delegation of certain state powers to local governments were contained in the oblast law "On the administrative and territorial structure..." This law stipulated that in the territories of districts the state powers could be exercised either by the territorial structural units of the state authorities, or local governments in the case certain state powers were delegated to them. Law of the Leningrad oblast No. 17-OZ of June 23, 1997, established the procedures governing the delegation of certain powers vested in the Leningrad oblast to local governments, as well as the terms and procedures governing the exercise of control over the implementation thereof.

This law stipulated that the delegation of certain state powers vested in the Leningrad oblast should be carried out in the interests of social and economic development of municipal entities taking into account the fact if local governments could exercise these powers. At the same time, it was envisaged that local governments of one municipal entity could exercise certain powers vested in the Leningrad oblast in the territory of another municipal entity on the approval of the local government of the latter.

The law also stipulated that no powers concerning the issues of administrative and territorial structure and those in the competence of federal authorities should be delegated to local governments; there also should be no delegation of powers in the cases, where such delegation resulted in infringement on the human and civil rights and freedoms, the supremacy of the RF Constitution, federal and oblast laws, territorial integrity of the Leningrad oblast. The delegation of certain powers vested in the Leningrad oblast should be carried out only by

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<sup>31</sup> Law of the Tyumen oblast No. 72 of October 7, 2002, "On the delegation of certain state powers pertaining to the performance of notary functions to local governments."

<sup>32</sup> Law of the Tyumen oblast No. 59 of November 11, 1998, "On the delegation of certain state powers pertaining to the use of forests to local governments."

oblast laws on the permanent basis or for a certain term. At the same time, the law “On the procedures governing the delegation...” contained the requirements pertaining to oblast laws concerning the delegation of concrete powers to the local level.

Besides, the law “On the procedures governing the delegation...” set up the procedures governing the transfer to municipalities of financial and material resources necessary for the exercise of certain state powers delegated to local governments. The financial resources were transferred to local governments from the oblast budgetary fund created in order to ensure the financial basis of the exercise of certain powers vested in the Leningrad oblast by local governments. This fund was entered in the functional classification of expenditures borne by the oblast budget as a separate item. The financial resources received by local budgets from this fund were also entered in the revenues of these budgets as separate items.

The procedures governing the transfer of material resources were regulated by law No. 12-OZ of June 3, 1998, “On transfer of material resources necessary for the exercise of certain powers vested in the Leningrad oblast to local governments.” In accordance with this law, the material resources necessary for the exercise of state powers could be transferred either in the ownership of municipal entities, or in the free use. The issuance of the regulatory legal act of the Government of the Leningrad oblast concerning the approval of the list of material resources transferred in the municipal ownership and the registration of the respective ownership rights of municipal entities should be carried out in accordance with the procedures set up by oblast law No. 31-OZ of August 18, 1997, “On the procedures governing the transfer of state-owned objects of the Leningrad oblast in municipal ownership.”

An analysis of laws on the delegation of certain state powers to local governments of the Leningrad oblast demonstrated that a significant scope of competence (more than 35 powers) had been delegated to the municipal level in the oblast. The lists of delegated powers only insignificantly differed across municipal entities. Mainly, these laws delegated to municipal entities, both of the district and settlement type, the following powers:

- in the sphere of social protection of the population:



- draw up state statistical reports on the social protection issues, keep records of citizens and collect documents necessary to provide disabled persons with means of transportation;
- grant and pay allowances to citizens with children;
- grant and pay compensations for harm to the health of participants in the liquidation of the consequences of the Chernobyl nuclear plant catastrophe and to former political prisoners;
- distribute preferential permits to sanatoriums and rest houses;
- distribution of documents certifying the right for benefits;
- in the sphere of health care: organize and render certain types of specialized medical aid to the population;
- in the sphere of education: attest municipal educational institutions with the exception of non-state establishments;
- in the sphere of land use planning and control:
  - approve the decisions taken by the oblast Government with respect to confiscation and distribution of land plots;
  - settle the borders of territories of urban and rural settlements, volosts, in the composition of municipal entities;
- in the sphere of housing stock management: take decisions concerning the re-designation of residential houses and premises as nonresidential premises;
- in the sphere of archive keeping: maintain, procure, register, and use archive funds and archive documents being in state ownership of the Leningrad oblast, which were situated in the territory of municipal entities;
- in the sphere of state registration of births, marriages, and deaths:
  - carry out state registration of births, marriages, and deaths, alter, change, restore, and annul entries;
  - form, control, and maintain the archives of birth, marriages, and deaths registers;
- in the sphere of licensing: license retail trade with alcoholic beverages;
- in the sphere of price control:
  - regulate prices (tariffs) of funeral and morgue services;
  - regulate prices (tariffs) of intra-town and suburban public conveyance.

Besides, to local governments of rural districts there were also delegated the following powers relating to the state support of agriculture:

- participation in the state support of agricultural producers;
- exercise of state control over the quality of seeds;
- exercise of state control over the quality of agricultural produce;
- exercise state supervision of the technical state of tractors and self-propelled vehicles, as well as technological equipment at the enterprises of the agri-industrial complex;
- exercise of state veterinary supervision and control over the activities of state and enterprise veterinary services, taking of measures against epizootic diseases.

To the municipalities, in the territories of which there were used such types of fuel as solid fuel, stove household fuel, and kerosene, there were delegated the powers concerning the regulation of the prices (tariffs) paid for these fuels by households. For instance, this power was delegated to the settlement of Pikalevo, the Boksitogorsk district, Vsevolzhsk district, etc. Certain state powers in the sphere of conservation of natural resources and the use of forests were also delegated to municipal entities.

As demonstrated by the discussed above list of powers delegated by the state authorities of the Leningrad oblast to the municipal level, first, the scope of these powers was rather significant, what indicated a rather high degree of decentralization of functions in the oblast. Second, a part of the state powers delegated to the municipal level represented unfunded mandates. In particular, it was true with respect to the powers in the sphere of social protection of the population. Third, in contradistinction to the situation in the Kaluga oblast, practically equal scopes of state powers were delegated to settlements, towns, and districts. The fact of delegation of a concrete power depended rather on the specifics of the social and economic situation existing in the municipality than the type of municipal entity.

In the **Tver oblast**, no law regulating the procedures governing the delegation of state powers to local governments had been adopted. The oblast law "On local self-governance..." stipulated that in the course of delegation of certain state powers to local governments there should be also transferred financial and material resources sufficient for the exercise of such powers. At the same time, the financial re-

sources necessary for the exercise of certain state powers vested in the oblast by local governments should be earmarked in the oblast budget as separate entries. In the case the transferred material and financial resources were insufficient for the exercise of state powers, the respective local governments should not bear responsibility for the exercise of such powers.

The same law determined the range of issues of state importance, which could be delegated to local governments. This range of issues included:

- organization and maintenance of the institutions and enterprises of social protection and social security;
- ensuring of employment of the population;
- environmental protection in the territory of the municipal entity;
- conduct of draft registration and organization of conscription of citizens;
- conduct of registration of births, marriages, and deaths;
- exercise of the state architectural and construction control;
- organization of activities related to the issues of civil defense and emergencies;
- ensuring of sanitary and epidemiological security;
- other issues.

By separate oblast laws to local governments were delegated the following powers:

- setting of the mercantile additions to the prices of domestic and imported drugs and products for medical purposes as concerned the enterprises of the pharmaceutical network<sup>33</sup>;
- state registration of births, marriages, and deaths;
- determination of the list of remote or difficult-to-access localities (with the exception of towns, district centers, urban-type settlements), where legal entities and individuals could conduct cash transactions with the population without the use of cash registers;
- awarding of the “Veteran of Labor” title;
- assignment of fishing grounds in relation to the licensing of industrial fishing.

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<sup>33</sup> The oblast had retained the powers pertaining to the setting of mercantile additions to the products of the state owned enterprise “Farmatsiya.”

In the **Astrakhan oblast**, the issue of the delegation of state powers to the municipal level had not been regulated. The law “On local self-governance...” contained provisions stating that state powers could be delegated to municipalities only in the case local governments simultaneously received the respective material and financial resources. It was envisaged that state powers could be delegated to local governments via oblast laws. However, no documents regulating the delegation of certain state powers to the municipal level had been detected in the regulatory and legal framework existing in the oblast. The oblast laws on the budget also contained no such information.

### **3.4. Local Governments**

In the monitored oblasts, the principles of organization and activities of local governments, their structure, powers, and procedures governing the establishment thereof were regulated by laws “On local self-governance...” In the Kaluga and Tyumen oblasts certain provisions were also contained in the oblast Charters. At the same time, the provisions of regional legislations were practically similar to the respective articles of the RF Constitution and the federal law of 1995 “On the general principles...”

The key provisions of regional laws regulating the activities of local governments were as follows:

- Local governments should be outside the system of state authorities. This provision was contained in the RF Constitution. At the regional level, this provision was included only in the laws of the Novgorod and Kaluga oblast. In the Tyumen oblast, this stipulation was excluded from the text of the law in 2001<sup>34</sup>.
- In accordance with charters of municipal entities, local governments were defined as legal entities.
- Representative bodies should be mandatory components in the structure of local self-governance.
- Municipal entities should independently set up the structures of the respective local governments, denominations thereof, the scopes of competence vested in them, the numbers of deputies in the respective representative bodies, etc, what should be stipulated by

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<sup>34</sup> Law of the Tyumen oblast No. 365 of July 5, 2001.

the charters of municipal entities. Municipalities should also set up the terms of office for representative bodies of local self-governance; however, these terms should not exceed five years. In the Novgorod oblast, there was also set the minimum term of office of the representative body of local self-governance – 2 years.

- Charters of municipal entities could envisage posts of heads of municipal entities.
- Heads of municipal entities could be elected either by RF citizens residing in the territories of municipal entities on the basis of the universal, equal, and direct suffrage by secret ballot, or by the representative bodies of local self-governance from the number of deputies in their compositions.
- Heads of municipal entities could hold the offices of the Heads of administrations of municipal entities, and also could be members of the representative bodies of local governments and chair the meetings held by these bodies.
- Heads of municipal entities should be directly accountable to the population and also to the representative bodies of local self-governance.
- The procedures governing the elections, terms, and scopes of competence, official functions, rights and duties of the heads of municipal entities should be set up by charters of municipal entities.
- In accordance with regional laws “On local self-governance..,” charters of municipal entities could envisage the establishment of other bodies or elected posts of local self-governance.

It should be noted that although in all regions under observation oblast laws declared that municipal entities should have the right to independently set the number of paid deputies and municipal officials, in the Novgorod and Kaluga oblasts there were introduced standards determining the maximum numbers of officials of local administrations. These standards were taken into account by the state authorities as concerned the granting of financial aid to municipal entities and the assignment to them of standard allocations of shared taxes. These standards had been a factor checking the growth in the number of officials of local governments in these regions. In the Astrakhan oblast, the standard numbers of officials of local governments were introduced

only in 2004. No such standards had been introduced in the Leningrad, Tver, and Tyumen oblasts.

In the **Novgorod oblast**, laws on the budget had annually set up the standards pertaining to the number of officials of local self-governance. These standards regulated the number of officials working on the central staffs of municipal entities (not taking into account the number of officials of rural and settlement administrations, which were structural units of district administration and were financed from the district budgets). The standards pertaining to the number of officials engaged in local self-governance were calculated proceeding from the size of the populations of municipal entities and were intended to limit the growth in the total strength of the administrative staff. These standards were used for the calculation of minimum necessary expenditures borne by the budgets of municipal entities, the financing of which was guaranteed by the oblast state authorities. Taking into account the fact that the majority of municipal entities of the Novgorod oblast were heavily subsidized and on the average half of their budgets depended on the subsidies from the oblast budget, it became apparent that the independency of municipal entities as concerned the setting of the numbers of officials on their administrative staffs was rather ephemeral.

A similar situation had formed in the **Kaluga oblast**, where there was in force the oblast law "On provisional minimum social standards of municipal entities." Alongside with the social standards, this law also set up the maximum number of officials working on the staffs of local governments and the standards regulating the numbers of officials in the territorial local governments, the establishment of which had been envisaged by the charters of the respective municipal entities. These standards should be on the mandatory basis used in the course of assignment of the standard rates of allocation of shared taxes to local budgets and the distribution of financial aid.

In the **Astrakhan oblast**, prior to 2004 there had been no standards regulating the maximum number of officials. These standards were introduced only in the framework of the current municipal reform. Similarly to the situation existing in other oblasts, these standards were not mandatory for municipal entities; however, these standards were used by the regional state authorities in the course of providing financial aid for the equalization of fiscal capacities to municipal entities. The stan-

dards pertaining to the maximum number of officials were introduced by Resolution of the oblast Governor No. 454-r of August 13, 2004, "On streamlining the remuneration of labor of municipal officials of the Astrakhan oblast." These standards regulated not only the number of municipal officials, but the number of the employees engaged in the technical support of the activities of local governments. The standards were applicable to all types of municipalities and differentiated depending on the size of the population in each respective municipal entity.

### 3.5. Municipal Property

The federal law of 1995 "On the general principles..." stipulated that municipal property should consist of:

- Financial resources of local budgets,
- Municipal extra-budgetary funds,
- Property owned by local governments, as well as municipal land and other natural resources in municipal ownership,
- Municipal enterprises and organizations, municipal banks and other financial and crediting organizations,
- Municipal housing stocks and non-residential premises,
- Municipal institutions in the spheres of education, health care, culture, and sports,
- Other movable and immovable property.

The law also stipulated that municipal property should be managed by local governments, which in accordance with the law should have the right to transfer municipal property in temporary or permanent use of legal entities and individuals, lease and alienate such property in accordance with the established procedures, as well as conduct other transactions concerning such property. The procedures and terms of privatization of municipal property should be determined by the population of the municipality at meetings (conferences) of citizens or by local governments. All privatization proceeds should be entered to local budgets.

In the Tyumen, Novgorod, Kaluga, and Tver oblasts, the issues relating to municipal property were regulated by the respective laws "On local self-governance..."

The **Tyumen oblast** law included only the list of property in municipal ownership, and the regulations concerning the establishment of

procedures governing the privatization of municipal property and transfer of privatization proceeds to local budgets. At the same time, these stipulations were practically similar to the provisions contained in the law of the Tver oblast.

However, the law of the **Novgorod oblast** differed from the federal law of 1995 “On general principles...” It included a broader list of assets defined as municipal property. In accordance with this law, not only the institutions in the sphere of education, health care, and sports, but also other municipal institutions created in order to perform administrative, social, cultural, scientific, technical, and other functions of not-for-profit nature could be in the municipal ownership. Besides, the municipalities could own securities and other financial assets, property, property complexes, objects of engineering infrastructure purchased by municipalities under the procedures set up by the legislation in force or transferred in ownership of municipal entities on the basis of agreements, contracts, and unilateral acts pertaining to the transfer of property.

In the **Kaluga oblast**, where the regional legislation envisaged the possibility that one municipal entity might be formed within the borders of another municipality, the most complex problem was the regulation of distribution of municipal property between municipalities of different levels. In order to settle this problem the law stipulated (article 7) that within the borders of districts municipal institutions of culture, health care, physical culture, sports, social protection, and other objects of the social sphere servicing several municipal entities at the moment the law “On local self government...” was enacted should be included in the composition of district municipal property. The same article contained the reference to article 10, in accordance with which the status of such institutions should be defined in accordance with article 10 of the law “On local self-governance...” immediately after this law had entered into force.

However, article 10 did not regulate the issues of division of property between the municipalities in the cases, where one municipal entity was situated within the borders of another one. This article guaranteed the right of municipal entities to create joint authorities in order to deal with certain issues of local importance and stressed that the scope of competence of such bodies should not exceed the scope of competence of



local governments, which had created such bodies. At the same time, it remained unclear if the institutions being included in the balance sheets of district municipalities could be transferred in management or use of joint authorities of settlement municipalities, and under what procedures.

In the **Leningrad oblast**, where it also was permitted to establish one municipal entity in the territory of another one, the issues of division of property drew significant attention. In 1997, in the oblast there was adopted law No. 30-OZ "On the procedures governing the division of municipal property objects among municipal entities in the cases where newly established municipal entities are situated within the borders of other municipal entities (with the exception of towns)" (of August 18, 1998). This law stipulated that the division of property should be determined by oblast laws and set the substance and procedures governing the elaboration of such laws. In accordance with the law "On the procedures governing the division," in the beginning of 1999 there was adopted a number of laws dividing municipal property between districts and municipal entities newly established in their territories (the town of Kommunar, the Koltushskaya volost, the town of Sertolovo, the settlement of Kuznechnoye, the town of Svetlogorsk, the town of Novaya Ladoga). Certain social and cultural objects, as well as utilities and amenities were transferred in ownership of these municipal entities.

As it has been mentioned above, in the Leningrad oblast there were also adopted oblast laws regulating the transfer of state property in municipal ownership. The procedures governing the transfer were set up by oblast law No. 31 oz of August 18, 1997, "On the procedures governing the transfer of state-owned objects of the Leningrad oblast in municipal ownership." In accordance with this law, property complexes of Leningrad oblast's state-owned unitary enterprises and state institutions, as well as certain movable and immovable property in the state ownership of the Leningrad oblast being under the economic jurisdiction of state-owned unitary enterprises and under the operative management of state institutions could be transferred in the municipal ownership. These objects had been transferred in the ownership of municipalities in order to enable them to settle issues of local importance or to exercise delegated state powers. The law also stipulated that no objects necessary for the ensuring of functioning of the state authorities of the

Leningrad oblast and the objects ensuring the exercise of state powers vested in the Leningrad oblast, which were necessary to deal with the issues under the joint jurisdiction of the Russian Federation and the Leningrad oblast, could be transferred in the municipal ownership.

In the **Astrakhan oblast**, since the late 1990s in the majority of districts there had been introduced a two-tier system of local self-governance. In the framework of this system, municipalities had been formed both at the level of settlements, and at the level of administrative districts. In this situation, the problem of division of jurisdictions, municipal property, and sources of revenues was especially important. The law "On local self-governance..." stipulated that such a division should be determined by oblast laws. However, no such law had been adopted. In the territory of the Astrakhan oblast, there had been registered only few isolated cases of official division of jurisdictions, municipal property, and revenue sources between settlements and districts. As an example of an attempt to formalize the relations between settlements and districts, there should be cited the agreement between the Ikryaninsk district government and the settlement of Krasnye Barrikady made in 1998. This inter-municipal agreement had divided the jurisdictions, objects of municipal property (each separate property object with the indication of its book value), and revenue sources (there were set up the standard rates of allocation of tax revenues due to the settlement budget). The agreement should remain in force for one financial year and envisaged prolongation. However, no further agreements had been signed and division of jurisdictions and municipal property had been carried out on an informal basis.

### **3.6. Territorial Community-Based Self-governance**

The federal legislation had practically failed to regulate the issues pertaining to the organization of territorial community-based self-governance. There had been elaborated no federal law, which would have set up the principles of organization of this form of citizens' self-governance. The law "On general principles..." of 1995 only provided a notion of the territorial community-based self-governance (hereinafter referred to as TCG). The TCG was defined as "self organization of citizens at their places of residence in parts of territories of municipal entities for the purposes of independent and responsible exercise of own

initiatives as concerns the issues of local importance directly by the population or via bodies of the territorial community-based self-governance established by the population.” The law also stipulated that the procedures governing the organization and exercise of TCG should be independently determined by municipal entities in accordance with the respective regional laws.

In the **Novgorod oblast**, the issues of organization and exercise of TCG were regulated by oblast law No. 36-OZ of September 30, 1998, “On the territorial community-based self-governance in the Novgorod oblast.”

In accordance with this law, the territorial community-based self-governance should be exercised by the population via:

- Direct expression of the citizens’ will via meetings (conferences) of citizens or polls;
- Bodies of the territorial community-based self-governance at the places of residence;
- Elected persons of the territorial community-based self-governance.

*General meetings (gatherings) and conferences* of citizens could be convened on the initiative of the Head of the municipal entity, local governments and their structural units, bodies of the territorial community-based self-governance, deputies of the representative bodies of local self-governance, and citizens.

Meetings (gatherings) of citizens should be considered competent if more than half of the citizens having the right to participate in such meetings (gatherings) were present. In the cases, where the convocation of meetings had been inconvenient, there should be held conferences of representatives of residents of settlements, micro-districts, quarters, streets, residential houses. Such conferences should be considered as competent if not less than two thirds of representatives of residents of the respective territories were present.

Meetings (gatherings) of citizens should be convened as and when needed, but not less frequently than 2 times a year.

The scope of competence of meetings (gatherings) and conferences held by citizens included:

- Discussion of draft TCG regulations for municipal entities;
- Amendments thereto;

- Adoption of the charter (regulations) as concerned TCG bodies and regulations concerning the elected persons of TCG;
- Election of TCG bodies and setting caps on the size of the respective staffs;
- Approval of TCG action plans with respect to the social and economic development of territories;
- Hearing of activity reports presented by heads of TCG bodies;
- Other issues as defined by the charters of respective municipal entities.

Meetings (gatherings) and conferences of citizens should have the right to submit requests and proposals to the state authorities, local governments, law enforcement agencies, and other organizations. These requests and proposals should be examined by the respective officials within 30 days and the residents of the territory should be informed about the results via their local governments or territorial bodies of local self-governance.

In the territory of the Novgorod oblast, *bodies of territorial community-based self-governance* could be established in the parts of territories of municipal entities in one of the following organizational legal forms (article 10):

- Committees or councils of the territorial community-based self-governance of towns and settlements;
- Committees or councils of village chairpersons (representatives of rural settlements) of rural councils;
- Committees or councils of micro-districts, streets, houses;
- Other organizational legal forms in accordance with regulatory and legal acts issued by local governments.

Along with the bodies of territorial community-based self-governance, in parts of territories of municipal entities (rural councils of separate localities, micro-districts of towns, streets) their functions could perform *TCG elected persons* – village chairpersons (elders, representatives of rural localities), authorized persons representing streets, houses, apartment house sections with separate entrances), etc.

The procedures governing the election of the bodies and elected persons of the territorial community-based self-governance, organization of the activities carried out by such persons and bodies, as well as the borders of the respective territories, where the bodies and elected

persons of the territorial community-based self-governance were performing their functions, were set up by local governments. Public opinion should be taken into account in the course of delimiting of the borders of territories under TCG jurisdiction.

As it has been noted above, in the **Leningrad, Astrakhan, and Tver oblasts** the scope of competence of the citizens' meetings (gatherings), the procedures governing the convocation and holding thereof, as well as the adoption and amendment of the decisions taken by such meetings were regulated by special laws:

- Law of the Astrakhan oblast No. 47/99-OZ of December 15, 1999, "On meetings (gatherings) of citizens in municipal entities of the Astrakhan oblast";
- Law of the Leningrad oblast No. 27-OZ of July 20, 2000, "On meetings (gatherings) of citizens in municipal entities of the Leningrad oblast";
- Law of the Tver oblast of February 27, 1997, "On meetings (gatherings) of citizens in municipal entities of the Tver oblast."

At the same time, the issues pertaining to TCG exercise were regulated differently. In the Astrakhan and Tver oblasts, only the laws "On local self-governance..." contained provisions regulating TCG organization, while in the Leningrad oblast there was adopted law of the Leningrad oblast No. 17-OZ of July 12, 2000, "On the territorial community-based self-governance in the Leningrad oblast."

The law adopted in the Leningrad oblast was rather unique. Alongside with such provisions as those establishing the legal basis and principles of TCG exercise, defining powers to organize and develop TCG vested in local governments, setting up TCG bodies, and other contained in the legislation of a considerable number of Russia's regions, the law included some provisions as a rule absent in other regional legislations. First of all, this law contained the complete list of powers vested in TCG bodies, which included 18 powers. Among these powers there were, for instance, assistance to the utility sector organizations with respect to control over the maintenance of staircases, elevators, yard territories, sports and children playgrounds; organization of voluntary participation of people in improvement and landscape gardening of settlements, scavenging, maintenance of roads and side walks, public wells and pumps, sports and children playgrounds, protection of his-

torical and cultural heritage, etc. Besides, local governments could take decisions concerning the delegation of certain powers with respect to issues of local importance to TCG bodies. The delegation of powers of local self-governance could be carried out only on condition of the simultaneous transfer of material and financial resources necessary for the exercise thereof to TCG bodies.

Also, the law “On the territorial community-based self-governance...” determined the economic basis of TCG. In accordance with the law, the TCG economic basis should consist of:

- a) own money resources of the territorial community-based self-governance;
- b) municipal property transferred in management of the bodies of the territorial community-based self-governance;
- c) financial resources of the budgets of municipal entities allocated to the bodies of the territorial community-based self-governance for dealing with the issues under jurisdiction of the territorial community-based self-governance.

At the same time, the law stipulated that own money resources of the territorial community-based self-governance should be formed by voluntary gratuitous contributions, donations made by citizens and organizations, and at the expense of other sources. In the cases where TCG bodies were not legal entities, their own financial resources could be formed only at the expense of citizens’ self-taxation. TCG bodies should be accountable to the population as concerned the expenditure of such financial resources for the designated purposes. In the cases where TCG bodies were legal entities, they had the right to carry out economic activities aimed at the satisfaction of social and economic needs of the population.

In the **Kaluga oblast**, no separate law regulating the issues pertaining to TCG organization had been adopted; however, these issues were regulated by the regional law “On local self-governance..,” which, in particular, set up the list of territories in municipal entities of different types, where TCG could be introduced. In accordance with the oblast law, the territorial community-based self-governance in volosts and rural councils could be introduced in the territories of farmsteads, villages, rural settlements, and rural councils not granted the status of independent municipal entities. As concerned towns and urban settle-

ments, such territories could be micro-districts, blocks of houses, streets, and yards.

The legal framework of the territorial community-based self-governance was determined by charters of municipal entities, while regional legislations set up only the basic principles of this form of local popular self-governance. In particular, the regional law stipulated that in rural localities and rural councils the territorial community-based self-governance could be exercised via meetings (gatherings) of citizens and / or bodies established by them. At the same time, in accordance with charters of municipal entities the territorial bodies could be granted the status of legal entities. The law also envisaged the possibility that territorial bodies of community-based self-governance could have own, borrowed, and transferred from local budgets financial resources.

The amendments made to the regional law “On local self-governance...” in 2002<sup>35</sup> had significantly broadened the scope of competence of the territorial bodies of community-based self-governance in rural councils. In accordance with the said amendments, the territorial bodies were granted the right to deal with issues of local importance in their respective territories; propose candidates for offices of the heads of rural administrations; apply for removal of such officials from their posts; establish organizations carrying out economic activities, etc. However, the decisions concerning the delegation of such powers to the bodies of the territorial community-based self-governance were vested exclusively in the representative bodies of municipal entities.

Yet another significant amount to the law made in 2002 concerned the ways of formation of the bodies of the territorial community-based self-governance in rural areas. While earlier in rural councils the role of TCG bodies had been played by the councils of village administrators, in accordance with the amendments made in 2002 these bodies should be not formed, but elected at village meetings. The number of deputies elected to the TCG bodies and the scope of their competence should be determined by charters of municipal entities. As concerned the scope of competence, it was as a rule limited to the right to make proposals with respect to the settlement of issues of local importance to local governments.

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<sup>35</sup> Law of the Kaluga oblast No. 106-OZ of March 1, 2002, “On amendments to the Kaluga oblast law ‘On local self-governance in the Kaluga oblast.’ ”

In the ***Tyumen and Astrakhan oblasts***, TCG was exercised in accordance with regional laws “On local self-governance...” It should be noted that the articles of these laws were practically similar to the respective provisions of the federal law. Therefore, in these oblasts the activities of TCG were regulated only by local governments, which should fix the borders of the territories where TCG bodies were functioning, the procedures governing their organization, and the scope of TCG competence in the charters of respective municipal entities.

### **3.7. Unions and Associations of Municipal Entities**

The federal law “On general principles...” adopted in 1995 stipulated that for the purposes of coordination of their activities and more efficient ensuring of their rights and interests municipal entities should have to form associations or unions. At the same time, no powers vested in local governments could be delegated to such associations or unions.

In all monitored oblasts with the exception of the Novgorod oblast, regional laws “On local self-governance...” also contained provisions that concrete terms and conditions of participation of municipal entities in the activities of associations or unions should be set up in the constituent documents of such associations or unions. The law of the Tver oblast contained the requirement that constituent documents were in conformity with the Constitution of the Russian Federation, legislation of the Russian Federation and the Tver oblast, and international obligations of the Russian Federation.

The laws adopted in the Astrakhan, Leningrad, Tver, and Tyumen oblasts stipulated that unions or associations of municipal entities should be mandatory registered in accordance with the procedures set up for nongovernmental organizations.

In the Astrakhan, Leningrad, and Tver oblasts, it was also envisaged that municipal entities could make collaborating agreements including those, in which there could participate local governments of other RF subjects and other states.

### **3.8. Conclusions**

The analysis of the legislation concerning the sphere of local self-governance adopted in the pilot regions demonstrated significant dif-



ferences in the ways the regions determined the territorial principles of local self-governance. In the majority of cases, regional legislations envisaged the establishment of different types of municipal entities (districts, towns, settlements). The only exception was the Novgorod oblast, where local self-governance could be exercised only in the territories of administrative districts and in the city of Novgorod.

At the same time, the possibility to establish municipalities of different types was differently used in the regions under observation. While in the Astrakhan oblast the creation of a two-tier system of local self-governance in the majority of administrative districts was initiated by the state authorities of the oblast, in the Kaluga oblast settlement municipalities were formed exclusively on the “from below” initiative. In the Leningrad oblast, there was observed a rather unique situation, where in the framework of the regional legislation, which in essence determined the principles of the settlement-based model of local self-governance, there was created the district model in the framework of which only a limited number of towns and settlements became independent municipalities.

The lists of issues of local importance determined by regional laws “On local self-governance...” was basically similar to the list formed by the federal law of 1995 “On general principles...” However, in several cases there were introduced deviations from the provisions of the federal law as both the issues relating to state powers, and the issues pertaining to the spheres, where the state interference was unfeasible, were included in the scope of competence of local governments. For instance, in the Kaluga oblast the creation of conditions ensuring the activities of lawyers and notaries, and in the Astrakhan oblast the issues of labor protection and working conditions were included in the composition of issues of local importance, while in other regions these problems were included in the scope of competence of the state authorities. It was rather strange to find such powers as the “struggle against high prices” to be included in the list of issues of local importance.

An opposite situation was observed as concerned the delegation of state powers to local governments. In a number of cases, the powers, which in accordance with the federal legislation were defined as issues of local importance, were delegated to the local level. For instance, in the Kaluga oblast the “organization, maintenance, and development of

municipal establishments providing secondary (complete) education” was delegated to the local level as a state power. In many cases, the state powers delegated to the municipal level represented unfunded mandates. In the Astrakhan oblast, the delegation of state powers to the municipal level was carried out on an informal basis.

The least regulated issues was the problem of division of property between districts and municipalities, and among municipalities in the cases, where such municipalities were situated in the same territories (town – district, settlement – district). Attempts to settle this problem in the terms of legislation were made in the Leningrad and Kaluga oblasts. However, the process of division of property had not been fully formalized. In the majority of regions, this sphere was regulated by separate decisions taken outside of the common “rules of the game.” This problem was especially acute in the Astrakhan oblast, where the two-tier system of municipalities existed practically across the whole oblast territory, but the said issues remained practically unregulated. In this situation, in some districts of the oblast there were made attempts to form agreement-based relations between municipalities as concerned the distribution of powers, financial resources, and property; however, there were registered only few such agreements.

## **Chapter 4. The Rise of Territorial Fundamentals of Local Self-Governance**

### **4.1. Milestones of the reform of *territorial* fundamentals of local self-governance**

The identification of territorial fundamentals of the institute of local self-governance in the Russian Federation has formed a critical reform avenue during the whole period of the rise of local self-governance in the country. In so doing, different stages of the emergence of the organizational and legal basis of local self-governance saw the issues of its territorial organization solved differently.

The first stage lasted since 1990 to October-December 1993. At that time, the first laws on local self-governance were adopted: the USSR law “On general principles of local self-governance and local economies in the USSR” and RSFSR law No. 1550-1 of July 6, 1991, “On local self-governance in RSFSR”. The characteristic feature of that period was an attempt to retain the former system of local administrations by modifying their authority and principles of organization.

Defining the territorial fundamentals of local self-governance, both laws proceeded from then existed administrative-territorial division. The law “On general principles ...” singled out the primary territorial level of local self-governance, which included rural councils, settlements and urban districts. It also provided other levels of local self-governance, if required by local or national conditions. Other levels of local self-governance could be established by the respective decisions of the autonomous and union republics of the USSR.

In the RSFSR law “On local self-governance ...”, the concept of primary level of local self-governance was no longer existent. The law contained a complete list of administrative-territorial entities, within the borders of which self-governance could be exercised. These were districts, towns, urban districts, settlements, rural councils and rural settlements.

The principles of the territorial and administrative structure, which suggested subordination between the bodies of power of different administrative-territorial entities were transposed onto the local self-governance system. Thus, while it was not specified directly that local

governments of district towns were subordinate to district councils, nonetheless, the competence of the latter provided allocation of subsidies and subventions to budgets of the lower-level councils, including those of district towns (art. 55). District councils could also delegate individual powers to the councils of settlements, rural councils and district towns and cancel their decisions in the event they conflicted with the law. Thus, the law that defined the local self-governance system as the one of organization of citizens' activity to solve local by their own issues still made local governments of settlements, rural councils and district towns subordinate, to district governments in terms of certain financial, economic and organizational activities.

The second stage of the rise of the territorial fundamentals of local self-governance is believed to cover the period of October-December 1993, prior to adoption of the federal law "On general principles of local self-governance in the RF" in 1995. Then Presidential Decree No.1760 of October 26, 1993 "On the reform of local self-governance in the RF" approved the "Provision on principles of organization of local self-governance in RF over a period of a gradual constitutional reform". The Provision reflected the settlement principle of the organization of local self-governance, under which main territories wherein local self-governance was exercised, were urban and rural settlements. In districts and the rural councils, the local government was represented by the head of administration of the district/rural council. In those territories local governments could also be formed by representatives of local governments of rural and urban settlements. *Table 4.1* highlights on the system of local governments within the borders of different types of territories and methods of their establishment. The table shows that the Provision did not specify the way the head of district/rural council was elected. Besides, the "Provision on principles of organization of local self-governance ..." did not provide by decision of which bodies a single local government of district/rural council could be formed; as well, it granted to regional governmental authorities the right to make decisions on the method of election/appointment of heads of large localities, while not answering to a number of other important questions.

Table 4.1

**Methods of Establishment of Local Governments in Different Territorial-Administrative Entities of the RF**

Local governments	Towns and rural settlements with population of up to			Districts and rural councils
	5 thousand	from 5 to 50 thousand	over 50 thousand	
Head	Is elected	Is elected	1) Is appointed by the head of administration of krai, oblast, autonomous republic, federal city, autonomous oblast or 2) Is elected	Is not specified
<i>Meeting of representatives</i>	Is not formed, local self-governance is exercised through meetings of citizens	Is elected	Is elected	Is formed out of representatives of local governments of towns and rural settlements

Source: "Provision on principles of organization of local self-governance in the RF for a period of gradual constitutional reform", approved by Presidential Decree No.1760 of December 26, 1993.

The 1995 law "On general principles ..." laid foundation for a new stage in the development of local self-governance. It was for the first time ever that the territorial organization of this institution of power was separated from the administrative-territorial structure of the state. Following the Civil Code, the law introduced concept of municipal entity, within the frame of which local self-governance is exercised. Under this law, municipal entity is characterized by the existence of the territory, local budget, municipal property and elected bodies of local self-governance. The law contained an open list of territorial entities, within the borders of which local self-governance could be exercised, while assigning to the RF Subjects the right to independently determine territories wherein municipal entities can be established. Article 12 of the law specifies that "local self-governance is exercised throughout the Russian Federation in urban and rural settlements, and other territories. The territories of municipal entities – towns, settlements, *stanitsas* (Cossack villages), districts (uyezd), rural okrugs (volosts, rural coun-

cils) and other municipal entities – are established in compliance with the federal laws and laws of Subjects of the Russian Federation with account of historical and other local traditions”.

As a result, the RF Subjects saw the rise of numerous forms and models of organization of local self-governance. According to the data available, the territorial organization of local self-governance looked as follows:

- exclusively at the district level – in 6 RF Subjects;
- at the level of districts and towns – in 37 RF subjects;
- at the level of districts, towns and rural districts – in 23 RF Subjects;
- at the level of rural districts and settlements – in 5 RF Subjects;
- at the level of urban and rural okrugs – in 3 RF Subjects;
- at the level of towns and rural districts – in 11 RF Subjects.

In a number of regions municipal entities were either non-existent, or they embraced only a part of the territory of the RF Subject. For example, in Republic of Ingushetia and the Chechen Republic municipal entities were non-existent at all, while there were only 1–2 of them in the republics of Tuva and Sakha (Yakutia) (*Zamotaev, Markvart, Kli-menko, 2002, p.49*).

If we consider a territorial organization of local self-governance in rural areas, the district model was undoubtedly a dominating model in the territory of the Russian Federation. This model was also used in those regions, which formally declared the two-level self-governance, but in reality formed budgets only at the district level. In that case, the settlements had no such characteristic sign of municipal entities as local budget.

In an insignificant number of regions municipal entities existed only at the settlement level. In that case, district administration was usually established within the frame of the regional administration and in many cases it assumed exercising a part of functions which the 1995 law “On general principles...” attributed to local issues. The number of the RF Subjects with the two-level structure of local self-governance that provided formation of on both district and settlement levels was equally small.

At this point it should be noted that not all the RF Subjects set a task of implementation of the uniform model of local self-governance in their territory. In some cases, a Subject allowed the coexistence of several

models, for example, the district and two-level settlement and district ones. Plus, a given local self-governance model in this or that region has always remained unchanged during the effective period of the Law “On general principles...” and many regions underwent the reform of municipal structure of various depth and radicality.

The choice of pilot regions was made in such a way, so that to allow a maximum possible coverage of all the available options:

- in all the regions the law “On general principles...” was effective on the entire territory;
- all basic models of organization of local self-governance: namely, district, settlement, two-level ones were in presence in the regions;
- in one region, the local self-governance model is uniform for its entire territory, while different models co-existed other ones;
- one of the regions has undergone a drastic change of its local self-governance model while in the others the chosen model proved to be rather stable.

Consequently, there are good grounds to believe that an analysis of establishment and development of local self-governance in the selected regions allows reflection of processes characteristic of a broader array of the RF Subjects and to identify some trends, which describe this process as a whole and possible options.

## **4.2. The Rise of Territorial Fundamentals of Local Self-Governance in Pilot Regions**

### *4.2.1. Novgorod Oblast*

In 1991, in the aftermath of the adoption of first the USSR and then Russian laws which established a legal basis for local self-governance, local governments had been organized on both the level of districts and urban and rural settlements in Novgorod oblast. Between 1991 to 1993 the settlement councils and rural and urban councils functioning in oblast, including those in cities Novgorod, Borovichi and Staraya Russa totaled 283, and another 22 district councils and 2 urban district councils in the city of Novgorod. All local administrations were granted with powers and could form their budgets. In 1993, all the local governments were abolished, the heads of the local administrations were since then appointed by bodies of the oblast state power .

The district model of territorial organization of local self-governance was established in 1996. As many as 22 municipal entities were functioning on the territory of oblast, of which 1 – in the territory of the city of Novgorod, 19 – in territories of the administrative districts of oblast, 2 – in territories of the consolidated administrative-territorial entities (Borovichi and Borovichi district, Staraya Russa and Starorussky district). However, the process did not stop at the point of the establishment of local governments at the district level. To draw local self-governance closer to population, territorial bodies of local self-governance were organized in all municipal entities. They were represented by administrations of settlements and rural councils, which were given powers on participation in solving practically all local issues, as well as individual state powers. In all, at the time as many as 283 rural and settlement administrations were functioning in oblast.

Staffers of both district and oblast administrations intensively cooperated with representatives of this submunicipal level of power. Starting from 1997, an advisory body – that is, the Council of Heads of Administrations of rural councils and settlements began functioning under the governor of the oblast with one head of rural/settlement administration from each district being coopted to it. Agendas of the Council meetings comprised consultations and formulating stance on critical issues of the oblast's political and socio-economic life. The agenda could be proposed by both the governor and the council members.

The bodies of territorial community-based self-governance, including 1560 chairmen and 2056 house and street committees operated in the territories of some rural localities, as well as districts and streets in settlements and cities. The activities of these bodies based upon detailed procedures stipulated both in the oblast statute "On territorial community-based self-governance ..." and local governments' n legal acts of.

#### *4.2.2. Kaluga Oblast*

Adoption of the USSR and Russian statutes regulating the local self-governance issues between 1990 and 1993, practically had no effect on the situation with local governments in Kaluga oblast. The Councils of People's Deputies elected in early 1990 as state power bodies continued their activity as local self-governance bodies until 1993. They had



no own budgets and were financed basing on the expenditure estimate. Post-presidential Decree “On general principles of local self-governance in the RF” in 1993, and the consequent adoption of the Constitution, the oblast began preparations for a large-scale self-governance reform. As a result, in early 1994, the regional Council of People’s Deputies of Kaluga oblast approved “Temporary provision on organization of local self-governance in Kaluga oblast”. The critical reform issues stipulated in the document could be reduced to the following:

- all rural councils, settlements and cities were bound to hold elections of heads of local self-governance;
- the representative bodies of local self-governance in settlements and towns were to be elected were selected;
- in rural councils, a representative body was to be formed by village chairmen of the who were members of of rural councils;
- in districts, a representative body of local self-governance – the district meeting – was to be formed by heads of rural, settlement and urban councils located in the district;
- the district head was not to be elected but appointed by the head of the oblast administration upon consultations with a district meeting.

As concerns financing the local governments’ operations, budgets were formed only at the district level as before, while rural, settlement and urban councils were financed according to the expenditure estimate. As well, the temporary provision did not specify distribution of property between districts and settlements, with the latter continuing to control \buildings of rural councils and property transferred to them by enterprises, including social and cultural objects, schools and health care facilities, except for district hospitals. While formally property was on the settlement councils’ balance sheet, in practice it was the district property management committees that administered the property, as councils had no right to do that.

In 1994, local elections were held. Post-elections the elected bodies found themselves *de-facto* subordinate to appointed heads of district administrations. Such a situation dissatisfied heads of rural, settlement and urban councils (in 1994 there were almost 360 of them). Since mid-1994, the oblast authorities had begun drafting a law that was supposed to regulate operations of local self-governance structures. In ad-

dition to the government bodies, non-governmental agencies, in particular, the Association of cities, settlements and rural councils, whose establishment in 1994 was initiated by a number of heads of local self-governance structures, also vigorously contributed to the work. However, the absence of a federal law had decelerated the progress on the issue. The adoption, of the federal law in 1995, as well as the fact that the tenures of all the elected heads of local self-governance were due to expire in mid-1996, while holding by-elections required a respective legal framework, accelerated the designing of the oblast law on local self-governance, which was ultimately passed in mid-1996. It fixed the local self-governance system that suggested the presence of settlement municipalities in the territories of municipal districts. In so doing, the reform of local self-governance in the oblast did not suggest establishing municipalities in all the settlements where local administrations had existed earlier.

Transitional provisions of the law allowed all earlier existed local administrations to decide whether they would like to create independent municipal entities, or consolidate with other local governments to form one of the types of municipal entities stipulated in the law (district, rural council, volost, town). Solving the issue suggested conducting an assessment of the territory's financial capacity, as the law emphasized that a rural council could be included in the list of municipal entities, providing only there are local revenue sources capable to cover no less than fifty percent of the funding of its local self-governance bodies.

After a long process of negotiations, 49 representative bodies of local self-governance, including 24 districts, 2 oblast cities, and 23 settlements declared their wish to become municipal entities. Having considered protocols of their sessions, the oblast administration entered them in the register of municipal entities. The municipal elections scheduled for autumn of 1996, were held only to bodies of the municipal entities entered in the Register, and, in compliance with the oblast law, both heads of local self-governance and the representative bodies were to be elected.

A number of settlement municipalities were reorganized over time, and by early 2004 as many as 45 municipal entities had been functioning in Kaluga oblast, including:

- 11 urban municipal entities, of which two ones are oblast cities (Kaluga and Obrninsk);
- 2 consolidated municipal entities “town plus district” (the town of Kirovsk and Kirovsk district, the twqon of Lyudinovo and Lyudinovo district);
- 22 districts, of which 10 ones have independent lower-level municipalities in their territory;
- 7 settlements;
- 2 rural councils (Bebelsky rural council, Oktyabrsky rural council), and
- 1 district (Ugorskaya volost).

On the sub-municipal level, a number of districts of Kaluga oblast formed territorial subdivisions of district administrations. Their operations were regulated both by municipal entities’ charters and special provisions approved by district heads of local self-governance. In some territories within the municipal entities there operated territorial community-based self-governance bodies (TCSG). It should be noted that amendments to the law “On local self-governance ...” made it compulsory to establish in rural councils elected bodies of TPSG, known as councils of deputies, but failed to identify their powers in respect to local issues and the sources of financing their operations. Ultimately, according to the data available, electing about 2.5 thousand deputies in 2003 had no substantial effect on the improvement of operations of the territorial community-based self-governance in the oblast.

#### *4.2.3 Tyumen oblast*

Adoption of the USSR and Russian laws on local self-governance in 1990–1991 did not affect considerably on the situation with local authorities in Tyumen oblast. The first changes began to occur in 1994, when by Resolution of oblast Administration No.3<sup>36</sup> of January 14 the heads of administrations of cities, districts, settlements, rural councils were renamed into heads of local self-governance of relevant territories, and the date for the first election to the representative bodies of the local self-governance had also been specified. In so doing, the

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<sup>36</sup> This Resolution was adopted by Decree of the RF President No. 1760 of October 26, 1993 «On the reform of local self-governance in the Russian Federation».

methods of forming representative bodies differed according to the status of the territory:

- with population of less than 5 thousand people local governments were not established, while self-governance had to be effected through meetings of citizens;
- in the towns and localities with population over 5 thousand local elections were conducted ;
- at a level of districts and rural councils local governments were not elected but were established from representatives of the local governments of their comprised localities.

In this way, the procedure was established for forming only representative bodies of power, as before, the heads of local self-governance were appointed by the heads of districts, while the latter – by the head of oblast administration. Besides, up until 1998 the majority of powers for supplying the population with budgetary services were performed by the administrations of districts and territorial subdivision of sectoral committees of oblast administration. District administrations also formed the budget of district, approved the estimate of expenditures of settlements and rural councils, appointed their heads. On the scope of authority of rural and settlement administrations may be charged by the share of their estimates in the total expenditures of consolidated budgets of districts. In the period 1994–1997 it amounted about a third of consolidated expenditures of district budgets (see *Table 4.2*).

*Table 4.2*

**Budget expenditure ratios of oblast cities, districts, settlements and rural councils, 1994–1998**

Share of expenditures funded from the budgets of	1994	1995	1996	1997	1998
oblast cities	59.3	66.2	63.8	57.8	67.3
districts	31.3	25.6	26.4	28.7	4.5
settlements	1.9	1.9	1.5	1.7	2.4
rural councils	7.5	6.3	8.3	11.8	25.8
For reference only: share of expenditures of the consolidated budgets of districts funded through estimates of settlements and rural councils	23.8	25.0	27.6	32.0	

With the adoption of oblast law “On local self-governance...” activities started in oblast in 1995 for developing the settlement structure of local self-governance. In 1996, by oblast law “On setting the borders and territories of municipal entities in Tyumen oblast” the borders of 301 municipal entity had been established. In such a way, settlement municipalities had been established in all districts of oblast except for Zavodoukovsky. Resulted from the local referendum it had been decided to organize a single municipal entity – Zavodoukovsky district – on that territory.

To raise the efficiency of settlement municipalities’ activity in oblast legislation, a possibility was provided for establishing consolidated municipal entities for solving all or part of questions within the competence of consolidating municipalities. Here, the consolidated municipal entities rather considered a form of voluntary cooperation of municipal entities than the method of compulsory consolidation of municipalities. The procedure of organization of consolidated municipal entity did not necessarily mean abolition of governing bodies of settlement municipalities being part of it. Besides, when consolidated the settlement municipal entities could delegate not all but only part of their powers to a “newly born” municipal entity, distributing on a contract basis the material and financial resources for their fulfillment. In mid-1998, under the provisions of oblast law the consolidated municipal entity Urvatsky district was established according to the results of local referendum.

In 1997, the local district administrations had been abolished. Instead, territorial bodies of oblast administration had been organized<sup>37</sup>. From this time on, district administrations lost the right to their own budget and to major part of their powers. All sectoral committees of oblast administration, that were earlier accountable to district administrations, were passed either directly under jurisdiction of oblast administration or local governments. As a consequence, the district administrations did not provide any more budgetary services to population and first and foremost began to perform information, controlling and coordinating functions. The final stage of establishment of settlement municipalities in Tyumen oblast became adoption of the budget for 1998 in oblast, by which for the first time the rates of allocations and

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<sup>37</sup> Resolution of the governor of Tyumen oblast No.8 of February 28, 1997 “On organization of the territorial bodies of government power of oblast administration”.

subsidy amounts had been established not for towns and districts, but for specific municipal entities represented at that time by the four cities: Tyumen, Tobolsk, Ishim and Yalutorovsk, Zavodoukovsky district, and rural municipalities.

As in the years to follow, in 1998 budgets were formed based on actual expenses and their volume depended on the number of objects of social sphere, being on the balance of municipal entities. The process of municipal budgets' forming was preceded by redistribution of property. The institutions that were earlier financed from district budgets, depending on the functions they fulfilled, were passed to the balance of oblast or that of municipal entities. The budget of oblast took an obligation to finance the central district hospitals with their branches, social security and educational institutions, and law-enforcement bodies, in case they served the population of several municipalities. Many culture institutions were integrated in coordinating methodical centers and also were passed for funding from oblast budget. The rest of objects of social sphere were passed to local authorities. As a result, the share of expenditures funded from oblast budget increased by 14% of the total expenditures of consolidated regional budget (from 41,4% to 55,4%). Regional to local budgets' expenditures ratio, by year, is presented in *Table 4.3*.

*Table 4.3*

**Regional to local budgets' expenditures ratio,  
Tyumen oblast, 1994–2003**

<b>Share of expenditures funded from</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
oblast budget	46.6	41.4	42.7	41.4	55.4	59.7	65.5	63.1	66.8	67,3
local budgets	53.4	58.6	57.3	58.6	44.6	40.3	34.5	36.9	33.3	32,7

*Source:* reports on execution of the consolidated budget of Tyumen oblast for 1994–2003, the Ministry of Finance of Russia.

Though, by and large, the system of local self-governance in Tyumen oblast had been established in 1998, there were still many problems left in that sphere, for which solving the government target

program had been set to promote local self-governance<sup>38</sup>. Under the program it was intended to create legal guarantees of local self-governance, divide the financial and material resources between the government bodies of Tyumen oblast and the local governments, and also establish the system of cadre and information support. To achieve these goals it had been planned to carry out the following measures:

- developing and passing oblast laws and other legal acts of the bodies of state power of oblast the issues of division of powers and financial resources between the bodies of state power and local governments, granting to local governments some of state powers;
- developing and implementing the system of methodical recommendations for local governments, and also develop the system of analysis of activity of the local governments;
- building new and developing existing information networks, their interfacing with federal information systems, rendering financial and technical aid to local governments in acquiring software and computing machinery;
- establishing the system of training, retraining and advanced training of deputies, elected officials of municipal entity and municipal officials, as well as the system of oblast consultative and retraining centers.

The implementation of the Program had to be carried out in 1998–2000 and to be financed largely out of the oblast budget and extra-budgetary sources. Control over the Program implementation was devolved upon the Committee for local self-governance and municipal reform of oblast administration. It comes under notice that in the analytical review on the state of the system of local self-governance, contained in Annex to the Program, one of the achievements of the performed reforms in this sphere was recognized the following: “The choice in each administrative district of its own model of organization of local self-governance, which is best suited to specific local conditions, confirmed practicability of establishing principles of diversity of models of organization of local self-governance and independence of population in finding the structure of local governments”.

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<sup>38</sup> Resolution of the governor of Tyumen oblast No. 200 of December 7, 1998 “On oblast program of state support of the development of local self-governance”.

However, in 2001, the ideology of development of local self-governance in oblast experienced considerable changes. It had been decided to quickly switch to a district model of self-governance. Resulted from amendments moved to the law “On local self-governance ...”, organization of consolidated municipal entities suggested organization of local governments only at the level of districts with simultaneous liquidation of them at a settlement level. Accordingly, all the powers and financial resources had been passed to districts. For a transition period representative bodies of transitional period had been organized, comprised of the deputies of representative bodies of consolidating municipalities. The competence of that body suggested development of the charters of consolidated municipal entities and assigning the election of the bodies and officials of local self-governance. Since the date of coming into effect of new charters, the charters of consolidating municipalities were recognized as losing effect. Consolidation embraced all the districts except for Tyumen. Therefore, in 2001 there had been established 20 consolidated municipal entities on the territory of districts, and the total number of municipal entities in oblast amounted 49, including:

- 4 towns (Tyumen, Tobolsk, Yalutorovsk and Ishim),
- 21 consolidated municipal entities – district and
- 24 settlement municipal entities of Tyumen district.

#### *4.2.4. Leningrad oblast*

In 1991, in accord with the Russian law “On local self-governance in RSFSR” local councils were organized in Leningrad oblast. The councils were organized at both the level of settlements and rural councils and the level of districts. The exception was some district towns included in the district (for example, Vyborg).

Early in 1994, pursuant to the Decree of the President, the resolution No.9 “On conducting elections to legislative meeting of Leningrad oblast and the local governments in March 1994” of the head of Administration of Leningrad oblast of January 18, 1994 had been adopted. This resolution, besides the provision on the legislative meeting of oblast, provision on elections and other documents, approved the Temporary provision on general principles of organization of local self-governance in oblast.



The Resolution established the following system of local self-governance in oblast. Local governments had been organized at two levels (district and settlement):

- at district level local self-governance was effected by the heads of districts appointed by the head of oblast administration;
- in oblast cities not being district centers; in district towns and volosts – by municipalities;
- in rural, settlement and other localities – chairmen.

It is to be noted that these local governments, principles of their organization and activity considerably differed from those that were implemented in 1995 by the law “On general principles...”. In particular, municipalities composed of the meetings of representatives (5-15 representatives) and heads of administrations (heads of municipalities). The heads of administrations of towns and volosts were appointed by the heads of administrative districts; the methods of organization of the meetings of representatives were different and depended on the status of the territory. In large localities (population over 5 thousand) the representatives were elected by population, in volosts meetings of representatives were organized of the chairmen of localities, their manning had been approved by the heads of districts as advised by heads of volosts. In turn, the chairmen in small localities (with population to 5 thousand) were elected by citizens; while in localities with a “perspective of social and economic development and increase of population” – were appointed by the heads of districts.

Thus, the principles of organization of local self-governance in Leningrad oblast, established by the temporary provision of 1994, differed substantially from principles declared at the federal level. As it was mentioned above, according to the Decree of the RF President, basically, the heads of administrations and the meeting of representatives of localities had to be elected by population. In districts and rural councils the methods of organization of local governments had not been found. on the contrary, practically all the local governments in Leningrad oblast were appointed. The exclusion was large localities, where the meetings of representatives contained of the elected by population representatives, and small localities, where chairmen were elected.

In so doing, the distinctive feature of the system of organization of local self-governance in Leningrad oblast in the period 1994–1995 was

existing of budgets at a level of settlements, to which taxes and fees were included set by meetings of representatives. At the level of administrative districts the consolidated budget of district was formed.

Adoption of the federal law on local self-governance in 1995 affected considerably the situation with organization of local self-governance in Leningrad oblast. Even before adoption in 1997 the oblast law "On local self-governance in Leningrad oblast" activities started in some large localities of oblast for the development and adoption of municipal charters. Svetlogorsk and Kamenogorsk of Vyborg district, Gatchina of Gatchina district etc., may serve an example. The charters were adopted by meetings of representatives of those localities, with the result of their being declared independent municipalities. In Vyborg an attempt had also been made to organize an independent municipal entity, but the leadership of the district categorically opposed that initiative. As a result, a referendum had been conducted in 1996 on the initiative of district authorities, one of the questions of which was as follows: "Do you agree if a single municipal entity is established?". Over 85% of population answered positively this question. As a consequence, Vyborg, which is comparable by its size with such towns as Gatchina and Volkhov, was incorporated into Vyborg district.

By the results of the reform of local self-governance in Leningrad oblast the following municipal entities had been established:

- 17 districts (Boksitogorsky, Volosovsky, Volkhovsky, Vsevolzhsky, Vyborgsky, Gatchinsky, Kingiseppsky, Kirishsky, Kirovsky, Lodeinopolsky, Lomonosovsky, Luzhsky, Podporozhsky, Priozersky, Slantsevsky, Tikhvinsky and Tosnensky);
- 9 towns (Volkhov, Gatchina, Ivangorod, Pikalevo, Sosnovy Bor, Kommunar (Gatchina district) and Svetogorsk (Vyborg district), Novaya Ladoga (Volkhov district), Shlisselburg);
- 2 settlements (Kuznechnoye (Priozersk district) and Sertolovo (Vsevolzhsk district));
- 1 volost (Koltushsk volost (Vsevolzhsk district)).

At the level of the rest of volosts and rural localities municipalities were abolished, local administrations became territorial subdivisions of district administrations. In all, as many as 204 volosts and 34 settlement administrations had been established on the territory of Leningrad oblast.

Under the federal law "On general principles of organization of local self-governance in the Russian Federation" and the oblast law "On elections of the bodies and officials of local self-governance in Leningrad oblast" the election to local governments had been held in November-December 1996, except for Novaya Ladoga, where elections had been held in at the end of January 1997. Of the total number of voters in election of deputies took part 41,31%, while in election of the heads of municipal entities – 39,45%<sup>39</sup>. According to charters, practically in all municipal entities were elected both representative bodies of local self-governance and heads of municipal entities. The exception was Kirishsky district, where, according to the charter, the head of municipal entity was hired on contract basis.

It should be noted that transition to the new system of organization of local self-governance led to a certain centralization of functions at a regional level. An analysis of regional to local budgets' expenditures ratio (*Table 4.4*) showed that in 1994–1995 about 63% of the expenditures of the consolidated regional budget had been funded from local budgets. Starting from 1996, considerable reduction of the share of expenditures funded from local budgets was observed. In 1996, that indicator was already 59,4 %, and in 2003 it went down to 41,8%.

*Table 4.4*

**Regional to local budgets' expenditures ratio,  
Leningrad oblast, 1994–2003**

<b>Share of expenditures funded from</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
oblast budget	37.3	37.5	40.6	45.0	50.3	46.9	49.0	58.2	57.8	58.2
local budgets	62.7	62.5	59.4	55.0	49.7	53.1	51.0	41.8	42.2	41.8

*Source:* reports on execution of the consolidated budget of Leningrad oblast for 1994–2003, the Ministry of Finance of Russia.

Besides the redistribution of functions between different levels of power, interbudgetary relations have considerably changed in oblast. In

<sup>39</sup> Resolution of the government of Leningrad oblast No.2 of January 23, 1997 "On the results of election of deputies of representative bodies of local self-governance and the heads of municipal entities and some measures on further development of the local self-governance in Leningrad oblast".

particular, this could be explained by the fact that financing of the activity of volost and settlement administrations, which earlier had independent budgets, became to be effected in accordance with estimates. In individual districts, in order to heighten the interest of local administrations in the development of economic potential on subordinate territory, attempts were made to provide the volost and settlement administrations with independent revenue sources. For example, in Vyborg district it had been planned to leave in possession of local administrations local taxes and fees, but, within the existing at that time legislation they could not implement that initiative. Under the decision taken in Volosvsky district, all land fees had been left at command of the administration.

In 2001, an experiment had been organized in Gatchina district that virtually provided for granting to volosts quasi-municipal status<sup>40</sup>. The district administration delegated to their territorial subdivisions, that manifested such a desire, execution of individual powers on solving the local issues and assigned them revenue sources. The base for assigning revenues here were calculated by the same formula for all territorial subdivisions minimum guaranteed expenses on major items of municipal expenditures. In practice, the experiment affected only one – Pudostskaya volost – and was carried out only during several months. The volost was delegated actually all municipal functions, except for Housing and utility sector (HUS). The list of revenue sources included the income tax, single presumptive tax, personal asset tax, land tax, rental payment, streets' clean charges, educational institutions' charges, and also a part of the corporate asset tax.

With adoption of oblast law "On local self-governance ..." and establishing municipal entities of varying type across Leningrad oblast, disputes about an optimal territorial structure of local self-governance continued. From time to time the question raised again about epy practicability to return to two-level system of local self-governance. For example, at regional seminars of the heads of administrations of volosts and settlements in March-April 1999 some deputies of the Legislative meeting suggested to establish 250 more municipalities to those exist-

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<sup>40</sup> Bobrov I.V., Lyubushkina E.V. Give us the source of revenue and Gatchina will be as good as Versailles // Munitsipalnaya vlast, 2002, No.1.

ing in all the settlements and volosts of oblast. But such proposal was not supported by the seminar participants<sup>41</sup>.

To minimize the negative consequences of changing the territorial fundamentals of the local self-governance in Leningrad oblast, activities had been performed energetically to develop the territorial community-based self-governance. By the beginning of 1999, in some rural localities street and house committees had been organized, in others – the work of chairmen. The total number of chairmen was about 1500, 70% of them were elected at citizens' meetings. In 2000, the oblast law "On territorial community-based self-governance in Leningrad oblast" had been adopted, that determined the sphere of competence of the territorial community-based self-governance.

It is to be noted that in Leningrad oblast all the work for the development and establishing of the local self-governance was performed within the target programs. During the implementation of the Program of state support of local self-governance for 1996–1998, the financial and territorial fundamentals of local self-governance had been established. In particular, the borders of municipal entities had been determined, oblast laws were adopted on granting state powers to local governments and passing them material resources, the normative documents had been approved that regulate distribution of municipal property between municipalities located on the same territory etc. Further work on enhancing greater independence of municipal entities, improving legal relationships of local governments and the government power, the reform of municipal authorities of social sphere and a number of other directions was carried out under the Program of state support and development of local self-governance in Leningrad oblast for 1999–2000 approved at the end of 1998<sup>42</sup>.

#### *4.2.5. Astrakhan oblast*

In Astrakhan oblast the elected bodies at both the level of districts and settlements existing since 1991. The adoption in 1996 of oblast law

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<sup>41</sup> Resolution of the government of Leningrad oblast No. 45 of May 27, 1999 "On the results of holding regional seminars of the heads of administrations of volosts and settlements and on measures of state support of the local self-governance in Leningrad oblast".

<sup>42</sup> Resolution of the government of Leningrad oblast No. 41 of December 10, 1998 "On program of state support and the development of local self-governance in Leningrad oblast for 1999–2000".

“On local self-governance ...” practically nothing changed in the system of organization of this institution of power. In contrast to the majority of regions of Russia, in Astrakhan oblast it had been decided to leave in force the two-level system of local self-governance practically in all the administrative districts of oblast. The exception is Privolzhsky and Chernoyarsky districts, where by the results of referendums it had been decided to abolish settlements municipalities, leaving representative local governments only at a level of districts. As a result, as many as 154 municipal entities, including the two oblast cities (Astrakhan and CATE (closed administrative territorial entity) Znamensk) had been established on the territory of Astrakhan oblast.

With adoption of the law “On local self-governance ...” practically in no way has changed the system of interbudgetary relations in oblast. Prior to 1996 the activities of governments at a level of settlements was financed according to estimates of expenditures. Although the federal law “On general principles ...” and then also the oblast law introduced the norms on impossibility of municipality hierarchy and on indispensable availability of budgets to all municipal entities, up to 2003 in all districts were approved the consolidated budgets of districts. All the rates of allocations from federal and regional taxes were assigned by laws of oblast budgets only to districts, which, in turn, assigned then to settlements. Distribution of financial aid between settlements also included in the powers of districts.

Starting from 2003 the situation somewhat changed. The cause of introducing changes in the system of extra-budgetary relations was a judicial proceeding, started by the local governments of Kharabali-city, who required establishing of interbudgetary relations of the city directly with oblast, rather than district governments. The proceeding was won by the administration of the city. As a consequence, for the first time the law of oblast budget for 2003 assigned the rates of allocations to all municipal entities of oblast: district and settlement. It should be noted that changing of interbudgetary relations in oblast led only to insignificant changing of the status of districts and practically did not exclude the dependence of the local governments of settlements on district administrations. This is explained by the fact that all the rates of allocations to settlement budgets approved in accordance with recommendations of district administrations, recalculation of fiscal capacity of set-

tlements at an oblast level had not been carried out. As a result, the size of rates assigned to settlement budgets by oblast laws left practically unchanged, as compared to previous periods when assigning rates to settlement budgets was carried out by district administrations.

Besides extra-budgetary relations in Astrakhan oblast, the activity of the local governments is also complicated by imperfection of legal base in other spheres. In particular, local issues, municipal property, had never been solved by law between the two levels of municipal authorities. Also, not formalized is the process of transferring to municipal levels of government powers. As a result, the process of execution by local governments their powers is concerned with numerous conflict situations. Furthermore, existing from 1997 Association of municipal entities of Astrakhan oblast could not take active position in resolution of conflicts between settlements and districts, as either of municipality was its member.

To protect their interests, in 2003 representatives of settlement municipalities established the Union of rural settlements of Astrakhan oblast. The Union's mission is:

- organization of mutual assistance in the settlement municipality community;
- formation of the legal base of local self-governance bodies of rural municipal entities and development of a respective new draft of the federal law "On general principles ...";
- protection of the rights of local self-governance bodies of rural localities as per by current legislation;
- cooperation with the Association of rural localities of the RF, exchange of experiences with local self-governance bodies of rural localities in other RF Subjects;
- provision of informational and methodological support to local self-governance bodies in settlements;
- exchange of experiences between local self-governance bodies of rural localities of different districts of the oblast, holding on-the-spot seminars and conferences.

Presently the Union vigorously participates in the oblast local self-governance reform in, and is keen to solidify the settlement municipal entities' position.

#### 4.2.6. Tver Oblast

In 1994, in compliance with the presidential Decree of “On the reform of local self-governance ...” local self-governance bodies were elected in towns and settlements of Tver oblast, , while representative local self-governance bodies of rural councils were formed by country chairmen. District heads appointed by the head of the oblast administration ran their districts in cooperation with bodies of representative power formed by representatives of settlement municipalities.

After enactment of the 1995 federal law “On general principles ...” the Oblast Legislative Assembly passed Resolution No.310 of February 22, 1996 “On some measures on implementation of the federal law “On general principles of organization of local self-governance in the RF” in Tver oblast”. According to the Resolution, the primary objectives in the sphere of the local self-governance reform were demarcation of the municipal entities’ borders, development and adoption of municipal charters, and preparations for elections to local self-governance bodies scheduled for March 1996. In addition, the Resolution set impossibility of a further establishment of local governments and appointment of local self-governance officials by the government agencies and officials.

In the course of the oblast reform of local self-governance, the region has accomplished the transition towards the single-level district system of organization of local self-governance, which resulted in establishment of 36 district municipalities of which 7 became single “town + district” municipalities, as they included oblast cities. The city of Tver and another oblast cities, namely, Vyshny Volochek, Kimry, Rzhev, and Torzhok became independent municipal entities (.). The status of municipal entity was also granted to two closed administrative-territorial entities (CATE) located in the oblast’s territory (urban settlements: Ozerny and Solnechny).

The organization of the territorial community-based self-governance at the regional level practically was not regulated. That is why the degree of its maturity depended largely on local authorities’ rulings. For example, in the city of Tver much attention was paid to the territorial community-based self-governance (TCSG). More specifically, the city legal acts regulated their operations, procedures between local self-governance bodies and grass-root-level groups of citizens organized



for the sake of establishment of TCSG bodies. As well, the city gave rise to a methodological council for TCSG<sup>43</sup>, whose mission was to mobilize the city community to participate in foesting and improving the local system of territorial community-based self-governance and designing its legal base. In addition, a public council on TCSG was established under the city administration<sup>44</sup>. Its mission was to engage citizens to run the city by means of TCSG, inform general public on the city head and administration's activities, as well as attract the TCSG activists to debate decisions on critical local issues.

It should be noted that much attention was paid in Tver oblast to enhancement of efficiency of both public and municipal administration. To ensure the implementation of this ambitious mission, in 2001 representative bodies of local self-governance in the and the legislative assembly of Tver oblast entered into the agreement on cooperation and interaction<sup>45</sup>. The agreement fixed mutual obligations and procedures of participation of the representative bodies of municipal entities and the Oblast Legislative Assembly in:

- the legislative process;
- exercising control over observance with, and execution of the legislation on local self-governance;
- informational interaction;
- organizational and methodological work.

In addition, the oblast was implementing the targeted program "Informational support to the bodies of state power and local self-governance of Tver oblast for 2002–2004"<sup>46</sup>. The program centered on boosting the administrative efficiency by introducing and spreading information and communication technologies.

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<sup>43</sup> Resolution of the head of Tver administration No.147 of January 23, 2002 "On the methodological council for territorial community-based self-governance at Tver administration".

<sup>44</sup> Resolution of the head of Tver No.663 of April 6, 2004 "On establishing the social council for TCSG under Tver administration".

<sup>45</sup> Resolution of the Legislative Assembly of Tver oblast No.753-P-2 of June 7, 2001 "On conclusion of an agreement of cooperation and interaction between the representative bodies of local self-governance and the Legislative Assembly of Tver oblast".

<sup>46</sup> The law of Tver oblast No.21-30 of April 9, 2002 "On approval of the oblast targeted program "Informational support to the bodies of state power and local self-governance of Tver oblast for 2002–2004".

### **4.3. Conclusions**

In the history of formation of the territorial principles of local self-governance in Russia, there may be singled out three stages. At the first stage, the Soviet Union and later Russian laws on local self-governance created the system of local governments, which replaced the system of soviets of people's deputies. Local governments were formed in all administrative and territorial subjects of the country. At the second stage, a Presidential decree declared the creation of the settlement based model of local self-governance with elected bodies formed at the level of settlements and rural councils. However, heads of districts were appointed. At the third stage, which was launched by the adoption of the federal law "On general principles of organization of local self-governance in the RF" in 1995, the system of local governments was separated from the administrative and territorial structure of the country, what permitted regions to introduce different models of territorial organization of local governments in their territories.

In the regions under observation, the reform of the territorial principles of local self-governance started in 1994, when in the majority of regions by tentative regulations there was introduced the settlement based model of local government. However, there were observed significant differences as concerned both the methods of formation of representative bodies of power and financing of activities carried out by such bodies. For instance, in the Kaluga oblast all heads of towns and settlement municipal entities (settlements, rural councils) were elected by the population, while in the Leningrad oblast there was taken decision to delegate the power to appoint heads of towns and volosts to heads of district administrations. Organization of financing of the activities carried out by local governments also differed rather significantly. For instance, in the Leningrad and Astrakhan oblasts there were formed budgets of settlements, while in other regions the activities carried out by local governments were financed on the basis of financial estimates.

Due to the fact that the federal law of 1995 "On general principles..." did not set any model of territorial organization of local governments as the nationwide one, regional authorities could independently choose the methods of organization of their systems of local self-governance. As a result, the district based model of local self-governance was established in the Novgorod and Tver oblasts, and a two-tier structure

was introduced in the Astrakhan oblast (with the exception of two districts). At the same time, in the Kaluga and Leningrad oblasts there was legislatively fixed the option to establish municipalities of different types. As a result, both settlement and district based municipalities functioned in the territory of the Kaluga oblast. In the Leningrad oblast, there have been also observed instances, where some municipalities were created within the territories of other municipal entities; however, oblast and district towns mostly became independent. In the Tyumen oblast, initially there had been formed the settlement based model, which in 2002 after the change of the oblast administration was replaced by the district model.

## **Chapter 5. Regulation of the Financial Fundamentals of Local Self-governance in Pilot Regions**

### **5.1. Legislative Framework**

Regulation of the financial fundamentals of local self-governance has turned out to be a least elaborated issue both in the federal and regional legislations. At the federal level, these problems were embraced by the laws “On general principles of organization of local self-governance in the RF” and “On financial fundamentals of local self-governance in the RF.”

The law “On general principles of organization of local self-governance in the RF” has declared that state authorities should guarantee the financial resources sufficient to ensure minimum necessary local budgets. In accordance with this law, federal and regional state authorities should have assigned to municipal entities revenue sources sufficient for defrayal of minimum necessary expenditures. At the same time, the minimum necessary revenue sources of local budgets should be set up by laws of RF subjects on the basis of standards of minimum fiscal capacity.

The law “On financial fundamentals of local self-governance in the RF” was adopted in order to regulate the mechanisms of assignment of shared taxes and allotment of financial aid to municipal entities. The law determined the minimum standards of shares of federal taxes due to local budgets; regulated the principles and mechanisms of granting financial aid to municipal entities, and set up the procedures governing the formation and functioning of the fund of financial support of municipal entities. The law attempted to ensure financial independence of municipal entities on the basis of the long term assignment to them of standard allocations of shared taxes.

As concerns the determination of financial fundamentals of local self-governance, regional laws “On local self-governance...” contained the same norms as the federal law “On general principles...” In particular, these laws declared the guarantees that state authorities should give as concerned the provision of financial resources sufficient to ensure minimum necessary local budgets, as well as the general principles of formation and execution of these budgets. Besides, the regional

laws defined the major sources of local revenues. The latter included the revenues generated by shared taxes and own revenues, as well as local taxes and fees, local fines, municipal loans and credits, revenues generated by municipal properties, and other non-tax revenues. In the Astrakhan, Novgorod, Tver, and Tyumen oblasts, there was also envisaged the possibility to use self taxation of citizens for the purposes of financing of the handling of local problems.

In the Leningrad oblast, the interbudgetary relations were regulated by law No. 36-oz of September 26, 2002, "On the budget process in the Leningrad oblast"<sup>47</sup>. The law stipulated that interbudgetary relations in the oblast should be based on the principles determined by the federal legislation. The law also approved the list of expenditures financed exclusively from the local budgets, as well as the list of expenditures financed from the regional and local budgets. The law of the Leningrad oblast "On the budget process..." also set up the forms of financial aid granted from the regional budget to the budgets of municipal entities and stipulated that the needs of local budgets in the financial aid provided from the regional budget should be calculated in accordance with a unified methodology. Besides, the law envisaged that the municipal entities in the region might be granted budget loans for the purposes of bridging temporary cash gaps. As concerns the granting of subventions and subsidies for financing of certain target expenditures, the law contained an open end list of such target expenditures. Besides, the methods of regulation of interbudgetary relations in the Leningrad oblast should be annually approved by the laws on the oblast budget.

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<sup>47</sup> Prior to 2002, in the oblast there had been in force regional law No. 11-oz of April 22, 1996, "On the budget system and budget process in the Leningrad oblast". That law contained practically no provisions setting up the financial fundamentals of local self-governance and determining the relations between the regional and local budgets. As concerns local budgets, the law envisaged the following:

- Budget regulation was based on the division of responsibility between the respective budgets;
- Targeted budget funds might be created within the structure of budgets;
- Equalization of expenditure capacities of local budgets by the method of transfer of subventions from the fund of equalization of fiscal capacity was a component of budget regulation, on the mandatory condition that fiscal capacity of the territory, which was granted the subvention, was at or below 95 per cent of the average fiscal capacity observed across the region. However, the law failed to envisage the separate calculation of fiscal capacity across different types of municipalities (district, settlement).

Law of the Tver oblast No. 138–OZ 2 of February 27, 2001, “On the budget system and budget process in the Tver oblast” also contained the lists of expenditures financed exclusively from local budgets, and expenditures, financed from budgets of several levels. Besides, the law determined the sources of formation of revenues of local budgets and introduced a limit on the amount of expenditures aimed at the repayment of municipal debts. In the Astrakhan oblast, a separate document regulating interbudgetary relations was adopted at the end of 2001. It was resolution of the oblast administration No. 579 of December 5, 2001, “On the formation of interbudgetary relations in the Astrakhan oblast for year 2002”. In spite of the fact that this document should have been in force only during year 2002, certain provisions of the resolution remained in force in the next few years. In particular, it concerned the methods of calculation of the budgetary expenditures index of municipal entities. In 2003, there was issued resolution of the oblast Governor No. 378 of August 8, 2003, “On the distribution of financial aid granted to municipal entities of the oblast for the purposes of equalization of fiscal capacity”, which established new principles of interrelations between budgets of different levels. The resolution remained in force for only one year and then was declared invalid.

In 1997 through 2000, in the Tyumen oblast interbudgetary relations were regulated by law No. 133 of December 1997 “On the formation of budgets of municipal entities”<sup>48</sup>. This law was practically similar to the federal law “On financial fundamentals...” and set up the principles of interbudgetary relations in the region, minimum standards with respect to tax shares due to local budgets, and a number of other provisions.

The delegation of certain state powers to local governments is a special issue of the normative and legal regulation. Both in the federal law “On general principles...” and regional legislations of all RF subjects under observation there was declared that the delegation of state powers to local governments may be carried out only on the condition that to such local governments there are simultaneously transferred financial resources sufficient for the execution of these powers. However, these declarations are not always put into practice.

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<sup>48</sup> The Tyumen oblast law “On the formation of budgets of municipal entities” ceased to be effective because of adoption of law No. 234 of November 11, 2000.

In the **Novgorod oblast**, the laws concerning the delegation of certain state powers to local governments stipulated the transfer of such powers as the power to license retail trade with alcohol beverages, the power to confer the title “Veteran of labor,” etc., i.e. the powers not requiring considerable financial resources. However, the list of state powers actually exercised by district administrations was far beyond those delegated to them by the regional laws. Judging by the bylaws of municipal entities, local governments also:

1) conducted registration of births, deaths, and marriages and performed notary functions;

2) organized registration of children left without parental custody and non-adults deprived of normal care in their families, undertook measures aimed at the placement of such non-adults in ward, adoption, their transfer to foster families, to care establishments or institutions of the social safety net, carried out monitoring of how well custodians and guardians performed their duties;

3) took measures aimed at the maintenance of the living space assigned to orphan non-adults placed in ward and assignment of such living space in the cases stipulated by the legislation of the Russian Federation currently in force;

4) conducted primary draft registration of citizens, notification of citizens as concerns calls issued by military commissariats and ensured the timely appearance of the draftees;

5) carried out the measures concerning civil defense, mobilization preparedness, reservation for mobilization period, and prevention and liquidation of emergency situations as stipulated by law.

At the same time, laws on the oblast budget did not envisage either targeted subventions aimed at the exercise of these powers, or additional allocation of shared taxes. It is possible that the oblast administration had included the expenditures pertaining to the exercise of these powers in the total estimated expenditures of municipal budgets for the next financial year and taken such expenditures into attention in the course of distribution of financial aid and assignment of the sources of financing to local budgets; however, these expenditures had not been set up in terms of law in any form. Starting from 2004, municipal entities of the Novgorod oblast began to receive financial resources targeted for the registration of births, marriages, and deaths.

As concerns social benefits set up by federal laws “On social protection of disabled persons in the RF,” “On veterans,” “On state allowances to citizens with children,” and a number of other laws, the amount of targeted subsidies and subventions from the Compensatory Fund was annually determined by the laws on the oblast budget. As concerns the financial resources necessary to defray the losses of transport organizations experienced in relation with the exercise of the right of free travel granted by federal and regional laws, such resources were envisaged in the composition of expenditures of municipal budgets in the course of calculation of the indicators of interbudgetary relations.

In the **Kaluga oblast**, state powers were mainly delegated to district municipalities and the oblast towns of Kaluga and Obninsk. In accordance with the laws on the oblast budget, a number of state powers could be also delegated to certain settlement municipalities. In order to back the delegated state powers with financial resources, until 2003 to these towns there were granted additional revenues generated by shared taxes. Thus, the standard rates of shared taxes allocated to local budgets consisted of two components: a part of financial resources generated by the tax were targeted for the exercise of state powers and the second part was aimed at the resolution of the issues of local importance. Besides, there were separately approved the rates of allocation to towns and districts of the shares of profit tax and income tax paid by the taxpayers situated in the territories of the settlement municipalities under the jurisdiction of such towns and districts.

Since 2003, in the oblast there has begun to be formed the Fund of Subventions aimed at the financing of certain state powers exercised by local governments of the Kaluga oblast. The Fund was formed via centralization of a part of standard allocations of shared taxes of municipal entities and own revenues of the oblast budget. The laws on the oblast budget approved the closed list of powers financed from the Fund of Subventions. In 2003, in this list there were included the following powers:

- To ensure the educational process in municipal establishments of secondary (complete) education, methodological support of municipal establishments of basic education, and control over the content of education;
- To organize registration of births, marriages, and deaths;
- To organize and to realize civil defense;



- To maintain employees of social protection agencies engaged in allocation of pensions and allowances;
- To implement the law of the Kaluga oblast “On social guarantees for foster families in the Kaluga oblast” as concerns remuneration of labor of foster parents;
- To pay allowances set up by the federal law “On granting social guarantees to Heroes of Socialist Labor and Holders of the Order of Labor Glory of all classes.”

At the same time, this list significantly differed from the list of state powers delegated to local governments by the regional law “On local self-governance...”. For instance, powers related to the provision of housing to employees of the prosecutor’s offices and internal affairs agencies, payment of benefits set up by federal laws, and a number of other powers were excluded from the list.

In 2004, the list of state powers financed at the expense of funds transferred to local budgets in the form of subventions was somewhat changed. Thus, in this list there were included the powers concerning the maintenance of employees public education departments engaged in organization of the educational process. At the same time, from the list there were excluded subventions for organization of the registration of births, marriages, and deaths, and financing of benefits set up by the federal law “On granting social guarantees to Heroes of Socialist Labor and Holders of the Order of Labor Glory of all classes.” In accordance with the law on budget, the expenditures for these powers borne by local budgets should be taken into account in the course of the distribution of financial aid granted from the fund of financial support of municipal entities.

In 2003, the towns of Kaluga and Obninsk retained the rates of allocation of shared taxes for the exercise of certain powers, while other municipalities received financing in the form of targeted subsidies; in 2004, the practice of assignment of standard allocations for these purposes was stopped and all municipal budgets became the recipients of financing from the Fund of Subventions.

In the Kaluga oblast, the funds aimed at the financing of social benefits set up by the federal laws “On state allowances to citizens with children,” “On social protection of disabled persons in the Russian Federation,” “On veterans,” and “On the status of servicemen” were central-

ized in the oblast budget and the expenditures related to implementation of these benefits were defrayed by the Social Policy Department of the Kaluga oblast.

In the **Tyumen oblast**, state powers delegated to local governments are financed at the expense of targeted subventions allocated from the regional budget. The list of all state powers and the amounts of targeted subsidies transferred to municipal entities for financing purposes is annually approved by laws on the regional budget for the respective financial year. The amount of subventions and subsidies for the implementation of federal laws “On social protection of disabled persons in the Russian Federation,” “On veterans,” and the regional law “On social protection of disabled persons in the Tyumen oblast” are also determined by the laws on the oblast budget.

In the **Tver oblast**, state powers were delegated to the municipal level by certain regional laws, while the amounts of financing allocated for the exercise of these powers were annually set up by the laws on the oblast budget. At the same time, the exercise of the majority of state powers did not require significant financial and material expenditures. For instance, such powers included the setting up of mercantile additions to prices of medicines and medical appliances, awarding of the title of “Veteran of Labor,” etc. The only exceptions were the powers relating to the state registration of births, marriages, and deaths. In the Tver oblast, the funding of this power in the form of targeted subsidies to municipal budgets had begun to be allocated only since 2002, although local governments were vested with the registration of births, marriages, and deaths yet in 1998<sup>49</sup>. It should be noted that the Tver oblast was one of few regions, where expenditures borne by local budgets in relation to the exercise of powers concerning the registration of births, marriages, and deaths were compensated in the form of targeted subventions from the oblast budget. In other regions, municipalities had to finance these powers at the expense of own funds.

As it has been mentioned in Chapter 3 of this study, in the **Astrakhan oblast** the process of delegation of state powers to the municipal level was not formalized. There were adapted no laws to regulate the procedures governing the delegation of state powers or assigning cer-

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<sup>49</sup> The Tver oblast law No. 38 OZ 2 of November 26, 1998, “On delegation of state powers to register births, marriages, and deaths to local governments.”

tain powers to the municipal level in the oblast. As a result, the delegation of state powers was carried out on the informal basis and there was envisaged no ways of provision of local budgets with financial and material resources necessary for the exercise of these powers. The regional budget laws determined the amounts of subventions, which were granted to municipal entities exclusively for the implementation of federal laws in the sphere of social assistance to the populace.

In the **Leningrad oblast**, to the municipal level there were delegated more than 35 state powers in 9 key spheres: social protection of the populace, health care, education, managing of the housing, keeping of archives, state registration of births, marriages, and deaths, licensing, price regulation, and agriculture (see Chapter 3, item 3.3). However, in the period from 2001 through 2004 the laws on the regional budget contained separate items allocating subventions for the exercise of only the following state powers:

- To collect, maintain, register, and use the state part of the Archive Fund of the Russian Federation;
- To ensure the activities of the department for the registration of births, marriages, and deaths in accordance with the legislation in force;
- To observe the agri-ecological specialization and special zoning of seed growing as concerns potato, vegetable, and fruit and berry crops; to evaluate the variety and sowing quality of seeds, state variety and seeding control;
- To ensure the activity of the veterinary service as concerns the prevention of animal diseases and protection of the populace from the diseases common for animals and humans; to ensure the state veterinary supervision.

Therefore, in the Leningrad oblast the targeted financing was carried out as concerned the exercise of state powers in only three spheres: agriculture, maintenance of archives, and the registration of births, marriages, and deaths. The expenditures for the exercise of other powers were imposed on local budgets. In the law on the oblast budget for year 2005, the list of state powers financed in the form of targeted subventions was significantly reduced and subventions were allocated only to finance the maintenance of the state part of the Archive Fund of the Russian Federation.

## **5.2. Assignment of the Standard Rates of Allocation of Shared Taxes to Local Budgets**

The legislation concerning the financial fundamentals of local self-governance set up a number of requirements pertaining to the regulation of tax revenues of municipal entities; however, not all these requirements were observed in practice in the regions under observation. Thus, in none of the monitored regions there was ensured the assignment of the standard rates of allocation of shared taxes on a long term basis. In all the monitored regions, the allocated rates of shared taxes due to local budgets were annually determined by laws on oblast budgets.

Until 2003, in the Kaluga oblast the standard rates of allocation of the contingents of shared taxes had remained rather stable, although the rates of regional shares allocated to local budgets set up by the respective budget laws somewhat fluctuated over time. For instance, in 2001 the standard rate of allocation of the regional share of the profit tax was reduced from 88.2 per cent to 75.1 per cent on the regional average; however, it practically did not affect the rate of allocation of the contingent of the income tax, since in the respective year its regional share increased from 84 per cent to 99 per cent. At the same time, the standard rates of allocation were significantly differentiated across the different groups of municipal entities. Thus, in the period from 2000 till 2002, on the average 89 per cent of the revenues generated by the profit tax remaining at disposal of the region were transferred to local budgets. At the same time, 100 per cent of the revenues were transferred to the budgets of municipal entities, to which state powers were delegated (with the exception of the city of Kaluga). The rate of allocation of the profit tax to the municipal entities of settlement type made 65 per cent of the respective oblast revenues on the average.

A quite different situation was observed in 2003. In accordance with the law on the regional budget, the standard rate of allocation of the profit tax declined by circa 50 per cent on the average, while the respective figures pertaining to the income tax on individuals decreased by 45 per cent. Such a sharp reduction of revenues of local budgets in the oblast was explained by a higher degree of centralization of expenditures. As stipulated by the law on the oblast budget, in 2003 the following types of expenditures were transferred to the regional level:

- Insurance contributions pertaining to the mandatory health insurance as concerns the unemployed population with the exception of municipal entities “city of Kaluga” and “town of Obninsk”;
- Expenditures for (gross) remuneration of labor of the employees of general educational schools of municipal entities with the exception of the municipal entities “city of Kaluga” and “town of Obninsk”;
- Expenditures of municipal entities for maintenance of children being in wardship (guardianship) and in foster families with the exception of the municipal entities “city of Kaluga” and “town of Obninsk”;
- Expenditures for additional nutrition of pupils of general educational schools of municipal entities;
- Expenditures for maintenance of the normative strength of the public safety militia (including the expenditures related to the pay for communal services) as concerns the municipal entity “Bebelevsky Rural Council.”

At the same time, practically all heads of municipal entities noted a significant deterioration of financial standing in 2003. However, it seems that these developments were not directly related to the centralization being in progress at that time. This conclusion may be drawn on the basis of the fact that in 2002 two most important centralized expenditure items, i.e. insurance contributions related to the mandatory health insurance and the expenditures related to the remuneration of labor of the employees of general educational schools made 27.1 per cent of the average expenditures of local budgets across the region. At the same time, 50 per cent of the profit tax on organizations and 45 per cent of the income tax centralized in the oblast budget on the average defrayed only 13.8 per cent of municipal expenditures.

In 2004, in the oblast budget there were additionally centralized the expenditures for maintenance of the normative strength of the public safety militia (including the expenditures related to the pay for communal services) as concerns certain municipal entities. However, the rates of allocation of the profit tax on enterprises and the income tax on individuals remained practically unchanged with the exception of the cities of Kaluga and Obninsk. The standard rate of allocation of the profit tax to the budget of the city of Kaluga declined from 71 per cent to 51 per cent of the total respective revenues due to the budget of the RF subject, while the share of revenues generated by the income tax de-

creased from 76 per cent to 61 per cent. As concerns the town of Obninsk, the decline in the standard rates of allocation of taxes was even more significant: the rate of allocation of the profit tax declined from 90 per cent to 45 per cent, while the share of the income tax decreased from 76 per cent to 40 per cent. It should be noted that the reduced standard rates of allocations to the budgets of oblast cities can not be explained by the centralization of funds targeted for the maintenance of militia, since there was carried no centralization of the funds allocated for these purposes.

In the **Leningrad oblast**, the laws on the regional budget set up the standard rates of allocation of the shared taxes for all municipal entities, both districts and towns (settlements, volosts), situated in the district territories and being separate municipal entities. However, in contradistinction to the Kaluga oblast, the standard amounts of allocations did not depend on the level of the municipalities.

An analysis of dynamics of the standards has indicated that in 2001 there occurred a change as concerns the policies pursued by the oblast administration with respect to the assignment of standard rates of allocation of the profit tax to local budgets. Prior to year 2000, the standards had been assigned to the majority of local budgets at the maximum possible levels. In the first quarter of 2001, the standards relating to the incomes of individuals were reduced and made 10 per cent of the respective total tax revenues due to the budget of the RF subject, while in the second quarter of 2001 this standard was somewhat raised (up to 20 per cent). During the period from 2001 till 2004, the standard rates of allocation of the income tax remained practically the same across the overwhelming majority of the region's municipal entities. At this level, the standards were set up for 27 municipal entities. The budgets of the Kirishsky district and the town of Svetlogorsk did not receive the allocations of the income tax on individuals. Over the next few years, the standards concerning two municipal entities (the Kirishsky district: in 2004, the standard was at 13.66 per cent, in other years at 0 per cent; the settlement of Kuznechnoye: in 2001 through 2002 the standard was at 20 per cent, in 2003 – at 0 per cent, in 2004 – at 10 per cent).

An opposite situation was observed in the oblast as concerned the allocations of the profit tax on enterprises. In this sphere, the standards had been revised on the annual basis across practically all municipal

entities being both reduced and increased. For instance, over the years under observation the following standards were set up as concerns the budget of the Boksitogorsky district (in per cent of the total amount of payments due to the oblast budget): 55.5 per cent in 2000, 100 per cent in 2001, 0 per cent in 2002, 47.28 per cent in 2003, and 100 per cent in 2004. At the same time, no system was detected as concerns the changes in the amounts of changes. In only 5 municipal entities the standards remained unchanged over the whole period under observation: in the Kirishsky district, the settlement of Kuznechnoye the standard was at 0 per cent, while in the town of Shlissersburg, the Koltushskaya volost, and the Volosovsky district the standard was at 100 per cent of the profit tax revenues due to the regional budget.

In the **Tyumen oblast**, in 2001 the transition from the settlement to the district model of the territorial organization of local self-governance involved the revision of the whole system of interbudgetary relations in the region. While in 2000 and 2001 the standards were rather stable, in 2002 they were significantly revised and reduced across practically all items. The local budgets were assigned 2 per cent of the profit tax due to local budgets in accordance with the legislation of the Russian Federation. The standard rates of allocation of the income tax on individuals were reduced and made 50 per cent of the share of the tax due to the budget of the RF subject as concerned the majority of municipal entities.

In 2004, there continued the reduction of the standard rates of allocation of the income tax on individuals with respect to certain municipal entities of the oblast. While in 2003, 45 out of 50 municipal entities received 50 per cent shares of this tax; in 2004 the number of such municipalities declined and made 36. In fourteen municipal entities the standard rates of allocation made from 0 per cent to 49 per cent. At the same time, the standard rates of allocation of the profit tax somewhat increased. District budgets began to be allocated this tax at the rate of 10 per cent out of 17 per cent of the respective tax revenues of the RF subject, while settlement budgets' share was set up at 1 per cent. The exceptions were the town of Ishim (where the standard rate of allocation made 1 per cent of the amount of profits), the city of Tyumen, the town of Tobolsk (to these budgets the tax was allocated only at the rate

stipulated for local budgets by the federal legislation), and several settlements.

In the **Novgorod oblast**, the regional authorities, although not formally committing themselves to assign the standard rates of allocation of shared taxes to municipal entities on the permanent basis, in practice tried to pursue this policy more consistently than in other regions. Over the last four years, 100 per cent of the revenues generated by the profit tax, income tax, and excise taxes due to the regional budget have been assigned to the budgets of subsidized municipal entities. This policy was pursued with respect to all districts with the exception of the Borovichevsky, Starorussky, and Chudovsky districts. The size of standard rates of allocations assigned to the donor municipal entities (the city of Novgorod, the Chudovsky district) has also been rather stable over the period under observation. On the average, to the respective budgets were allocated 60 per cent of the income tax and one third of the profit tax due to the consolidated budget of the oblast. In 2001, a significant decline in the standards was observed in two municipal entities: the town of Borovichi and Borovichevsky district, and the town of Staraya Russa and the Starorussky district, whose statuses were changed from recipients of financial aid to donors. At the same time, the standard rates of allocation of the profit tax were dramatically reduced as concerned these municipalities (almost 3 times with respect to the Borovichevsky district and 1.3 times as concerned the Starorussky district). However, it seems that the regional authorities' hope to have additional donors in the oblast were vain. In 2002, the municipal entity of the town of Staraya Russa and the Starorussky district was again granted the status of a subsidized municipality, and the standard rates of allocation of the shared taxes were restored to the maximal possible levels. Since 2003, the standard rates of allocation had begun to be reduced again with respect to the municipal entity of the "town of Borovichi and the Borovichevsky district", in particular, in 2003 as concerned the profit tax the standard made 72.5 per cent of the respective revenues due to the budget of the RF subject and 51.1 per cent in 2004. In 2004, there was also reduced the standard rate of this tax allocated to the town of Staraya Russa and the Starorussky district.

The standard rates of allocation of the shared taxes to local budgets have remained rather stable in the **Tver oblast**. At the same time, these



standards were set up at the maximum possible level. As concerned the income tax on individuals, a reduction of standards was observed in the city of Tver (from 44.3 per cent in 2000 to 25 per cent of the total amount of the tax in 2004, and in the Udomelsky district (from 54.8 per cent in 2000 to 8 per cent in 2004). As concerned the Kashinsky district and the town of Torzhok, over the period under observation the standards pertaining to this tax increased by circa 80 per cent (in the town of Torzhok – from 30.2 per cent registered in 2000 to 56 per cent in 2004; in the Kashinsky district – from 11.2 per cent to 19 per cent of the amount of the tax). In three more municipal entities the increases in the standard rates of allocation of the income tax observed in one financial year alternated with declines in the next financial year. A similar situation was observed in the Tver oblast with respect to the profit tax on enterprises.

In the period from 2000 till 2004, in the **Astrakhan oblast** the oblast Administration pursued a policy aimed at the retention of the proportions of distribution of tax generated revenues across the tiers of the budgetary system at a possible constant level given the constant standard rates of allocation of the shared taxes to the oblast budget. This situation is in particular indicated by the Regulations on the key principles of interbudgetary relations approved by Resolution of the Head of the oblast administration No. 579 of December 5, 2001, which determined that for year 2002, “the oblast Administration should leave the proportions at the level of year 2001 taking into account the fact that since 1997 the shares of federal taxes and fees due to transfer to local budgets had been significantly above the levels stipulated by Article 7 of the federal law “On financial fundamentals of local self-governance”. From our point of view, such an approach to the distribution of shared taxes is fair and aimed at the creation of incentives for the development of own tax bases of municipal entities.”

As a result, the standard rates of allocation of the income tax on individuals to local budgets in terms of the shares of the tax contingent had constantly increased across the majority of municipal entities (from 67 per cent observed in year 2000 to 79.8 per cent in 2002). The only exception was the Krasnoyarsky district, where the standard rate of allocation of this tax made 4 per cent, and since year 2001 it had been set up at the zero level. The Astrakhan budget had been receiving the reve-

nues generated by this tax at the standard rates of allocation varying from 67.2 per cent in 2000 to 69 per cent in 2002. As concerns the profit tax in 2000 and 2001, the standards were set up at 17 per cent of the amount of profits across the majority of municipalities; however, in 2002 due to the reduction of standard rates of allocation of this tax to the regional budget, the standards pertaining to local budgets were reduced as well.

It should be noted that prior to 2003, the laws on the regional budget set up the standard rates of allocation of the shared taxes only with respect to the consolidated budgets of districts, while the powers to set up the standards for settlements were vested in district administrations. Since 2003, the situation had changed significantly as the standards for all municipal budgets began to be set up by the oblast laws. At the same time, in 2003 the standard amounts of allocations assigned to local budgets remained practically at the levels set up in 2002.

In 2004, the oblast administration changed its policy with respect to organization of interbudgetary relations, and the standards began to be set up at a significantly lower level than in the preceding years. In particular, the standard rate of allocation of the income tax was set up at the level of 10 per cent across the majority of consolidated local budgets, while only 2 per cent of the revenues generated by the profit tax should be allocated to budgets as stipulated by the federal legislation. At the same time, the distribution of tax revenues among the municipal budgets of different levels significantly differed across districts.

Yet another parameter relevant for evaluation of the conformity of regional practices relating to the standard rates of allocation of the shared taxes with the federal legislation was the assignment of federal taxes at the rates at or above the minimum shares set up by the law "On financial fundamentals..." In accordance with this law, municipal entities should be assigned:

- No less than 50 per cent of the income tax;
- No less than 5 per cent of the profit tax;
- No less than 10 per cent of VAT;
- No less than 10 per cent of excise taxes on alcohol, vodka, and other alcoholic beverages, and no less than 10 per cent of excise taxes on a number of other excisable goods.

At the same time, the legislation stipulated that these shares should be assigned not to each individual municipal entity, but on the average level for the RF subject. In this case, the wording of the law is rather vague and provides no clear basis for understanding of the method applicable to determine the said shares and on what basis such shares should be calculated.

In this situation, it seems feasible to use two indicators in order to evaluate the conformity between the policies pursued by regional authorities and the federal legislation:

- The average RF subject shares of the taxes mentioned above assigned to municipal entities in terms of the percentage of the shares of the taxes due to the budgets of RF subjects;
- The shares of revenues of consolidated municipal budgets generated by the said taxes in terms of the percentage of the total tax generated revenues transferred to the consolidated budgets of regions.

Apparently, these two indicators are mutually complementary, since they in different ways characterize financial relations between regions and their municipal entities. Since as concerns the calculation of the average standard rate of allocation it is not determined if it is set up for a large or small, wealthy or poor municipality, even given high average standards the real share of revenues generated by any tax left at the disposal of municipal entities may be rather small.

The centralization of VAT generated revenues at the federal level implemented in 2001 excluded this tax from the number of those distributed across the tiers of the budgetary system. As concerns other taxes, the respective indicators are presented in *Table 5.1*.

As *Table 5.1* demonstrates, in 2002 in 5 out of 6 RF subjects under review the regional policies pursued with respect to the assignment of the rates of shared taxes to municipal entities were in general in conformity with the stipulations of the federal law "On financial fundamentals...". The only exception was the Leningrad oblast, where since 2001 the laws on the oblast budget had set up the average regional standard rates of allocation of the income tax at or below 20 per cent of the amount of the respective tax revenues due to the oblast budget, what had been significantly below the standard set up by the federal law.

Table 5.1

**The assignment of shares of federal taxes to municipal budgets in 2000 through 2004**

	The share of revenues of the consolidated local budget in the total amount of the tax transferred to the consolidated budget of the RF subject, in %				Average regional standard rates of allocation* to municipal budgets, in %					
	2000	2001	2002	2003	2000	2001	2002	2003	2004	
<b>Astrakhan oblast</b>										
Profit tax on organizations	25.4	42.3	54.6	50.6	15.4	20.6	13.98	14.85	5.01	
Income tax	58.9	52.5	55.5	56.6	73.5	70.7	72.3	78.1	51.4	
Excise taxes on alcohol, vodka, and other alcoholic beverages	59.9	59.9	60.1	59.9	25.8	25.8	25.8	25.8	25.7	
Excise taxes on other goods	96.1	96.6	94.4	26.8	99.6	99.6	n. a.**	n. a.	n. a.	
<b>Kaluga oblast</b>										
Profit tax on organizations	87.4	88.3	93.9	56.7	16.5	21.5	15,1	3.3	3.2	
Income tax	88.2	75.1	75.3	50.3	88.2	75.1	62	17.4	15.7	
Excise taxes on alcohol, vodka, and other alcoholic beverages	5.0	5.0	5.2	5.0	5	5	5	5	5	
Excise taxes on other goods	12.3	10.0	8.6	8.7	10	10	10	10	10	
<b>Leningrad oblast</b>										
Profit tax on organizations	16.8	44.9	35.3	40.7	8	8.4	8.3	12.1	4.3	
Income tax	70.6	16.2	17.9	18.0	74,1	16,2	18.6	17.9	18.6	
Excise taxes on alcohol, vodka, and other alcoholic beverages	59.6	45.2	41.1	38.5	23	62.8	56.6	48.35	65.6	
Excise taxes on other goods	18.5	8.9	6.0	7.7	41.3	62.8	56.6	48.35	65.6	
<b>Novgorod oblast</b>										
Profit tax on organizations	59.0	48.3	49.5	60.9	18	17	15.1	16.7	17.2	

	<b>The share of revenues of the consolidated local budget in the total amount of the tax transferred to the consolidated budget of the RF subject, in %</b>				<b>Average regional standard rates of allocation* to municipal budgets, in %</b>				
	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Income tax	80.8	75.9	76.5	76.0	81.3	95.3	96.2	96.2	93.8
Excise taxes on alcohol, vodka, and other alcoholic beverages	56.8	50.0	50.6	50.0	50	50	50	50	50
Excise taxes on other goods	100.0	100.0	100.0	58.0	100	100	100	100	100
<b>Tver oblast</b>									
Profit tax on organizations	28.1	39.2	38.7	28.8	16.6	20.9	11.6	13.9	13.1
Income tax	67.2	56.6	45.1	50.9	87.9	75.4	74.8	87.5	96.5
Excise taxes on alcohol, vodka, and other alcoholic beverages	41.2	68.5	54.1	43.1	5.2	5.6	5.8	6.5	5
Excise taxes on other goods	33.8	40.4	42.3	28.5	21.8	22.9	11.6	12.8	n. a.
<b>Tyumen oblast</b>									
Profit tax on organizations	19.7	33.9	14.7	11.4	15.8	15.5	2	2	7.4
Income tax	55.0	42.1	30.3	32.2	80	79.9	50	47.6	42.1
Excise taxes on alcohol, vodka, and other alcoholic beverages	9.8	15.2	10.0	10.0	31.9	29.5	5	5	9
Excise taxes on other goods	98.7	47.9	16.0	0.7	100	83.1	10	13	27.3

\* The standard rates of allocation of the income tax and excise taxes are indicated as percentages of the shares of the taxes due to the budgets of RF subjects, while the standards pertaining to the profit tax are set up in per cent of the amounts of profit.

\*\* It does not seem possible to determine the average regional standard rates of allocation of excise taxes on other goods, since individual standards are set up for each type of goods.

Source: Reports on the execution of consolidated regional budgets in 2000 through 2003, the RF Finance Ministry, laws on oblast budgets in 2000 through 2004.

Since 2002, there had been observed a significant revision of financial relations between the regions and municipal entities in a number of pilot regions. As concerns the pilot regions, the Tyumen oblast had started this revision first as in 2002 in this oblast there was registered nonobservance of the requirements set up by the law “On financial fundamentals...” with respect to the profit tax and in 2003 with respect to the profit tax and income tax. In 2003 and 2004 a similar situation was observed in the Kaluga oblast. However, over the whole period of monitoring there was observed no infringements on the provisions set up in the legislation.

It seems apparent that the mechanism regulating the financial fundamentals of local self-governance as defined in the law of 1997 has significant flaws. The assignment of the sources of financing without pegging such sources to the scope of delegated powers in the way set up by the law is not an optimal method to ensure financial guarantees of local self-governance. However, the changes in the situation observed in this sphere discussed above can be viewed as a clear indication of the trend towards a more significant limitation of the independency of local self-governance and growing dependency of local finances on regional authorities.

### **5.3. Regulation of Local Budgets' Expenditures**

In accordance with the federal law “On general principles...”, the state authorities of the subjects of the Russian Federation had the duty to ensure that municipal entities had at least minimum budgets by the way of assigning to them sources of revenues. Therefore, in the process of making decisions concerning the assignment of the rates of shared taxes to municipal entities and distribution of financial aid the regional authorities estimated the minimally necessary expenditures of municipalities. Out of 6 monitored regions, in the **Tver** and **Tyumen** oblasts the mechanisms of evaluation of expenditures for interbudgetary relations purposes were not reflected in the respective regional legislations. Since 2000, the same situation has been also observed in the **Leningrad** oblast. As concerns the Astrakhan oblast, in accordance

with the regulatory documents the standard expenditures should be used in the course of estimation of financial aid provided to municipal entities, however, these documents had not been implemented in practice. In the **Novgorod** and **Kaluga** oblasts, the standard based regulation of expenditures was formally carried out; however in practice actual expenditures played a rather significant role and were taken into account in the course of estimation.

For instance, in the **Novgorod** oblast the system of regional standards was developed for three areas within the public sector: education, health care, and culture.

The regional standards of budget financing of educational establishments within the oblast's budget scope included:

- Regional standards of budget financing of the expenditures for remuneration of labor with payroll tax (measured in Rubles a year per 1 student (pupil, methodologist) or 1 rated class / group);
- Regional standards of budget financing of material maintenance of students and pupils (measured in Rubles a year per 1 student or pupil);
- Regional standards of budget financing of material expenditures (measured in Rubles a year per 1 student, pupil, resident, 1 class set).

These standards were calculated in accordance with the Regulations governing the estimation of the standards of financing of educational establishments adopted by the Novgorod Oblast Duma in 2001 and later approved by regional laws on budget. The oblast budget laws also approved adjustment coefficients relating to the payroll fund of teachers as to take into account their qualitative composition both across towns and districts, and across educational establishments financed from the regional budget.

The regional standard of financing of health care organizations were measured in per capita terms for each municipal entity and approved by laws on the oblast budget. This standard was uniform for the whole territory of the region. In order to take into account the specifics of the health care systems in different municipal entities, the same laws set up the respective adjustment coefficients with respect to per capita standard of financing the health care system across towns and districts, thus taking into account the age and gender structure of the populace

and the shares of residents of other municipalities treated by these towns and districts.

The standards of financing of culture organizations had been approved by the laws on the oblast budget since 2003. These standards were calculated for each type of organizations as defined by the existing budget schedule on the basis of standard staff lists.

Alongside with the standards of financing of public sector organizations, in the oblast there were elaborated the standards of personnel arrangements as concerned the employees of local governments taken into account in the course of formation of interbudgetary relations. The said standards determined only the personnel arrangements of district administrations and their committees for municipal entities with different population sizes, while financing of employees of settlement administrations and rural councils was carried as per actual expenditures. In the oblast, such a course was explained by the fact that all attempts to develop a uniform method of calculation of the standards determining the sizes of the administrations at the sub-municipal level had failed to achieve satisfactory results. It is of interest to evaluate the degree, to which these standards facilitated an increase in efficiency of management of the public sector. An illustrative example is the sphere of science and culture, where the respective standards of financing were developed across all types of the culture institutions existing in the framework of the regional budgetary network. Therefore, although these indicators were formally defined as standards, in practice they were actual expenditures for maintenance of culture organizations. In the oblast administration, the employment of this method of calculation of regional standards was explained by the fact that the region pursued a policy aimed at the preservation of all existing culture institutions thus facilitating the attractiveness of rural settlements for the population, especially that at able bodied ages.

A rather similar situation was observed to exist in the sphere of education. As *Table 5.2* demonstrates, the standards of financing of educational establishments were set up in three different ways. The standards of expenditures with respect to the schools situated in large cities and settlements depended on the number of students. In small settlements, where only one school existed per locality, as well as in rural areas, the standard units represented rated class sets and actual class sets. At the



same time, the amount of pay to the administrative staff and school teachers was calculated depending on the number of rated class sets (1 class of 25 students), while the expenditures for the remuneration of labor of the technical staff were determined basing on the actual number of classes.

Besides, in order to finance small basic and secondary schools there was developed a minimum standard of financing of schools in general. In 2003, this standard was at Rub. 137 thousand. This standard ensured the financing of the minimum expenditures necessary for the functioning of a school and had been applied in the cases, where the amount of payroll fund estimated in terms of class sets was below this standard. Therefore, it may be assumed that the minimal expenditures of municipal entities calculated in accordance with the regional standards of financing were sufficiently adequate to the actual expenditures for the maintenance of the network of educational establishments in rural areas.

As concerns the sphere of preschool education, the standard of financing was established per one child, at the same time, the standards introduced for urban and rural localities differed insignificantly. Such an approach, in contradistinction to that discussed above, should in principle facilitate the restructuring of the municipal budgetary networks by the method of reduction of the number of kindergartens on the part of municipal entities.

In the **Kaluga** oblast, the estimation of the expenditures borne by municipal entities was carried out on the basis of minimum social standards for municipal entities of the Kaluga oblast approved by the oblast law of April 20, 1999. The social standards were developed for the following segments of the public sector:

- Maintenance of local governments;
- Law enforcement activities;
- Housing and utility sector;
- Education;
- Culture and arts;
- Mass media;
- Health care;
- Physical culture and sports;
- Social policy.

Table 5.2

**Regional standards of financing of the educational establishments from the budget of the Novgorod oblast in 2003**

<b>Type of establishment</b>	<b>Payroll fund with payroll tax</b>	<b>Education related expenditures</b>	<b>Material costs</b>
<i>Schools in towns and urban type settlements, where the number of schools makes</i>			
More than one school	1925,6 1 rated student		1101 rated student
One school	45581,3 1 rated class		27401 class set
Additionally	2556,6 1 actual class set	78,61 rated student	
<i>Schools in rural areas</i>			
	56116,6 1 rated class		30551 class set
Additionally	2556,6 1 actual class set		
<i>Basic and complete (secondary) general educational schools with less than 9.3 rated classes</i>			
	137429,6 1 school		
<i>Preschool educational establishments</i>			
Urban areas	4826,3 1 rated student	58,111 rated student	3501 pupil
Rural areas	5544,7 1 rated student		4491 pupil

*Source:* oblast law of the Novgorod oblast No. 93-OZ of December 19, 2002, "On the oblast budget for year 2003".

In accordance with the law, social standards were defined as the "indicators of the necessary degree of provision of the population with most important housing, utility, social, cultural, and other services in kind and money terms" (article 2).

The system of social standards was comprised of:

- Basic values of social standards reflecting the minimum annual cost of the service per one resident of the municipal entity if it is not stipulated otherwise;
- Adjustment coefficients applied in order to take into account the specifics of the geographical situation, infrastructure development level, and social and economic development of individual municipal entities.

The basic values of social standards had been annually indexed with the use of sectoral deflators calculated by the RF Ministry of Economic Development and Trade and adapted to the real regional conditions. Besides, it was possible to approve adjustment coefficients by the regional laws on budget.

The basic values of social standards were uniform across the whole oblast territory. However, the final value of the social standard was calculated as the product of the basic value and the adjustment coefficient. It should be noted that in the situations, where the values of the adjustment coefficient may significantly fluctuate (for instance, from 0.02 to 1.28 as concerns the expenditures for remuneration of labor in social and rehabilitation establishments for minors and from 0.2 to 75.05 as concerns other expenditures for such establishments), the use of the adjustment coefficient increases the differentiation of the rated amount of expenditures several times tenfold. All municipal entities were grouped per each social standard, each being assigned its own adjustment coefficient. The number of groups of municipal entities and the values of adjustment coefficients across different social standards were different. The law stipulated that the use of adjustment coefficients was determined by the necessity to take into account the specifics of the geographical situation of municipal entities, the levels of their social and economic development, and a number of other objective factors; however, in the course of grouping municipal entities a significant degree of subjectivism could not be excluded.

In the areas of the social sphere noted above, the social standards were introduced with respect to remuneration of labor and other expenditures borne in relation with the maintenance of municipal institutions belonging to the social sphere. The standards of expenditures for procurement of equipment and capital repairs were set up by the laws

on budget in per cent of the aggregate expenditures for maintenance of municipal organizations belonging to the social sphere. Alongside with the social standards, the law set up the caps on the size of the administrative staff of local governments and the standards determining the staff lists of territorial bodies created in accordance with bylaws of respective municipal entities.

Let us attempt to evaluate to what degree the expenditures assessed with the use of minimum social standards facilitate optimization of the budgetary network. Similarly to the case of the Novgorod oblast, let us review the minimum standards pertaining to the financing of education. *Table 5.3* contains the standards of expenditures for maintenance of the establishments providing primary and secondary (complete) general education. The data presented in *Table 5.3* indicate that the standards of financing of small secondary schools were significantly above the standards of financing of schools both in rural areas (for instance, the excess in the expenditures for remuneration of labor made 1.7 times), and in towns (a 4.2 times excess). A similar situation was observed with respect to financing of primary schools. These facts indicate that the existing system of social standards had failed to play its incentive-creating role to a sufficient degree, since it permitted to bring the rated amount of expenditures for financing of public sector organizations to the level of actual expenditures. These policies facilitated the preservation of the budgetary network; however, they failed to create incentives for the restructuring of that network.

Therefore, it seems apparent that in the regions under observation the applied methods of standard-based regulation failed to create real incentives to optimize expenditures, since they did not facilitate reduce expenditures to standard values; on the contrary, these methods permitted to raise standards up to actual expenditures.

Table 5.3

**Minimum social standards of municipal entities in the Kaluga oblast  
in the sphere of education**

	<b>Expenditures for routine maintenance of primary educational establishments, standard of expenditures per one student</b>		
	<b>Remuneration of labor</b>	<b>Ensuring of educational process</b>	<b>Other costs</b>
<i>Rural small schools (up to 40 students)</i>	14137	3560	1157
<i>Rural schools</i>	11372	3304	950
<i>Urban schools</i>	4029	2606	470
	<b>Expenditures for routine maintenance of establishments providing secondary (complete) education , standard of expenditures per one student</b>		
<i>Rural small schools (up to 40 students)</i>	22638	2411	1362
<i>Rural schools</i>	13256	2580	922
<i>Urban schools</i>	5390	2890	592

*Source:* law of the Kaluga oblast No. 7-OZ of April 20, 1999, "On minimum social standards of municipal entities of the Kaluga oblast".

An attempt to develop a system of regulation of expenditures borne by local budgets had been taken also in the Leningrad oblast. In 1997, the region adopted two laws: law No. 12-OZ of June 10, 1997, "On social standards in the Leningrad oblast" and law No. 15-OZ of June 16, 1997, "On the minimum budgets of municipal entities in the Leningrad oblast." The law "On minimum standards..." determined the list of social standards in four sections of the functional classification: education, health care, housing and utility sector, and social policy. A list of services subject to standardization was determined for each respective section. These lists of services included:

- Organization, maintenance, and development of establishments providing preschool, basic general, and professional education in the section of "education";
- Organization, maintenance, and development of health care establishments, assurance of sanitary security of the population in the section of "health care";

- Maintenance and use of the housing stock; organization, maintenance, and development of electrical power supply, natural gas supply, heating, water supply and sewer system; organization of fuel supply to households and municipal organizations in the section of “housing and utility sector, city planning”;
- Development of social support and employment in the section of “social policy.”

In accordance with this law, in order to calculate the amounts of social standards in terms of money, in the Leningrad oblast there should have been used the amounts of municipal budgets (estimated on the basis of budget execution reports) across the nomenclature of social standards in the Leningrad oblast registered over the base period defined as the preceding three year period, for which there was available the data on the execution of respective budgets. The amounts of social standards in money terms were defined as the quotient of the division of the statistical average amount of expenditures by the average annual population of the Leningrad oblast. Therefore, for all municipal entities there were determined uniform amounts of social standards, which should have been annually approved by the resolutions issued by the oblast Governor. The amount of social standards had been set up both for local budgets and the oblast budget.

These social standards should have been used in the course of estimation of minimum municipal budgets in accordance with the regional law “On the minimum budget...”. Alongside with the social standards, the minimum budgets should have included current expenditures not regulated by social standards. The closed list of such expenditures had been approved by the same law.

The amount of current expenditures not taken into account in the framework of social standards was also calculated basing on the data on the execution of budget over the three preceding years. The procedures governing the calculation of the amount of expenditures were completely similar to the procedures set up for the determination of social standards in money terms. At the same time, it remained unclear what exactly made the expenditures associated with social standards different from other types of expenditures borne by local budgets. By summing up of the expenditures calculated in accordance with the social standards and other current expenditures and dividing of this sum

by the average annual population, the regional financial authority determined the per capita expenditures. Information about the amount of calculated per capita expenditures of local budgets was forwarded to local authorities and used for the determination of minimum budgets as concerned the calculation of the amount of financial aid granted to local budgets from the oblast budget.

In the course of estimation of minimum budgets, there were also taken into account adjustment coefficients characterizing the social, economic, and demographical specifics of a municipality and deflator indexes. The adjustment coefficients were introduced in all spheres, where social standards existed, i.e. education, health care, housing and utility sector, and social policy.

However, this system of regulation of expenditures borne by local budgets had not taken root in the Leningrad oblast. The amounts of social standards and values of adjustment coefficient were approved only for the period of 1998 through 1999. After that period, there was conducted no further work on the issue and the minimum budgets were determined proceeding from the amounts of expenditures borne by municipal entities in the preceding financial year.

Legal and regulatory documents of the **Astrakhan oblast** also stipulated the use of standard expenditures. At the same time, in the oblast it was planned to use the most radical method of regulation of expenditures, i.e. the use of average standards of current budgetary expenditures calculated by federal ministries and agencies in a way taking into account the indexation of wages and salaries paid to the employees of the public sector. It was envisaged to carry out the calculations for the base segments of the sector financed from the budget (housing and utility sector, education, health care, social policy, public transport, law enforcement activities, and administration).

Expenditures for the housing and utility sector should be calculated on the basis of the federal standard of maximum cost of the services rendered by the housing and utility sector, the standard determining the amount of payments for the housing and public utility sector services on the part of households, the standard of living space per person and per the size of the population of the municipal entity. In other segments, expenditures should include:

- Coefficient of the rise in the cost of the conventional unit of budgetary services (in accordance with the calculations carried out by the RF Finance Ministry for the Astrakhan oblast);
- Standard of financing of this type of services for the next financial year per one consumer in the Russian Federation on the average;
- Number of consumers of services in the municipal entity;
- Adjustment coefficients.

Adjustment coefficients were included in order to take into account the specifics of the segment in each municipal entity and were different for each segment. For instance, in the sphere of health care and social policy there were used such adjustment coefficients as the ratio between the unit weight of the population below 18 years of age and pensioners in the total size of the population of a municipality and the respective indicator for the Russian Federation at large. According to the available information, these methods had been used to estimate the expenditures borne by local budgets only in the course of formation of the budget for year 2004.

#### **5.4. Financial Aid to Local Budgets**

The federal law “On financial fundamentals...” set up the procedure governing the formation and functioning of the fund of financial support of municipal entities in a RF subject. According to article 10 of the law, the funds of financial support should be created in the budgets of RF subjects at the expense of allocations of regional and federal taxes due to the regional budgets. The distribution of the funds’ financial resources was carried out in accordance with a fixed formula, which took into account the social, economic, and demographical specifics of municipal entities. Therefore, the federal legislation had regulated only the most general principles of distribution of transfers. At the same time, the exact methods of allocation of the resources of the funds of financial support of municipal entities, as well as the procedures governing formation thereof should be set up at the regional level.

In the **Novgorod oblast**, the fund of financial support of municipal entities was formed at the expense of financial resources of the regional budget and allocated in proportion to the gap between the estimated tax revenues of municipal entities and the necessary expenditures. However, the methods of the distribution of resources provided by the



fund of financial support of municipal entities had not been approved officially.

In 1999, in the **Tyumen oblast** there was adopted the law “On the oblast fund of financial support of municipal entities in the Tyumen oblast”<sup>50</sup>. This law had determined the procedures governing the formation, utilization and management of the Fund’s resources. In accordance with the law, the Fund of financial support of municipal entities should be created in the framework of the regional budget and aimed at the equalization of fiscal capacities of municipal entities at the regional average.

The law stipulated that the Fund should be formed at the expense of the shares of tax generated revenues due to the regional budget. The share of tax revenues of the regional budget allocated to the Fund should be annually approved by the oblast laws on budget. In 2000, 1.9 per cent of revenues were allocated for these purposes, while in 2001 the respective allocations made 2.8 per cent. In accordance with the law, the share of each municipality in the Fund ( $D_i$ ) was calculated according to the following formula:

$$D_i = \frac{(BO - BO_i) * Num_i}{\sum_{i=1}^n (BO - BO_i) * Num_i}$$

where  $BO$  is the level of the average regional fiscal capacity per one resident of the oblast;

$BO_i$  is the level of fiscal capacity per one resident of the  $i$ -th municipal entity;

$Num_i$  is the number of residents in the  $i$ -th municipal entity;

$\sum_{i=1}^n (BO - BO_i) * Num_i$  is the sum of negative deviations of the per capita fiscal capacities of municipal entities from the regional average;

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<sup>50</sup> Prior to the adoption of the law, in 1998, there were in force the Regulations for the Fund of Financial Support of Municipal Entities for year 1998 approved by Resolution of the oblast Governor No. 75 of June 15, 1998.

$n$  is the number of municipal entities in the oblast, where the fiscal capacities were below the average regional budget capacity.

The share of each municipal entity in the Fund and the standards of allocation of tax revenues of the regional budget to the Fund had been annually approved by the laws on budget.

However, since 2000 the formation of the Fund had been stopped due to the fact that the law was suspended by laws on the oblast budget because of the lack of financing necessary for its implementation. As concerns financial aid to municipal entities, it had been provided in the form of subsidies directly from the regional budget and, according to the information presented by the oblast administration, distributed in proportion to the gaps between estimated revenues of municipal entities and necessary expenditures.

In the **Leningrad oblast**, the method of allocation of financial aid among municipal entities had been annually approved by the laws on the regional budget. According to this method, the amount of funds distributed among municipal entities in the form of financial aid was determined as the difference between the estimated revenues of the consolidated regional budget and the amount of expenditure obligations of the regional budget. The obligations of the regional budget included the revenues of target funds, financial resources for remuneration of labor of employees of the budgetary sphere, etc.

Prior to 2004, the methods of determination of the potential revenues had not been approved by regulatory documents, later the estimated revenues were calculated in accordance with the calculation methodology approved by Resolution of the Leningrad oblast Governor No. 127 pg of August 10, 2004, "On the approval of the methodology of calculation of potential revenues of the consolidated budget of the Leningrad oblast for the planned financial year." This indicator was determined on the basis of expected amount of revenues in the current year, which, in turn, were evaluated on the basis of the data on actual receipts of tax payments in the current year, the levels of tax collection in previous periods, changes in the budget and tax legislation, indicators of social and economic development of the oblast, etc.

Financial aid to municipal entities comprised of two components: the equalizing component (80 per cent of the total financial aid) and incentive-creating one (20 per cent of the total financial aid). The methodol-

ogy of calculation of the equalizing component had not been approved by any regulatory document. The laws on the oblast budget there had been stipulated that the “equalizing component should be distributed among municipal entities in such a way that to bring per capita revenues taking into account the own funds to the possible maximum value uniform for each municipal entity.” In 2003, for the first time the methods of calculation of budget capacity was approved by a regulatory document. In accordance with these methods, fiscal capacity should be equal to the ratio between own revenues of the municipal entity and the number of consumers of budgetary services calculated with the use of the index of budgetary expenditures. The incentive-creating component of financial aid depended on the share of revenues generated by a municipal entity transferred to the oblast consolidated budget in the total amount of budgetary revenues.

In the **Tver oblast**, the methods of distribution of subsidies and transfers from the fund of financial support of municipal entities were approved only for year 2001<sup>51</sup>. Subsidies and transfers were granted to local budgets from the fund of financial support. The equalization subsidies were intended to raise revenues of municipal entities with low fiscal capacities to the maximum possible uniform level. In the course of calculation of fiscal capacity, there was also used the index of budgetary expenditures, which represented the ratio between the per capita expenditures of the municipal entity and the per capita expenditures of the consolidated local budget. The allocation of transfers was carried out upon the determination of the amounts of subsidies. Transfers were spent for defrayal of the estimated excesses of expenditures borne by municipal entities over their own revenues taking into account the already allocated subsidies for equalization of fiscal capacities and the fixed budget deficit uniform for all municipal entities.

In 2003, in the structure of the fund of financial support of municipal entities of the Tver oblast there was also singled out the incentive-creating component, which, in contradistinction to the situation observed in the Leningrad oblast, depended not on the share of revenues received from the territory of a municipal entity, but on the increase in these revenues in comparison with the respective figures registered in

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<sup>51</sup> The Tver oblast law No. 136 OZ 2 of January 25, 2001, “On the oblast budget of the Tver oblast for year 2001.”

the preceding period. Since in this case the amount of the incentive-creating component of financial aid granted to the municipal entity dependent on the increase in the revenues collected in its territory, it should create incentives for local governments to put forth extra efforts with respect to collection of taxes and fees.

In the ***Kaluga oblast***, the procedure governing the distribution of financial aid was most formalized. In the oblast, there was adopted the law on the minimum social standards for municipal entities, which were taken into account in the course of assignment to them of standard allocations of shared taxes and distribution of financial aid. Besides, the oblast laws on budget annually approved the methods of distribution of financial aid from the fund of financial support of municipal entities. In contradistinction to two other regions, prior to 2002 in the oblast there had been mandatory used the procedure governing the reconciliation of municipal budgets. Basing on the results of such reconciliation, there were signed protocols, which were on mandatory basis forwarded to the committee on budget, finances, and taxes of the Legislative Assembly of the Kaluga oblast and the Audit Chamber of the Kaluga oblast. In the case of disputes disagreements, there were created conciliation commissions comprised of representatives of the Legislative Assembly, the Oblast Government, and interested municipal entities.

The situation somewhat changed in 2002 in connection with the adoption of the oblast law “On the budget process in the Kaluga oblast”<sup>52</sup>. Similarly to the preceding law, the law “On the budget process...” envisaged that local governments should have the right to submit to the financial authority of the Kaluga oblast their proposals concerning the changes and refinements with respect to the underlying data of draft local budgets. The financial authority should analyze these proposals and reconcile the underlying data of draft local budgets (article 1). However, the law did not clearly defined the procedure of reconciliation, while failing even to mention the creation of conciliation commissions and signing of reconciliation protocols. Therefore, although

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<sup>52</sup> Elaboration of the law “On the budget process...” started after the oblast Public Prosecutor appealed to the oblast Legislative Assembly (Appeal no. 7/2-3-01 of April 6, 2001) against a number of articles of the oblast law “On the budget system and budget process in the Kaluga oblast.” The appeal concerned the fact that certain stipulations of the oblast law were inconsistent with the requirements set by the RF Budget Code.

formally the financial authority should have reconcile the data underlying the budget estimations with representatives of municipalities, in reality these reconciliation measures had not been taken due to the lack of control on the part of the legislature.

Prior to 2002, in the Kaluga oblast financial aid had been distributed in proportion to the gaps between the expected revenues of municipal entities and planned minimum necessary expenditures. The law on the oblast budget for year 2002 approved the Methods of distribution of financial aid from the fund of financial support of municipal entities to be applied in 2002. The law stipulated that the primary task related to the determination of the amount of financial resources allocated from the Fund of financial support of municipal entities should be equalization of fiscal capacities of municipal entities in terms of revenues. However, eventually this task as before was reduced to the task to defray deficits of local budgets. In this case, the deviations of fiscal capacities of municipal entities from the average regional fiscal capacity were taken into account only in the course of evaluation of the amounts of deficits<sup>53</sup>.

In the course of estimation of the amount of financial aid granted to municipal entities from the Fund in 2003, there was used a quite different method of calculation. The new methodology was rather similar to the methods of distribution of transfers for equalization of fiscal capacities of RF subjects employed at the federal level. This methodology was based on equalization of the tax collection potential of municipal entities in a way which would take into account their expenditure needs. In accordance with this method, transfers from the Fund of financial support of municipal entities should be allocated not to defray the needs in additional revenues calculated in absolute terms, but in proportion to a certain rated value characterizing the intensity of the need for financial aid in relation to the average regional indicator.

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<sup>53</sup> In accordance with this methodology, the conventional deficit of the municipal entity should be calculated as the difference between the deficit and the deviation of the fiscal capacity of this municipal entity from the regional average multiplied by the number of residents of the municipal entity. Therefore, in the case the fiscal capacity of the municipality was above the average regional fiscal capacity, the amount of the deficit of this municipal entity was diminished by the amount of financial aid for equalization of revenues, thus reducing the amount of financial aid aimed at the defrayal of deficit and vice versa.

As concerns the calculation of transfers, the method involved such definitions as the index of budgetary expenditures and index of tax potential. The index of budgetary expenditures reflected the differentiation of costs of budgetary services in municipal entities of the region. The index of tax potential was a relative quantitative evaluation of the capacity of a municipal entity to generate tax revenues. The major difference between the methods of calculation of transfers granted from the Fund of financial support of municipal entities of the Kaluga oblast and the methods of calculation employed at the federal level was the method of calculation of the tax potential index. In the course of calculation of the amounts of transfers granted to RF subjects, the tax potential index was calculated as the aggregate amount of added value in a region in relation to the respective average indicator in the Russian Federation at large and adjusted by the sectoral structure of economy in this RF subject. As concerns the methods adapted in the Kaluga oblast, the tax potential was determined on the basis of forecasts of the size of potentially possible tax collection across a group of representative taxes (profit tax, income tax, and excise taxes) due to the budgets of municipal entities and the consolidated budget of the oblast.

A similar method of calculation of financial aid was adopted also in the **Astrakhan oblast** in 2003. However, this method had been applied only for the calculation underlying the formation of the budget for year 2004; at the end of 2003 it was abolished by a Resolution of the oblast Governor<sup>54</sup>. In practice, the amount of subventions from the fund of financial support of municipal entities was calculated proceeding from the necessity that municipal entities meet their expenditure obligations. It should be also noted that all subsidies provided from the oblast budget were transferred from the consolidated district budgets and district administrations carried out the allocation of subsidies among the settlement municipalities. Such an organization of interbudgetary relations resulted in the fact that local governments at the settlement level depended on decisions taken by district authorities, what was at variance with the federal legislation on local self-governance.

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<sup>54</sup> Resolution of the Astrakhan oblast Governor No. 528 of October 29, 2003, "On amendments to and invalidation of resolutions of the Head of the Astrakhan oblast administration and the Governor of the Astrakhan oblast".

Although in not all regions the mechanisms aimed at equalization of fiscal capacities had been defined in regulatory documents concerning interbudgetary relations, in practice financial aid had a significant equalizing effect. *Table 5.4* demonstrates the spread of fiscal capacities across municipal entities of the regions under observation prior and after allocation of financial aid. It seems apparent that the spread of fiscal capacities across municipal entities declined several times as a result of financial aid allocation (from 1.2 times to 4.1 times). However, the initial spread significantly affected the final indicators. As the data presented in *Table 5.4* demonstrate, the differences in revenues prior to the granting of financial aid were at the minimum in the Novgorod oblast and at the maximum in the Tyumen oblast. The same situation was observed after financial aid had been granted. At the same time, due to the fact that tax revenues were primarily formed at the expense of shared taxes, the standards of which were set up individually for each municipal entity, it does not seem possible to definitely conclude to what extent such a situation was objective and to what extent it was created artificially because of non-optimal assignment of shared taxes.

*Table 5.4*

**Spread of fiscal capacities of municipal entities in 2000 through 2002 \***

	Coefficient of variation of fiscal capacities of municipal entities (in %) for					
	Tax and non-tax revenues			Total revenues		
	2000	2001	2002	2000	2001	2002
Astrakhan oblast	97.9	88.1	63.8	39.4	35.6	18.2
Kaluga oblast	n.a.	70.2	63.1	n.a.	23.3	17.8
Leningrad oblast	87	72.6	74.9	63.5	41.8	38.7
Novgorod oblast	44.1	51.9	46.7	18.9	14.5	11.4
Tver oblast	85.6	118.3	99.7	68.3	98.7	78.9
Tyumen oblast	101.2	96.2	99.3	32.8	39.3	31.6

\* No data are available for year 2003.

Source: reports about execution of the budgets of towns and districts in 2000 through 2002, RF Finance Ministry.

## **5.5. Structure of Revenues of Municipal Entities in Pilot Regions**

*Table 5.5* presents the structure of revenues of consolidated municipal budgets in the pilot regions. As it is demonstrated by the Table, in four out of six regions there was perceptible a clear trend towards an increase in the share of financial aid in the structure of budgetary expenditures, while it should be noted that this increase can not be completely explained in an increase in the target financing of federal benefits. However, while in the Kaluga and Tver oblasts this increase occurred gradually and did not significantly affected the structure of revenue sources, in the Tyumen and Leningrad oblasts the observed changes were of radical nature. Over three years, the structure of revenues had practically reversed. In the Leningrad oblast, the share of financial aid increased more than 2.5 times. In 2000, in the Tyumen oblast the share of financial aid made somewhat above one third, and in 2002 it made circa two thirds. It should be noted that this change coincided with the transition from the settlement to the district based model of organization of local self-governance. Proceeding from the general notions, the process should have been opposite, since in the framework of districts there should have been observed the internal equalization of both expenditures and revenues, because the need of financial aid should have diminished. However, financial policies pursued by the regional administration produced opposite results.

Differences in approaches to financing of municipal entities were illustratively indicated by the levels of financial security of municipal entities as concerned tax and non-tax revenues presented in *Table 5.6* (for analysis accuracy purposes target funds for financing of social benefits were excluded). In the Tyumen oblast, where the extent of subsidization of local budgets had been rather significant even from the outset, the increase in the centralization of financial resources resulted in the fact that in 2002 96 per cent of municipal entities formed more than 50 per cent of their revenues at the expense of financial aid. At the same time, in the overwhelming majority of municipal entities the share of financial aid exceeded 70 per cent.



Table 5.5

**Structure of revenues of consolidated municipal budgets  
in 2000 through 2003**

	<i>Astrakhan oblast</i>				<i>Kaluga oblast</i>			
	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Tax revenues	67.3	65.5	61.9	71.1	72.2	67.2	63.9	60.7
Non-tax revenues	2.9	4.5	5.4	6.7	6.7	3.9	4.2	5.1
Financial aid, including	29.9	29.9	32.7	22.2	21.2	28.9	31.8	34.2
<i>Target subventions for defrayal     of social benefits</i>	0.4	3.8	4.1	5.6	2.5	2.2	0.5	0.6
	<i>Leningrad oblast</i>				<i>Novgorod oblast</i>			
	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Tax revenues	77.2	67.5	62.6	46.7	59.6	64.3	59.8	59.6
Non-tax revenues	6.0	6.0	6.3	7.3	3.8	4.7	5.2	9.8
Financial aid, including	16.9	26.4	31.1	45.9	40.2	35.1	39.2	30.6
<i>Target subventions for defrayal     of social benefits</i>	0.2	3.6	3.7	3.8	7.6	13	13.4	10.5
	<i>Tver oblast</i>				<i>Tyumen oblast</i>			
	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Tax revenues	54.2	53.0	52.2	48.9	58.3	40.8	30.3	33.0
Non-tax revenues	7.0	4.1	5.4	6.4	4.3	2.6	3.6	4.5
Financial aid, including	38.8	42.8	42.4	44.7	37.4	56.6	66.1	62.5
<i>Target subventions for defrayal     of social benefits</i>	0.4	1.0	1.5	0.9	0.2	4.6	7.8	7.4

Source: reports about execution of the consolidated oblast budgets in 2000 through 2002, RF Finance Ministry.

An opposite situation was observed in the Leningrad oblast. Over the same period, in this region the degree of security of municipal entities as concerned tax and non-tax revenues had steadily increased, and in 2002 more than 60 per cent of municipalities formed the larger portions of their revenues (more than 50 per cent) at the expense of own revenue sources. Similar trends were observed in the Novgorod oblast: there the share of municipal entities, where the share of financial aid in the general expenditures of budgets made less than 50 per cent, had increased from 45.5 per cent in 2000 to 54.6 per cent.

In the Astrakhan oblast, a rather interesting situation had formed. On the one hand, the share of financial aid in the revenues of the oblast consolidated municipal budget declined. On the other hand, the share of municipal entities, where the share of financial aid in budgetary revenues made from 50 per cent to 70 per cent, increased.

Table 5.6

**Extent of subsidization of municipal entities in 2000 through 2002**

Share of financial aid in revenues of local budgets	Share of municipal entities receiving financial aid, in %								
	Astrakhan oblast			Kaluga oblast			Leningrad oblast		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
below 20%	25.00	16.67	16.67	15.40	3.90	n.a.	51.72	37.93	34.48
from 20% to 50%	25.00	41.67	16.67	15.40	19.20	n.a.	34.48	34.48	27.59
from 50% to 70%	33.33	25.00	50.00	42.30	38.50	n.a.	13.79	27.59	34.48
over 70%	16.67	16.67	16.67	26.90	38.50	n.a.	0.00	0.00	3.45
	Novgorod oblast			Tver oblast			Tyumen oblast		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
below 20%	4.60	22.70	13.70	2.44	12.20	12.20	11.50	0.00	0.00
from 20% to 50%	40.90	27.30	40.90	48.78	19.51	24.39	3.90	3.90	19.20
from 50% to 70%	18.20	27.30	22.70	36.59	34.15	43.90	11.50	34.60	19.20
over 70%	36.30	22.70	22.70	12.20	34.15	19.51	73.10	61.50	61.60

Therefore, it is apparent that the structure of revenues of municipal entities had been to a significant extent determined not by objective factors, but political preferences of regional administrations. Basing on these data, it is impossible to draw any conclusions with respect to the actual degree of financial security of municipalities and prospects of their financial standing as concerns changes in the system of inter-budgetary relations.

## 5.6. Conclusions

Regulation of the financial fundamentals of local self-governance was a least elaborated issue both in the federal and regional legislations. For instance, it was true with respect to the issue of the delegation of state powers to the municipal level. As concerns this problem, the most critical situation was observed in the Astrakhan and Novgorod oblasts, where laws on oblast budgets did not envisage subventions aimed at the financing of activities carried out in relation to the exercise of state powers. In other monitored regions, although there were ear-

marked subventions for financing of certain state powers, the amounts of unfunded mandates were also rather significant.

An analysis of the policies pursued by regional authorities with respect to the assignment of rates of shared taxes allocated to local budgets has also revealed significant differences across the regions under observation. Although in neither region the standard rates of allocation of shared taxes had not been assigned on the permanent basis, in the Novgorod, Tver, and Astrakhan oblasts the standard rates of allocations to local budgets remained rather stable. Quite a different situation was observed in the Leningrad oblast, where standards have been significantly altered on the annual basis. In the Tyumen oblast, the change of the model of territorial organization of local governments was also accompanied by significant changes in the policies implemented by the regional authorities to ensure their financial independency, i.e. an increase in the degree of centralization of financial resources at the regional level.

In the sphere of regulation of expenditures borne by local budgets, there were also observed significant changes as concerns the thoroughness of elaboration of this issue in the legislations of monitored regions. For instance, in the Novgorod and Kaluga oblasts, the standard based regulation of expenditures was formally carried out; however, in practice actual expenditures played a rather significant role. At the same time, in the Leningrad, Tver, and Tyumen oblasts the mechanisms of evaluation of expenditures for interbudgetary relations purposes were not reflected in the respective regional legislations.

A similar situation was observed as concerned the mechanisms aimed at equalization of fiscal capacities, which have been legislatively regulated not in all regions. It should be noted that in practice financial aid had a significant equalizing effect. However, our analysis revealed that the structure of revenues of municipal entities was to a significant extent determined not by objective factors, but political preferences of regional administrations.

## **Chapter 6. The Results of an Analysis of Different Models of the territorial structure: Specifics of Local Self-governance**

### **6.1. Classification of Models of Territorial Structures of Municipal Entities**

This chapter reflects the results of an analysis carried out on the basis of a study of municipal structures in six regions (Kaluga, Novgorod, Tyumen, Astrakhan, Leningrad, and Tver oblasts), as well as visits the report's authors made to more than 30 municipal entities situated in these regions in order to gather the necessary raw data. There were also conducted non-formalized interviews with top level officials of regional and municipal administrations and rural councils. All information presented in this chapter reflects the situation existing at time this study was conducted, i.e. prior to the start of the transformations relating to the enactment of law No. 131-FZ. In spite of a rather significant volume of this study, the authors can not assert that the conclusions they have made are adequate across the whole Russia's territory, although it is apparent that these conclusions reflect rather significant and recurrent characteristics of functioning of local self-governance in the framework of different territorial models.

#### *6.1.1. Classification and Comparative Characteristics of Different Types of Municipal Structures.*

As it has been pointed out above, this study focuses on three basic types of the territorial structure: district, settlement, and two tier structures. However, our analysis has demonstrated that to single out these types of structures *per se* is not the sufficient condition to understand the mechanisms of functioning of municipal authority. In the framework of practically each of these types, there exist unique varieties, which sometimes significantly differ. Similarly to the preceding stages of our analysis, in order to single out and study these varieties we primarily focused on two types of municipal entities – districts and settlements, primarily rural ones. The specifics of the study resulted in the fact that much less attention was paid to urban settlements and urban municipal entities.

District municipal entities. In the framework of the district model, the internal classification could be based both on geographical characteristics, and the nature of the policies pursued. As concerns the geographical characteristics, districts can be classified as follows:

- Monocentric;
- polycentric;
- ring shaped districts.

**Monocentric districts** are characterized by the presence of rather large district centers, where concentrate significant parts of the population and the tax base. An example of such a district is the Valdai district of the Novgorod oblast, which includes 14 rural councils consisting of 213 localities. However, 18 thousand people of the total population of 30 thousand reside in the town of Valdai, while seven of eight industrial enterprises are also situated in the district center. A similar situation exists in the Bezhetsk district of the Tver oblast, where 31 thousand people of the total population of 45 thousand reside in the town of Bezhetsk, where there are also situated 11 enterprises engaged in mechanical engineering and food production. Basing on the authors' observations, such districts are often characterized by a rather high professional level of the managerial personnel. However, district centers are their primary sphere of activities, what is often reflected in the combination of functions pertaining to the management of the town and the district (i.e. the district center have no own administration different from the district administration), while other localities seem to form the periphery.

This observation is clearly illustrated by the management of the housing and utility sector. The widely used model of management in this case envisages the presence of several specialized enterprises (water supply, heating energy supply, housing maintenance enterprises); however, the sphere of activities of such enterprises is reduced to the district center. As concerns the rest of the territory, there may as before exist subdivisions of rural administrations managing housing and utility sector. Such an approach is used, for instance, in the Zavodoukovsky district of the Tyumen oblast and the Zhukovsky district of the Kaluga oblast (in both districts the share of the population concentrated in the district center exceeds 50 per cent). The other possible variant is realized in the already mentioned above Valdai district, where there was

created a municipal public utility enterprise, which, alongside with the management of rural boiler houses, was also vested with the functions encompassing landscape gardening, maintenance of urban roads, funeral services, garbage disposal.

Yet another specific feature of such districts is a lesser dependence of the district administration on the moods of rural population (which makes minority during elections), what in certain political situation may result in more active conduct of reforms in rural localities. For instance, in the Bezhetsk district of the Tver oblast mentioned above the restructuring of the network of rural schools is conducted more actively than in districts of other types situated in the same oblast. However, it is apparent that this trend is far from being the general one and requires serious prerequisites for realization (in the case of the Tver oblast this prerequisite is the policy pursued by the regional administration with respect to the acceleration of the restructuring of the school network).

Monocentric districts are usually characterized by a rather stable financial standing, since their center towns in many cases are donors and can financially support the surrounding rural territories. At the same time, such a situation results in less favorable conditions for the development of the central town and lesser incentives to increase the tax base, since in the situation of active redistribution of financial resources in favor of poorer territories a significant financial gain of the central town is less possible. At the same time, other things being equal, the motivation of other territories of the district to increase their economic potential declines, although this trend does not necessarily develop.

Therefore, among the positive characteristics of monocentric districts there are more significant personnel and financial potential, as well as the possibility of more active conduct of institutional reforms in rural areas. However, the concentration of administrative activities in district centers may negatively affect the quality of administration in other territories of such districts. This factor is rather acutely felt by heads of rural administrations, who in a number of cases expressed their opinion that the division of towns and districts could create more favorable conditions for development of rural areas (for instance, such an opinion has been expressed in the *Vyborgsky district of the Lenin-grad oblast*).

**Polycentric districts** are characterized by more even distribution of populations and economic bases across the district territory. In such cases, the role of the district center may be played by a settlement or a large village, usually with its own administration. An example of such a district is the Nizhnetavdinsky district of the Tyumen oblast, where only 7 thousand people of the total population of 25 thousand reside in the Nizhnetavdinsky rural council, while agriculture is the economic basis of the area. A similar situation exists in the Sandovsky district of the Tver oblast, where the population is only 9.4 thousand and where there are no large enterprises. In such cases, district administrations as a rule manage districts as the single whole without singling out any priority territories. As concerns the management of the housing and utility sector, these specifics are usually manifested by the creation of one HUS enterprise operating in the territory of the whole district, or several such enterprises (however, such enterprises are not tied to the territories of existing rural councils). At the same time, in such districts the progress of structural reforms is more difficult and, other things being equal, populist moods in such districts are more pronounced. As a rule, the economic situation in such districts is worse than in monocentric districts, since they lack apparent "points of growth"; however, their interest in investment is not less and sometimes even greater than in monocentric districts, since investments are the crucial factor of their survival and further development.

**Ring shaped districts** are the districts surrounding the towns being independent municipal entities. A typical example of such a district is the Novgorodsky district of the Novgorod oblast situated around the city of Novgorod. The population of the district makes about 56 thousand, while it should be noted that the population of the city itself is four times more. Such districts are characterized by rather contradictory trends. On the one hand, populations of such districts rather intensively use the infrastructure of the single large center, what permits the district administrations to organize the performance of certain municipal functions using the center's resources and tend to live at the expense of the center. On the other hand, there exist certain trends to separate from the center and create own administrative structures. Thus, in the Novgorodsky district health care used to be managed in coordination with the city of Novgorod; however, later the district preferred to sepa-

rate from the city as concerned this sphere. Since there was no central district hospital, which usually combines not only medical, but also administrative functions, in the district there was created the central district outpatient polyclinic as the lead agency vested with the management of health care. Yet another example of a ring shaped district is the Yalutorovskiy district of the Tyumen oblast situated around the town of Yalutorovsk. The population of the district makes circa 17 thousand, what is two times below the population of the town.

The economic standing of such districts may considerably differ. In the cases where the centers of such districts are large urban localities, the economic standing of respective districts is rather favorable, since the nearness of large centers of economic activities attracts investors and facilitates the creation of own “points of growth” in the districts territories. However, in the cases where the independent municipal entities of such districts are small towns, they may draw economic activity from the district at the same time failing to create prerequisites for the development of neighboring territories. In such cases districts may become depressed areas with underdeveloped economies. The same is true with respect to the personnel capacity basing on the observations made in the course of the study, which had demonstrated very significant differences in this respect.

As concerns the policies pursued by municipal entities, districts may be classified with respect to the distribution of municipal powers within districts. However, it should be taken into account the fact that the problem of division of powers exists not only as concerns the relations between district administrations on the one hand, and settlement and rural administrations on the other hand. A similar problem manifests itself in relations between rural administrations and constituent localities; however, it should be noted that the latter problem is less acute. As concerns the distribution of municipal powers, district may be classified as:

- centralized;
- decentralized;
- intermediate.

As concerns the **centralized districts**, the specific feature of such districts is the maximum concentration of functions and financial resources at the level of district administrations, what leaves extremely lim-



ited possibilities for independent actions on the part of submunicipal structures. An example of such policies may be the *Ugorskaya volost of the Kaluga oblast* – a peculiar mini-district consisting of five rural councils with the total population of 2.5 thousand people. In this volost, rural administrations are subunits of the volost authority. They are not separate legal entities and have no separate accounts. Therefore, the budgets of rural councils are conventional, since all financial resources including those formed at the expense of self-taxation are managed at the volost level. At the same time, even financial reserves formed at the expense of self-taxation may be redistributed among rural councils.

The specifics of **decentralized districts** are as follows:

- the status and functions of rural / settlement administrations are defined in municipal regulatory and legal acts; at the same time, certain state powers may be transferred to this level;
- although heads of rural and settlement administrations are appointed by the district, to a certain extent they depend on the population;
- rural and settlement administrations have own accounts;
- certain objects in municipal ownership are listed in the fixed assets of rural and settlement administrations;
- rural / settlement administrations have certain rights to independently dispose of certain financial resources of the municipal budget (take decisions concerning the allocation of expenditures, make and control execution of contracts with contractors, etc);
- oblast and / or municipal administrations financially and organizationally support the initiatives of settlements and rural councils.

As concerns the regions included in this study, the concept of decentralized districts is most frequent in the Novgorod oblast. In this oblast, rural and settlement administrations have the status of territorial agencies of local self-governance and are vested with significant scope of powers defined in district charters. For instance, the list of respective powers included in the Charter of the municipal entity *Borovichi and the Borovichesky district* contains 55 entries, of which 50 entries characterize the powers concerning issues of local importance and 5 entries concern the exercise of state powers. Every year, the oblast budget allocates financial resources to rural councils to be used for financing of necessary works (digging of wells, maintenance of cemeteries, and re-

pair of roads). The planning of the respective expenditures is conducted by the heads of rural councils jointly with the councils of village chairpersons (as a form of community-based self-governance). In accordance with district charters rural and settlement administrations independently conclude contracts with municipal enterprises and organizations aimed at the handling of problems of territorial development. The financing of certain municipal public sector institutions is also made via these administrations. According to the available information, at the time the study was carried out in the *Valdai district* in this way there were financed all public sector institutions. An example of joint work at the level of the district and rural administrations may be organization of three voluntary fire squads in the *Shimsky district*, to which the district administrations provides organizational and insignificant financial support.

As concerns the procedures governing the appointment of heads of rural councils, in a number of districts of the Novgorod oblast there is envisage that the respective nominations should be approved by the population. In some cases there have been carried out experiments concerning the elections of the heads of rural councils. Thus, in the Lokotsky rural council of the Krestetsky district, the list of candidates running for the office of the head of the rural administration had been formed at citizens' meetings and later the voting was held at the conference of representatives of villages. The elected head of the rural council was approved in office by the head of the district. In the same Krestetsky district, there was held an experiment concerning the popular election of the head of the rural council by secret voting. In the autumn of 1996, simultaneously with the elections of deputies of the representative body and the head of the local government, there were held the elections of the head of the Novorakhinskaya rural administration. However, this practice has had no further development.

An example of the decentralized model in the region not pursuing so unambiguously the policy facilitating decentralization is the *Dzerzhinsky district of the Kaluga oblast*. The population of the district makes about 22 thousand people, the district comprises 2 settlements and 14 rural councils. Local administrations (in this case including both rural and settlement structures) are outside the structure of the district administration and are territorial bodies of local self-governance. At this level,

deputies are also elected (for instance, in a rural council with the population of 1100 people there were elected 7 deputies). The powers vested in local administrations in accordance with the Charter are somewhat less detailed (the total number of entries is 20) and are not clearly defined than in the analyzed above Charter of the municipal entity Borovichi and Borovichesky district of the Novgorod oblast. However, in this case the list of powers is open. Local administrations also have the right to independently conclude contracts concerning the rendering of municipal services.

In many aspects, the specific features of the status granted to territorial units of the district administration of the Zavodoukovsky district of the Tyumen oblast are similar to the example discussed above. The district consists of the town of Zavodoukovsk and 16 settlement and rural administrations, it includes 49 localities, and its total population makes about 49 thousand people. Territorial units of the district administration are included in the system of local government of the district and are vested with about 40 different powers. In spite of the fact that heads of rural administrations are appointed by the head of the district, this appointment is made taking into account the public opinion, as candidates are nominated by the meetings of citizens or their representatives. The specific feature of this district is also that according to the information presented by the head of the district, budgets of territorial units are formed taking into account the amounts of revenues collected in each territory.

The districts of the Astrakhan oblast, where the one-tier municipal structure was introduced (for instance, the Privolzhsky district) may also be to a certain extent defined as decentralized districts. Thus, the population of the Privolzhsky district makes about 40 thousand; the district comprises 12 rural administrations, 39 localities. Heads of rural administrations are appointed from candidates residing in the respective territory and taking into account the opinion of the local population and activists. There were registered cases, where heads of rural administrations were dismissed because of popular discontent expressed at meetings. However, the powers vested in sub-municipal structures in accordance with the Charter are rather limited, the number of such powers is only 16.

The specifics of the status granted to the administrations of settlements and rural councils pursuing the decentralization policy may be to a certain extent illustrated by comparing the powers vested in local administrations in the Borovichesky, Dzerzhinsky, and Zavodoukovsky districts (see Annex 6.1).

As concerns **intermediate districts**, such districts are characterized by a mix of features of both the centralized and decentralized models. An example of the intermediate district may be the Nizhnetavdinsky district of the Tyumen oblast, which comprises 17 rural councils and 83 localities. The district charter contains practically no regulations pertaining to the status of rural and settlement administrations. The charter only defines that territorial units of the district administration may be granted the rights of legal entities. The scope of powers vested in such units, their rights and responsibilities, the procedures governing the formation of such units and the respective terms of powers, issues of accountability, organization and operation, powers vested in the heads of such units are defined in the regulations on territorial units of the administration as approved by the head of the district. Rural and settlement administrations of the district have own accounts; however, they have no right to independently dispose of municipal financial resources, conclude contracts for rendering of municipal services. The extent of their financial independence is mainly limited to the financial resources obtained via self-taxation and sponsor aid. Heads of rural councils are dismissed and appointed under administrative procedures without popular approval.

In the same category is the Vyborgsky district of the Leningrad oblast. The district includes 5 towns (the population of one of these towns – Vyborg – makes circa 80 thousand people), three urban-type settlements, and 22 volosts. The total district population exceeds 175 thousand people. Although the district charter rather thoroughly defines the powers vested in okrug administrations (this term was adopted in the district with respect to sub-municipal structures), in practice over the last few years the centralization of functions at the district level has been increasing. The appointment of heads of sub-municipal structures is carried out under administrative procedures. Meetings of citizens do not discuss this issue; however, opinions voiced by activists (heads of public sector institutions and economic agents) are taken into account.

Heads of sub-municipal structures should not necessarily be residents of the territories, where they perform their official duties.

As concerns the relations between rural administrations and populated localities situated in respective rural areas, these relations may also be structured in different ways. Thus, meetings of citizens may be organized at the level of rural councils or at the level of settlements. The revenues generated by self-taxation may also be used either in each populated locality or concentrated at the level of rural councils. Interests of the population may or may be not represented at the level of rural councils. For instance, in the Novgorod oblast, under rural councils there function committees or councils of village chairpersons (representatives of rural settlements) as a form of the territorial community-based self-governance. At the same time, village chairpersons are elected officials of TCG and represent one or several villages in the composition of respective rural councils. In the structure of functioning of local self-governance, village chairpersons perform the following functions:

- assist in collection of local taxes;
- assist in organization of citizens' meetings;
- assist in the issuing of passports;
- assist district militia officers;
- assist in organization of fire squads;
- participate in distribution of material aid;
- participate in distribution of plots of land;
- assist in censuses;
- assist in the course of elections.

Mechanisms of the territorial community-based self-governance introduced at the level of settlements are also used in a number of other regions. At the same time, the study revealed that there are also in use quite different mechanisms, i.e. those where village chairpersons are not representatives of the population, but representatives of heads of rural councils and are respectively appointed by the latter. Village chairpersons may work *pro bono* or on partially paid basis; however, the level of pay is insignificant and is at about several hundreds Rubles per month. Usually, not all populated localities are represented. For instance, in the *Pudostskaya volost of the Gatchinsky district of the Leningrad oblast* (8560 residents) there are only 17 village chairpersons,

although the number of populated localities is 28, while in the rural okrug "Gradnitsy" of the Bezhetsk district of the Tver oblast (650 residents) there are 5 village chairpersons for 17 populated localities. In the Krasnoselsky volost of the Vyborgsky district of the Leningrad oblast village chairpersons are elected only in the localities, where the number of residents exceeds 50 persons.

In the districts of the Kaluga oblast, representation of interests of separate populated localities is organized in a different manner. There, these functions are performed by the deputies elected at the level of rural councils. At the same time, in certain rural councils of the Privolzhsky district of the Astrakhan oblast, this representation is not formally envisaged at all.

The efficiency of activities carried out by village chairpersons mainly depends on the regular communications with the administration of rural councils. As it has been revealed in the course of this study, problems with such communications exist even in the most developed territories. Thus, in the Krasnoselsky volost of the Vyborgsky district of the Leningrad oblast, only 3 village chairpersons out of 5 have the possibility to communicate via telephone, while others have to forward information by messages.

Two-tier municipal structure. In the framework of this study there have been analyzed two regions, where the two-tier structure of local self-governance is implemented: the Astrakhan and Kaluga oblasts. However, the mechanisms of implementation of this structure in these two regions differ significantly. The main differences may be reduced to the following.

1. Mechanisms of formation of the two-tier structure differ significantly. In the greater part of the territory of the Astrakhan oblast, the two-tier structure has been formed administratively; all administrative districts and rural councils have been granted the status of municipal entities. In the Kaluga oblast the mechanism of formation was antipodal – the regional legislation permitted settlements to form independent municipal entities on the voluntary basis; however, certain powers (primarily those related to education and health care) remained at the district level.
2. Financial relations between districts and settlements have been formed differently. In the Astrakhan oblast, budgets of settlement

municipalities principally depend on districts. For several years, in formal terms there have been no settlement budgets at all, and only consolidated budgets of districts have been formed. Even after a trial, which resulted in the ruling requiring to form own budgets of settlements, only minimum sources of revenues were assigned to settlements (in most cases these sources made less than 10 per cent of budget revenues), while financial aid was distributed at the district level. In the Kaluga oblast, separate municipal entities at the settlement level are independent of districts as concerns financial issues, while procedures governing the formation of budgets for settlements and districts are similar.

3. In both regions, the division of powers and property objects is not clearly defined. In the Astrakhan oblast, charters of municipal entities (both settlements and districts) contain full lists of issues of local importance envisaged by the federal legislation. With the exception of two districts, where powers and property objects are divided on the basis of agreements concluded between the districts and settlements, in all other cases the division of powers and property objects is informal. In the Kaluga oblast, initially powers had been divided rather consistently; however, later these powers were transferred between two tiers of municipal administration without a clear legal procedure. However, in the Kaluga oblast these issues are regulated more thoroughly than in the Astrakhan oblast.

Therefore, it is apparent that the two-tier system formed in the Astrakhan and Kaluga oblasts may be classified as two significantly different varieties of this model. There arises the question to what extent the regions under observation are typical in terms of the situation forming in Russia as a whole.

Usually, as concerns the classification of the two-tier system of local self-governance in Russian regions there are singled out two varieties thereof: that envisaging budgets at the level of settlement municipalities and that without such budgets. The example of the Astrakhan oblast demonstrates that this difference is not always significant. A formal approach to the model envisaging settlement budgets has not changed the situation as concerns its base characteristics as the amount of financial resources available to settlements has been still determined at the district level. In 2004, settlements were assigned the following

sources of revenues: 2 per cent of the profit tax, the personal asset tax, the land tax, lease payments, and, in certain districts, a share of the income tax (differing across settlements). However, as it has been pointed out above, in most cases these revenue sources could cover only an insignificant part of budgetary expenditures. The overwhelming share of financial resources was distributed by districts for specific purposes on the basis of actual expenditures. According to numerous statements of settlement administrators, in the cases where own revenues of settlements increased, it automatically resulted in declines in subsidies. Therefore, in fact differences between budgets and estimates were insignificant<sup>55</sup>, although formally representative bodies of settlements approved independent budgets.

Basing on the facts discussed above, the Astrakhan oblast may be considered as a typical Russian region with the two-tier model of local self-governance. It should be noted that the new legislation on local self-governance reproduces many characteristics of the Astrakhan model: mandatory introduction of the two-tier structure, insignificant role played by assigned revenue sources in financing of expenditures, the possibility to provide financial aid from the district level. At the same time, the issues pertaining to the distribution of powers and property objects, and mechanisms of allocation of financial aid are regulated much more clearly.

As concerns the approach adopted in the Kaluga oblast, it is rather unique for Russia. Primarily, it concerns the diversity of models of local self-governance introduced in the territory of the region and the initiative voluntary nature of separation of settlement municipalities. These basic features characterizing the approach adopted in the region with respect to organization of local self-governance form a variant alternative to that used in the new legislation on local self-governance. At the same time, this legislation includes a number of instruments characteristic of the two-tier model adopted in the Kaluga oblast: the possibility to transfer powers between the district and settlement levels; the pos-

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<sup>55</sup> However, it should be noted that even in this situation independent budgets had a certain stimulating effect. Thus, in a number of cases the assignment of the personal asset tax to settlements resulted in significant revaluations of real estate objects (in certain cases the pre- and after-valuation figures differed 5 to 10 times).



sibility of financial equalization of both districts, and settlements from the district level, etc.

In spite of all differences between the two-tier models adopted in two regions, the functioning of these models has resulted in a number of common consequences. This fact is the more interesting, as it may be assumed that if the consequences in two so different regions were similar, the same trends may manifest themselves in the case the two-tier model is introduced in the whole territory of the country in the framework of the municipal reform.

1. The two-tier model has proved to be rather unstable. In both cases, it demonstrated a clear trend towards deterioration in a one-tier structure, although these trends manifested themselves in different ways. In the Astrakhan oblast, the two-tier system clearly gravitated to a one-tier district structure. This was manifested by a high degree of financial centralization at the level of districts (to the extent of formation of consolidated district budgets), arbitrary redistribution of powers between the settlement and district levels, hierarchical system of relations between the oblast administration and different types of municipal entities (in practice, the oblast administration directly worked only with districts). On the contrary, in the Kaluga oblast there manifested itself the trend towards deterioration of the two-tier model to the one-tier settlement structure. Over time, settlements somehow or other more and more concentrated powers pertaining to the spheres of education and health care, which had been originally vested in districts. This concentration was carried out in several ways:

- Dynamically developing settlements of good financial standing got these powers as a result of political pressure;
- Districts transferred powers to the settlement level in the framework of the mechanism of transfer of powers;
- Objects owned by departments were transferred in the municipal ownership at the level of settlements.

Therefore, the two-tier system “*per se*” has not lasted in neither of the regions under observation.

2. The two-tier model has demonstrated that it was highly prone to conflicts. It was especially apparent in the Astrakhan oblast, where, on the one hand, at the level of settlements there existed elected authorities, but, on the other hand, in practice settlements almost completely

depended on districts. Unable to take independent decisions in the interests of the population, which elected them, the administrations of settlements spent considerable energy for conflicts with district administrations. It may be stated that out of all regions under observation, conflicts in the sphere of local self-governance were most intensive in the Astrakhan oblast. In the Kaluga oblast the scopes of conflicts were more limited; however, in this region the specifics of the two-tier model generated problems relating to the transfer of powers between the district and settlement levels. Conflicts originated due to inconsistency between the transferred powers and their financial substantiation. At the level of settlements, there had formed the opinion that districts retained more “lucrative” powers transferring to settlements the most expenditure-intensive ones, and what is more, without sufficient financing. Taking into account the fact that the mechanism of transfer of powers almost similar to that used in the Kaluga oblast is envisaged by the new legislation on local self-governance, it may be predicted that similar conflicts will originate in the course of introduction of this legislation.

3. The practices observed in the Astrakhan and Kaluga oblasts have demonstrated that it would be feasible to retain the maintenance of the majority of budget sector objects at the level of settlements. In the Astrakhan oblast, initially powers have been distributed exactly in this way. At the district level, there were usually financed central district hospitals, district cultural centers, and certain specialized objects (for instance, boarding schools). Besides, from the district level there could be financed certain powers in the spheres of education and health care not related to the maintenance of public sector objects (for instance, teachers' salaries). Further, there began to manifest itself the trend toward centralization, which was extremely negatively perceived by administrations of settlements. In the Kaluga oblast, many objects pertaining to the spheres of education and health care had been initially assigned to the district level, what resulted in numerous conflicts. The point is that in fact settlements had to finance these objects anyway, since normal functioning of these objects was crucial for the population, i.e., the electorate of settlement administrations. Procurement of medicines for paramedic and obstetric stations (POS), or repairs of a school's roof are immediate problems, while as a rule it takes a rather long time to resolve such problems at the district level and there are no

guarantees that the final decision will be positive. The new legislation on local self-governance failed to take this lesson into account as it blindly copied the experience of the Kaluga oblast in this sphere. Therefore, it is highly probable that there will be reproduced the same problems and conflicts as those resulting from the distribution of powers in this region.

Settlement municipalities. Differences among settlement municipalities are mainly of technical nature and eventually determine the abilities of settlement to handle issues of local importance assigned to them. At the same time, it should be taken into account that, as quantitative studies have revealed, the range of these issues is significantly narrower than, for instance, under the district model of municipal organization.

The most significant differences among settlements are related to the following factors.

1. Urban or rural population. Rural settlements differ from urban-type settlements, in certain cases these differences may be principal.

2. Territorial organization of settlements. Settlements consisting of 1 to 2 populated localities have own specifics in comparison with less concentrated and more territorially scattered settlements (for instance, the Chervishevskoye municipal entity of settlement type situated in the Tyumen oblast comprises 8 territorially scattered populated localities).

3. Size of the population. For instance, in the Tyumen district of the Tyumen oblast this indicator varies from 500 to 600 thousand (municipal entities Knyazhevskoye and Mollashinskoye) to 15.5 thousand (municipal entity Borovskoye). These differences inevitably affect the abilities of municipal entities to exercise their powers and the quality of their activities; however, this effect is not direct and unambiguous.

4. Economic capacity of the population. The existence or lack of the economic base affects the ability of the population to meet the respective objectives.

However, basing on the conducted analysis it can not be asserted that, for instance, in larger settlements local authorities act more efficiently than in smaller localities, or that the territorial de-concentration unambiguously impairs the efficiency of the settlement model, although there could be detected influence of the economies of scale on certain factors pertaining to the functioning of municipal entities. Reviewing two

most successful and steady developing municipalities of the settlement type monitored in the course of this study, they considerably differ in terms of their objective characteristics. Thus, the municipal entity *Borovskoye of the Tyumen oblast* is a rather large urban-type settlement, while the municipal entity *Detchino of the Kaluga oblast* may be defined as a medium-sized settlement municipality since its population makes circa 5.7 thousand. The settlement comprises the village of Detchino and 15 neighboring villages. In the municipal entity Detchino the density of population is almost 1.5 times less than in Borovskoye.

As it follows from this study, the most important objective factors affecting the activities of settlement-type municipal entities are the existence of economic bases and sources of trained personnel, and both these factors are of greater importance for settlements than districts. It is highly probable that these factors will prove to be more favorable in urban settlements than in rural ones, although this relation is far from being unambiguous. At the same time, in all appearance the efficiency of activities of settlements is significantly affected by subjective and random factors, the role of which turns out to be more significant than at the district level. It may be assumed that this circumstance is related to the fact that the local elite is less formed and stable, as well as the objective lack of qualified personnel, which is not sufficient to form several administrative teams.

#### *6.1.2. Development of Local Self-Governance in Municipal Entities of Different Types*

The most widespread notion of the influence of the territorial structure on the development of local self-governance is that the settlement model, which puts authorities into closer contact with people, creates adequate prerequisites for participation of population in government, while under the district model the conditions for local self-governance are insufficiently favorable. In the framework of this study, this notion has not been confirmed. In the course of the study, there have been established two groups of facts.

On the one hand, in many settlement-based municipal entities, their heads complain about aloofness of the population and its unwillingness to participate in any form in the organization of local life and rendering of municipal services even in the situations, where municipal authorities

due to any reasons are unable to perform their functions. Thus, one of the settlements situated in the Tyumen district of the Tyumen oblast faced an emergency situation as a bridge collapsed due to a flood. Pastures and meadow lands were situated on the other bank of the river. In this situation, both residents and local authorities were passive and did not attempt to organize a crossing, for instance, by attracting private firms, and react by decreasing livestock. The only way to resolve this problem they see in the transfer of financial resources in amount of Rub. 25 million from the oblast budget; however, this decision has not been taken yet.

The unwillingness of the population to tackle even insignificant problems by the way of self-organization manifests itself not only in critical situations, but in everyday life as well. Thus, residents refuse to clean well and have to hire outside help. If a bucket drowns in a public well, Rub. 80 needed for replacement are demanded from the local budget. In some settlements there is introduced self-taxation; however, administrations of many settlement-based municipalities either find no sense in this tool, or have encountered serious opposition to attempts to introduce it.

On the other hand, in the course of the study there have been collected rather significant data characterizing forms of self-organization employed by the population and active participation thereof in governance. However, these forms have most clearly manifested themselves not in settlement-type municipalities, but at the level of rural councils in the districts pursuing the policy of decentralization. In such districts, heads of rural councils become central figures organizing local communities for handling of current problems with the help of minimum administrative structures and minimum financial support on the part of districts. For these purposes, they have to establish different contacts and relations with different groups within local communities<sup>56</sup>, which are always internally heterogeneous. For instance, in the *Polotnyano-zavodsky rural council of the Dzerzhinsky district of the Kaluga oblast*, the head of administration has pointed out the following groups, which most influenced organization of local life:

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<sup>56</sup> In fact, the head of the rural council performs the so-called “networking” function, the term, which can not be adequately translated into Russian.

- Population at large is involved in the resolving of important problems at meetings (for instance, assignment of responsibilities pertaining to fires) and collects financial resources, the amounts of which in financially unfavorable years are comparable with the financing provided from the district budget, via self-taxation;
- Summer residents are a special group of population of better financial standing in comparison with the rest of local residents; they pay higher self-taxation contributions (local residents pay Rub. 20 per year per household, while summer residents pay Rub. 100), assist in gasification (they have fully sponsored gasification of the houses of 6 old women), they have donated a computer, a type-writer, and a refrigerator to the rural council;
- Neighboring enterprises (both from this rural council and another neighboring settlement-type municipality) also sponsoring the municipal entity: the paper mill has assisted in repairs of the kindergarten, sponsors have built a bridge.

Financial resources collected via self-taxation, although totaling to a not very significant amount (about Rub. 40 thousand a year) are used for handling of a wide range of local problems, i.e.:

- Road repairs;
- Procurement of medicines for POS;
- Construction of the bridge;
- Material aid;
- Organization of funerals;
- Aid to people who lost their houses and property in fires;
- Aid to the school, kindergarten, club (it should be noted that the school is situated in another municipal entity – the village “Polotnyany zavod”);
- Wages of two HUS workers employed by the local administration.

The interaction among different groups of local community may be demonstrated by the example of organization of road repairs. The decision to spend financial resources for this work was adopted at a meeting. At the expense of funds collected via self-taxation there were purchased two truck loads of asphalt. A discount price of gravel and permission to use construction equipment were arranged with the director of a quarry.

The prompt repairs of the water supply system after an accident, which occurred in winter, may be cited as an example of mobilization of the local community in an emergency situation. In December, when temperature was at minus 30 degrees centigrade, there burned out two pumps. The head of the rural council called a meeting, where it was arranged that financial resources necessary for repairs (circa Rub. 15 thousand) would be borrowed from the population. One pump was borrowed in the neighboring settlement "Polotnyany zavod," where there was available a reserve pump. In March, the debt to the population was repaid. In the case the council tried to resolve this problem via the district, it would have required much longer time and the system could be frozen.

Another example of active self-organization of the population is voluntary fire squads in the Shimsky district of the Novgorod oblast. There are three such squads in the district. The creation of these squads was initiated by professional firepersons. This decision was approved at meetings. Populations of the majority of rural councils (but not of all) supported this idea, since in the districts there were only two professional fire squads and often they were too late to efficiently fight fires. In the course of the study, there was thoroughly analyzed the work of the voluntary fire squad in the rural council "Medved". The fire engine was available in an agricultural cooperative, but it lacked fuel, spare parts, etc. For organization of the voluntary fire squad, there has been imposed an additional fee (Rub. 20 per year per household), the district administration has vested the collection of this fee in rural councils. It should be noted that "Medved" also receives funds collected in other rural councils the fire squad services. However, the respective financial resources are rather limited amounting to several thousand Rubles, which suffice to cover the expenditures for fuel and some spare parts. Firepersons work practically for free; the main form of remuneration of their services is gifts the district administration provides annually on the day of the professional firepersons' holiday.

Through self-organization population tackles not only the issues related to the rendering of municipal services, but to the sphere of economy as well. Thus, in the same Shimsky district of the Novgorod oblast, village meetings tackle such issues as hiring of herdsmen (example of such decision: Rub. 100 and two buckets of potatoes per cow). Some-

times village residents keep a common horse to plough kitchen gardens and meetings of citizens set the order of priority as concerns the use of the horse. Meetings also take decisions concerning the re-allotment of meadow lands on the basis of proposals prepared by the heads of rural councils and village chairpersons of respective localities.

In the rural council "Osyynoy bugor" of the Privolzhsky district of the Astrakhan oblast, the population participated in the taking of decision concerning the construction of a water supply system and financed the laying of pipes. In the rural council, there was introduced self-taxation providing financial resources, which are expended for instance to pay the cemetery keeper.

The study has registered only one instance of active participation of the population in organization of municipal services in a settlement-type municipality – the municipal entity of Tuluganovsky rural council in the Astrakhan oblast. At the time the study was conducted, the situation in this municipality could be characterized as critical. The population of the municipality made 820 residents, 70 per cent of residents were unemployed. At the time of elections of the head of the municipal entity it experienced problems related to water and electrical power supply, there was no natural gas supply and transport communications between the municipality and the district center. As concerned the administrative personnel, the salary arrears were at a critical point (the delay in payments made 7 months at the time of the study).

In this difficult situation, the new head of the municipality (former school teacher) began to actively develop relations with the local community. There was introduced self-taxation (Rub. 20 per household), population took active part in repairs of the cemetery, construction of a solid domestic waste disposal site. In fact, the head of the municipality practically alone developed the disposal site project with the help of senior school students, who worked on the project during school informatics lessons (the school disposed of the only computer in the rural council). The head of the rural council could also attract sponsor funds for repairs of the local cultural center and a number of other objectives, arrange a faster gasification of the village (there were laid 9 kilometers of gas pipes in stead of 6 kilometers), resolve the issue of transport communications with the district center. According to the head of the



municipality, in all these matters the assistance of the district administration was minimal (“they promised much and did nothing”).

It seems that the explanation of the paradox revealed in the course of the study is related to the specifics of organization of municipal governance as a whole and primarily to the regulation of financial and economic basis of municipal activities. In the settlement-based municipalities with own municipal budgets and administrative structures performing municipal functions, populations do not feel any need for self-organization in order to tackle local problems. At the same time, local taxes play no significant role, while amounts of financing are completely determined by decisions taken at the regional level. In this situation, the most important issue for local authorities is not relations with the population, but the ability to lobby their interests in the regional or district administration, and exactly this parameter primarily determines the efficiency of their activities. The lack of such an important form of participation in administration as financing of municipal services at the expense of local taxes, the rates of which are independently set by municipal entities, inevitably results in aloofness of residents from local authorities and their “consumer” attitude to local budgets, on the formation of which they have no significant influence.

At the same time, in rural councils of the districts pursuing the policy of decentralization there form principally different conditions. The observation made by a district administrator to the effect that rural and settlement administrations are vested with the same powers as municipal entities, but without adequate financing very well characterizes the situation forming in these municipalities. In fact, heads of rural councils have to be responsible for the resolving of all issues of local importance in their territories notwithstanding in what structures the handling of these issues is formally vested. In the situation of the extreme scarcity of financial and administrative resources, the only way to tackle pressing problems is to rely on local communities and self-organization of the population. At the same time, residents realize that at the level of rural councils there are no levers of power permitting to resolve their problems, while district authorities are too far from them, become more susceptible to the attempts to involve them in the management of local affairs. Therefore, it follows from the conducted analysis that the lack of

institutionalized power structures creates better conditions for real self-governance.

The unique example of a settlement-type municipality, where there were detected active processes of self-organization of the population is the exception proving the rule. The sad plight of the municipal authorities in the settlement, lack of many basic municipal services, minimum administrative staff (4 to 5 people), acute deficit of financial resources, absence of efficient assistance on the part of the district authorities in the situation, where a strong leader was elected to manage the municipality, in fact reproduced the situation, which has been analyzed with respect to sub-municipal structures having no municipal status. On the one hand, under the crisis conditions the role played by the formal institutions of municipal governance (administrative structure, local budget) significantly deteriorated; these institutions apparently failed to meet the vital needs of the population. On the other hand, the availability of a strong leader permitted to efficiently develop informal institutions (sponsor aid, involvement of the population), which proved to be the only option guaranteeing at least the minimum level of municipal services.

The conclusions arrived at in the course of the study can hardly be unambiguously evaluated. On the one hand, the lack of incentives for self-governance in the framework of the existing municipal structure, the "dependent" attitude of local authorities, aloofness of the population, and crisis-forced nature of self-governance at the level of rural councils and municipalities demonstrate the principal faults of the existing system of organization of local self-governance. On the other hand, participation of the population in the handling of local problems is a positive factor notwithstanding in the framework of which structures it is carried out and if it corresponds to the theoretical notions in this sphere. The conclusion that the lack of formalized power structures facilitates self-organization requires serious consideration and observed in practice real forms of self-governance should be carefully dealt with in the course of the municipal reform.

### *6.1.3. Theoretical Model of Local Self-Governance and Administrative Staff (the Economies of Scale Problem)*

As it has been pointed out above, optimization of the size of the administrative personnel and expenditures for governance is a significant parameter determining the choice of the model of local self-governance. The general trends characteristic of the dynamics of expenditures for governance in regions with different territorial structures have been discussed in the chapter focusing on the results of the quantitative analysis, which were ambiguous. This section primarily focuses on the testing and complement of the results obtained earlier on the basis of data pertaining to the pilot regions.

In the course of the study, there have been collected rather fragmented data on the size of the administrative personnel and it should be noted that these data mainly pertained to municipal entities at the settlement level. The available information presented in Annex 6.2 permits to conduct the primary analysis aimed at detection of economies of scale in the case of enlargement of municipal entities, although the available sample is not sufficiently large to detect statistically significant regularities. *Fig. 6.1* demonstrates that there exists a clearly visible inversely proportional relation between the size of the population residing in a given municipal entity and the size of the administrative staff per one thousand residents and that this relation is of the non-linear nature. The most significant losses associated with insufficient scale of activities were detected in municipal entities, where populations made less than 4 to 5 thousand residents. In larger municipal entities the specific weight of administrative personnel continued to decrease, although much more smoothly. In the framework of this study there has not been detected a flex point after which the increase in scale resulting in a growth in the size of the administrative staff would become apparent; however, it should be noted that in two largest municipalities the specific weight of administrative personnel began to grow smoothly.

The transition from more fragmented to more concentrated territorial structure also has a significant potential of economies of scale. This fact may be monitored by the example of the Tyumen oblast, in the whole territory of which with the exception of the Tyumen district in 2001 there was carried out the transition from the settlement-based to the district model of organization of local self-governance. Prior to that

year, in the oblast there had been only two district municipalities – Zavodoukovsky and Uvatsky districts. In the other territories of the oblast there existed municipal entities at the level of settlements and territorial bodies of state power at the level of districts. In spite of the fact that the functions of territorial bodies were rather limited, the number of such bodies was comparable to municipal district administrations. By the example of two districts, *Table 6.1* presents the ratio between the sizes of administrative staffs in the framework of the settlement-based and district models.

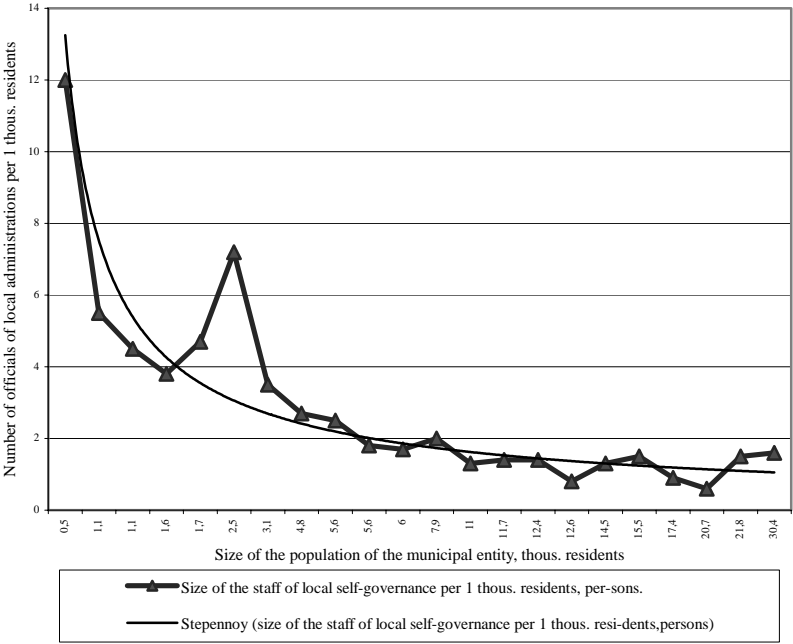


Fig. 6. 1. Dependence of the sizes of the administrative staffs of municipal entities of the Kaluga and Tyumen oblasts on the sizes of settlements

Table 6.1

**Size of administrative staff by example of two districts  
of the Tyumen oblast in 2001**

<b>Indicators</b>	<b>Zavodoukovsky district</b>	<b>Golyshmanovsky district</b>
Model	District	Settlement-based
Size of the population (thous. residents)	48.6	29.5
Number of local administrations	16	16
Size of administrative staff at the district level (persons)	128	105
Size of administrative staff at the settlement level (persons)	34	100
Total size of administrative staff (persons)	162	205
Size of administrative staff per 1 thous. residents (persons)	3.3	6.9

After the transition to the district model, the following changes were registered with respect to the administrative staff:

- in settlements deprived of the status of municipal entities the size of administrative personnel significantly declined;
- on the whole, the size of administrative staff at the municipal level significantly increased, since in stead of earlier existing territorial bodies of state power there were created municipal district administrations; however, the size of administrative staff in the oblast administration declined respectively;
- in a number of districts, remuneration of the staffs of district administrations significantly increased after creation of municipal entities.

Financial consequences of all the transformations discussed above are presented in *Table 6.2*. *Table 6.2* demonstrates that the resulting economies of scale may be detected in the course of analysis of not municipal, but regional budget, since, as it has been pointed out above, in stead of territorial bodies of state power at the district level there were formed municipal entities.

Table 6.2

**Expenditures of budgets of different levels, item “State administration and local self-governance”, Tyumen oblast, 2000 through 2002**

	Average per capita expenditures for administration in constant prices, Rub.*			Share of expenditures for administration in the structure of budgetary expenditures, in %		
	2000	2001	2002	2000	2001	2002
<i>Consolidated regional budget</i>	826.5	886.3	862.6	8.1	8.0	5.7
<i>Regional budget</i>	526.2	552.3	494.5	6.9	6.3	4.8
<i>Total local budgets</i>	300.3	334	368.1	7.5	6.5	7.2
Districts (without the Tyumen district)	247.8	285.2	424.5	6.5	6.4	8.6
LSG organization model	settlement	settlement	district	settlement	settlement	district
Tyumen district	230.7	302.4	352.4	6.1	6.8	7.1
LSG organization model	settlement	settlement	settlement	settlement	settlement	settlement

\* Year 2000 is used as the base period.

Source: budget execution reports of towns and districts of the Tyumen oblast for years 2000, 2001, and 2002, RF Finance Ministry.

At the same time, an analysis of expenditures for administrative staff in the Kaluga oblast does not unambiguously confirm the trends discussed above. In fact, in the oblast there exist two models of local self-governance – the district and two-tier ones. It would be logical to assume that in the districts with the two-tier model the size of the administrative staff the expenditures for administration should be higher than in municipal entities of the district level. However, the data presented in *Table 6.3* demonstrate that it is not so. In *Table 6.3* there are presented specific expenditures for administration (in constant prices) and the average share of administrative expenditures in the total expenditures

of municipal budgets in the oblast, as well as across the following groups of municipal entities:

- municipalities with the district-based structure (13);
- districts with the two-tier structure (10);
- districts with the two-tier structure without the Dzerzhinsky district, where certain municipal functions are performed by the territorial body of state power (a peculiar form of external management).

Table 6.3

**Expenditures of municipal budgets for administration in the Kaluga oblast (on the whole across the sample of municipal entities) in 2001 through 2002**

Sample of municipal entities	Average per capita expenditures for administration in constant prices, Rub.*		Share of expenditures for administration in the structure of budgetary expenditures, in %	
	2001	2002	2001	2002
<i>On the whole across local budgets</i>	259.5	288.0	9.3	8.9
<i>Districts with one-tier structure of local self-governance</i>	312.0	369.2	13.8	13.2
<i>Districts with two-tier structure of local self-governance</i>	263.9	293.8	10.1	9.3
<b>Districts with one-tier structure of local self-governance (without the Dzerzhinsky district)</b>	276.0	312.3	10.5	9.7

\* Year 2000 is used as the base period.

Source: budget execution reports of towns and districts of the Kaluga oblast for years 2000 and 2002, RF Finance Ministry.

It is apparent that the expenditures for administration are lower in the districts with the two-tier structures even in the case the Dzerzhinsky district, where certain municipal functions are performed by state officials and this ratio is of a rather stable nature. The same trend is confirmed in the course of comparison between the expenditures for administration in the Kaluga and Astrakhan oblast. In the Astrakhan oblast, first, on the whole the share of expenditures for administration in districts is significantly above the respective figure registered in the Kaluga oblast, and, second, this share is almost similar in districts with

the one-tier and two-tier structures. However, the latter comparison is not quite accurate, since in the Astrakhan oblast there are only two districts with the one-tier structure and the share of administrative expenditures there differs 1.8 times. At the same time, it should be noted that the size of the administrative staff in settlement municipalities of the Astrakhan oblast is reduced to the extreme minimum and is, for instance, 2 to 3 times below the size of the staff in sub-municipal structures of many districts of the Leningrad oblast. The comparison of the data pertaining to the Kaluga and Astrakhan oblast are presented in *Table 6.4*.

*Table 6.4*

**Share of expenditures for administration in the structure of expenditures borne by local budgets of the Kaluga and Astrakhan oblast in 2002, in per cent**

	<b>Kaluga oblast</b>	<b>Astrakhan oblast</b>
<i>On the whole across local budgets</i>	8.9	8.9
<i>Consolidated budgets of districts (total)</i>	10.5	13.0
<i>Districts with two-tier structure of local self-governance</i>	9,3	12.9
<i>Districts with one-tier structure of local self-governance</i>	13.2	12.5

From our point of view, the phenomenon of the Kaluga oblast may be explained by the fact that in this region the two-tier structure has not been mandatory introduced “from the top”, but formed on the basis of voluntary separation of settlement-based municipalities from districts in the cases, where there existed the respective financial and organizational prerequisites. It seems that this circumstance permitted to activate additional factors facilitating higher efficiency of organization of administration not related to the economies of scale and compensate for unfavorable consequences of de-concentration of governance.

Unavailability of data characterizing the sizes of administrative staff in all municipal entities of the Kaluga oblast does not permit to arrive at unambiguous conclusions as concerns the question if the uncontrolled growth in the size of administrative staff has been prevented due to high skills of administrative personnel, or if the decisive factor was lower salaries of administrative work at the level of settlements. Nevertheless, the example of the Kaluga oblast demonstrates that although the trend



towards the economies of scale is clearly perceptible in the sphere of municipal administrative expenditures, there exist other significant factors affecting this parameter, and it should be noted that the effect of these factors may turn out to be more significant than the economies of scale.

## **6.2. Territorial Model of Local Self-Governance and Economic Development of Municipal Entities**

Traditionally, it is believed that municipal entities at the level of districts are more able to handle economic development issues than settlements. This notion is based on a number of factors:

- districts dispose of more skilled personnel able to competently make business plans, attract investors, etc;
- districts are more “important” administrative units, they are perceived as serious partners as concerns the establishment of inter-regional relations and making of investment-related decisions;
- districts can use more levers of influence on the investment climate and environment of business development in their territories.

In fact, this study actually confirmed that district authorities influence economic development in their territories, and that this influence may be rather mixed.

Positive examples in this sphere are primarily related to the creation of positive environment for attraction of investment, lowering of administrative barriers to business development, development of inter-regional cooperation, assistance in training of personnel. Thus, in the *Valdai district of the Novgorod oblast* in the structure of administration there has been introduced the post of deputy head of the district for development and investment activities. In the district, there have been prepared 10 investment sites ranging from 10 to 100 hectares. Respective information is readily available, in particular, it has been included in the actively distributed advertisement booklet “Valdaiskaya Zemlya” (indicating contact information). Support of investment primarily includes granting of tax privileges and assistance in overcoming administrative barriers. In the *Isetsky district of the Tyumen oblast*, the head of the district has quarterly held meetings with commercial structures and inspection agencies in order to resolve any mutual problems. In three districts of the Novgorod oblast municipal entities are responsible for

vocational schools; however, the district authorities try to influence the training in order to adapt it to the needs of the local labor market. In the Bezhetsky district of the Tver oblast, there has been introduced micro-crediting of small businesses. For 2 years, these credits have been financed from the budgets, at present no budgetary financing is required. This form of support is in great demand and practically 100 per cent of credits are repaid. Besides, with the support of Canadian donors there has been established a business center.

However, influence of district administration can be of a different nature as well. Thus, in the *Novgorodsky district of the Novgorod oblast* district authorities for 6 years have hinder the bankruptcy of a large industrial enterprise. Although it is a private enterprise (a joint stock company), the district administration actively interferes in the activities of the creditors' committee and tries to find a "suitable" investor (all investors showing interest in the enterprise have not suited the district authorities yet). Representatives of the district still believe that in spite of changes in the form of ownership enterprises still depend on and believe only in the authorities. However, it should be noted that such interventionist positions are not universal. Thus, in the Valдай district all large enterprises have long ago underwent bankruptcies, obtained new owners and, with the only exception, have been successfully restructured. Thus, in the process of bankruptcy of the LLC "Yupiter", one of the largest taxpayers situated in the territory of the district, the number of employees has been reduced 2.5 times; however, as a result the enterprise exports practically 100 per cent of its products, which are in stable demand.

As concerns settlements, by all appearances many of them can influence economic development to a rather limited extent. Heads of a number of settlement municipalities complained that they could establish no normal contacts with managers of enterprises situated in their territories. According to available information, the transition from the settlement-based to the district model in the territory of the Tyumen oblast was accompanied by the expansion of territorial cooperation and gaining of entry to new markets on the part of local producers. Thus, after the founding of the *Nizhnetavdinsky district of the Tyumen oblast*, the new municipal entity proved able to establish economic relations with autonomous okrugs in the north of the oblast and with the Sverdlov

oblast. There have been concluded several agreements on cooperation. At present, local producers supply the north of the oblast with agricultural produce and have started supplies of prefabricated houses. The district administration has proved to be able to resolve the problem, which could not be resolved at the settlement level, i.e. it arranged that the Yamal Nenets autonomous okrug maintained the therapeutic mud-baths situated in the territory of the district.

However, there were registered opposite examples. By the moment there was founded the municipal entity "Detchino" in the Kaluga oblast (1996), the settlement had practically lost its economic base, only one enterprise still operated on the short-week basis. However, the combination of a favorable geographic location and well thought-out policies aimed at the attraction of investments resulted in a real investment boom. Practically every year new enterprises have been established in the district, including a wood working plant, a vine-bottling enterprise, and a coffee processing plant. The milk processing plant is being reconstructed. The activities of the local administration aimed at the attraction of investments include the streamlining of procedures governing the land allocation, granting of privileges pertaining to local taxes, rejection of additional requirements and exactions, assistance in resolving of different problems at the local level. At the same time, in the course of the study there was obtained information that in the framework of the district model the investments agreed upon at the lower level were not made, since the district authorities made exorbitant demands on investors.

However, more typical have been situations, where micro-businesses could be attracted at the level of settlements. For instance, in the municipal entity of the Baibeksky rural council of the Krasnoyarsk district of the Astrakhan oblast (1800 residents), where authorities try to actively attract businesspersons, they succeeded in attraction of employers ensuring 10 to 15 jobs at their enterprises. At the same time, the head of the municipality actively negotiate with the collective farm as concerns the transfer of redundant land and equipment to businesses, while the district authorities do not participate in attraction of investments.

However, there have been also detected other trends related to the wish of municipal authorities participate in businesses. This desire

manifests itself both at the level of settlements and districts. Thus, settlement-based municipalities of the Limansky district strive to engage in commercial activities related to fishing and salt production in order to replenish local budgets. The administration of the Sandovsky district of the Tver oblast takes the same stand being of the opinion that municipal authorities should act as businesspersons. A form of interaction between the authorities and businesspersons in the district is the procurement of equipment for private businesses and leasing thereof.

In the opinion of representatives of a number of municipal entities, this trend may become more perceptible as concerns the new organization of financial relations with municipalities, which does not envisage the assignment to municipalities of taxes related to the attraction of businesses to their territories: the profit tax, the property tax on organizations. Thus, in the depressive Sandovsky district there were made significant efforts to attract an investor, who would develop a gravel site. However, at present the revenues the district receives from this business are minimal, since the respective tax revenues are mainly transferred to the regional level.

Therefore, in the course of the study there have been revealed both the cases of positive and negative influence of district authorities on the prospects of economic development both at the district level, and at the level of settlements. By all appearances, there are no universal regularities. If district authorities consciously strive for creation of favorable conditions for businesses, they have more ample opportunities for that than settlements. However, if no such objectives are set, district authorities can even hinder economic development by preventing the use of the potential of the settlement model resulting from the fact that it is closer to the population and has to orient itself towards its interests.

It follows from the study that administrations of municipal entities, primarily those existing at the district level, may rather significantly influence economic development. Ignoring of this conclusion in the course of formation of financial relations at the municipal level (in particular, as concerns the assignment of taxes) may bring about negative consequences, i.e. to diminish the incentives for attraction of investments in the territory and, simultaneously, even more motivate the authorities to participate in commercial activities.

## **Annex 6.1. Powers Vested in Rural Administrations in Municipal Entities of the Town of Borovichi and the Borovichesky District of the Novgorod Oblast, Dzerzhinsky District of the Kaluga Oblast, and Zavodoukovsky District of the Tyumen Oblast**

<b>Town of Borovichi and Borovichesky district</b>	<b>Dzerzhinsky district of the Kaluga oblast</b>	<b>Zavodoukovsky district of the Tyumen oblast</b>
1	2	3
<i>1. In the sphere of planning, budgeting, financing, management of municipal property, relations with enterprises, institutions, and organizations territorial units of district administrations:</i>		
<ul style="list-style-type: none"> <li>• Elaborate and submit to the administration of the municipal entity proposals relating to district projects in the sphere of social and economic development of the territories of rural councils;</li> <li>• elaborate and implement plans of social and economic development of the territories of rural councils at the expense of the financial resources envisaged in the estimate of revenues and expenditures, as well as borrowings;</li> <li>• submit proposals concerning draft budgets to the administration of the municipal entity; approve and execute the estimate of revenues and expenditures of the administrations of rural councils</li> </ul>	<ul style="list-style-type: none"> <li>• Manage and dispose of municipal property transferred in the operative management of the administration in accordance with the procedures set by the Duma of the town of Borovichi and Borovichesky district;</li> <li>• detect derelict property</li> </ul>	<ul style="list-style-type: none"> <li>• Develop and submit for approval of the Duma draft plans and programs of social and economic development of the territory, draft budgets, organize implementation and execution thereof</li> </ul>
<ul style="list-style-type: none"> <li>• Manage and dispose of municipal property transferred in the operative management of the administration in accordance with the procedures set by the Duma of the town of Borovichi and Borovichesky district;</li> <li>• detect derelict property</li> </ul>	<ul style="list-style-type: none"> <li>• Manage municipal property transferred to them in operative management;</li> <li>• handle the issues of creation, procurement, use, and lease of municipal property objects;</li> <li>• submit proposals concerning alienation of municipal property objects to the Committee of Property Relations</li> </ul>	<ul style="list-style-type: none"> <li>• Manage municipal property transferred to them in operative management;</li> <li>• handle the issues of creation, procurement, use, and lease of municipal property objects;</li> <li>• submit proposals concerning alienation of municipal property objects to the Committee of Property Relations</li> </ul>

Own, dispose of, and manage the housing stock, nonresidential premises and objects of the engineering infrastructure transferred to their fixed assets

Resolve the issues of construction, reconstruction, and maintenance of municipal housing, social and support facilities, and engineering infrastructure at the expense of financial resources envisaged in the estimate of revenues and expenditures, as well as borrowings

- Have the right to request and receive from municipal enterprises and organizations situated in the territories of rural councils notwithstanding their organizational and legal forms the necessary information about their development plans and measures, which could have ecological, demographical, or other consequences affecting the interests of the populations of these territories;
- approve such plans and measures under the respective procedures

Assist in the founding of organizations of different ownership forms engaged in servicing of the population and farms in the territories of rural councils

Prepare proposals concerning acceptance of objects situated in the territories in their jurisdictions in municipal ownership

Assist in the founding of organizations of different ownership forms engaged in servicing of the population and farms in their territories

1	2	3
<ul style="list-style-type: none"> <li>• Independently conclude contracts concerning the issues of territorial development with municipal enterprises and organizations;</li> <li>• create favorable environment in the sphere of consumer services and trade; organize markets and fairs;</li> <li>• control compliance with trade regulations, sanitary conditions in sales areas;</li> <li>• exercise control over the schedules of operations of public utilities, organizations of trade, public catering, and consumer services, make proposals concerning improvement thereof, approves the schedules of operations most suitable for the population</li> </ul> <p>Submit to the administration of the town of Borovichi and Borovichesky district proposals concerning personnel, approval of appointments or dismissals of heads of municipal enterprises and organizations</p>	<ul style="list-style-type: none"> <li>• Create favorable conditions for rendering of services of trade, public catering, and consumer service enterprises to the population;</li> <li>• determine the locations of such enterprises;</li> <li>• establish working schedules for such enterprises</li> </ul>	<p>Conclude cooperation agreements with enterprises and organizations not in municipal ownership as concerns economic and social development of their territories, production of consumer goods and other products, rendering of services</p>
<p>Under the respective procedures, lease plots of lands situated in the territories of rural councils and lands from the reserve land fund</p>	<p><i>2. In the sphere of agriculture, land use, conservation of nature:</i></p>	<p>Plan the use of municipal land under jurisdiction of territorial units</p> <p>Organize elaboration and implementation of general plans of development of settlements and rural localities</p> <p>Approve withdrawal and granting of land by higher authorities</p>

1	2	3
transferred in the jurisdiction of the administration in accordance with the Land Code of the Russian Federation		
Collect land related fees		Collect land related fees
Exercise control over the land use in the territories of rural councils	Exercise control over the land use	Exercise control over the land use and protection
		Protect the rights of land owners and leaseholders
		Settle land related disputes within their competence
Participate in environment protection, ensure the observance of procedures governing the collection of wild plants, berries, fruits, etc.		Control the observance of nature protection legislation, rules of hunt, fishing, etc in their territories
<ul style="list-style-type: none"> <li>• Inform population about environmental situation;</li> <li>• undertake safety measures in the cases of natural calamities and accidents;</li> <li>• inform the relevant authorities about the actions of enterprises, institutions, and organizations threatening environment and infringing on the legislation governing the management of natural resources</li> </ul>		<ul style="list-style-type: none"> <li>• Inform population about environmental situation;</li> <li>• undertake safety measures in the cases of natural calamities and accidents;</li> <li>• inform the relevant authorities about the actions of enterprises, institutions, and organizations threatening environment and infringing on the legislation governing the management of natural resources</li> </ul>
<p><i>3. In the sphere of construction, transport, communications, housing, public utilities, consumer services, and trade:</i></p>		
Regulate the planning and development of residential locations situated in the territories of rural councils	Participate in the resolving of the issues of planning and development of territories of	Organize elaboration of projects of development of residential locations, submit for approval



1	2	3
<p>In accordance with the legislation currently in force take decisions concerning reconstruction and construction of objects of local importance, individual residential and garden houses, garages situated in the territories transferred in the jurisdiction of the administration</p>	<p>residential locations</p>	<p>projects and lists of construction sites, control implementation thereof</p> <p>At the expense of own funds organize construction and repairs of municipal residential houses, objects of the utility sector and social amenities, roads. Attract enterprises, institutions, and organizations notwithstanding the forms of ownership thereof for repairs of roads</p> <p>Manage objects and property under their operating control, establish municipal enterprises, approve charters thereof, appoint managers controlling operations thereof</p>
<p>Approve the locations of all objects of the district, oblast, and federal importance, horticultural businesses, garage cooperatives, and farms situated in the territories of rural councils</p>	<p>Create conditions for provision of transport</p>	<p>Issue permits for construction of objects in their territories, suspend construction works infringing on approved construction projects, plans and regulations</p> <ul style="list-style-type: none"> <li>• Approve routes and schedules of public transport;</li> <li>• attract enterprises and organizations operating in the territories under their jurisdiction to transport servicing of the population</li> </ul> <p>Assist in development of services rendered to the</p>

1	2	3
<p>Register citizens needing better housing conditions and provide to them apartments in houses of the municipal housing stock as instructed by the administration of the town of Borovichi and Borovichesky district</p>	<p>and communications services to the population</p> <ul style="list-style-type: none"> <li>• Ensure maintenance and use of municipal housing stock and nonresidential premises;</li> <li>• conclude privatization agreements with respect to housing</li> </ul>	<p>population on the part of radio stations, communications enterprises, television stations, control the quality of such services</p> <p>Organize maintenance of the municipal housing stock, objects of utility sector and road facilities, operation of organizations involved in trade, public catering, and rendering of consumer services to the population</p> <ul style="list-style-type: none"> <li>• Distribute the municipal housing stock under the respective procedures;</li> <li>• register citizens needing better housing conditions and provide to them apartments in houses of the municipal housing stock;</li> <li>• issue certificates for apartments, resolve the issues pertaining to the sale of houses and apartments, use of non-residential premises, rent of buildings and houses in municipal ownership</li> </ul>
<p>Assist the population in procurement of fuel</p>	<p>Create conditions for operation of facilities supplying the population and municipal institutions with energy, natural gas, and water, procure fuel for such facilities</p>	<p>Undertake measures to provide population with fuel</p>

1	2	3
<ul style="list-style-type: none"> <li>Organize public services and amenities in settlements, attract to the respective works municipal enterprises, institutions, organizations, and the population;</li> <li>control development of territories around the said organizations;</li> <li>organize landscape gardening, protection of vegetation and water reservoirs;</li> <li>participate in organization of recreational sites;</li> <li>give names to streets and other parts of settlements;</li> <li>assign house numbers</li> </ul>	<p>Work on development and landscape gardening of territories, including construction and maintenance of ponds, planting of parks, control over the exterior appearance of buildings, kiosks, outdoor advertisements, etc.</p>	<ul style="list-style-type: none"> <li>Organize development and landscape gardening of settlements;</li> <li>participate in organization of recreational sites;</li> <li>give names to streets;</li> <li>assign house numbers</li> </ul>
Maintain cemeteries and other burial sites, including military memorials;	Maintain cemeteries	Maintain cemeteries
Organize domestic waste disposal	Organize road and street cleaning, disposal of domestic waste	

*4. In the sphere of health care, education, culture, physical culture and sports, and social protection of the population:*

<ul style="list-style-type: none"> <li>Assist in organization, maintenance, and development of municipal establishments providing preschool, basic general, and professional education, health care institutions, ensuring of the sanitary safety of the population;</li> <li>assist in resolving the issues pertaining to provision of vehicles and control transportation of students to educational establishments from neighboring residential localities;</li> <li>participate in organization of work of municipal social and cultural institutions</li> </ul>	<ul style="list-style-type: none"> <li>Ensure maintenance of health care institutions;</li> <li>ensure maintenance of establishments providing preschool, basic general, and professional education;</li> <li>create conditions for functioning of organizations of culture, physical culture and sports, organization of recreation of the population</li> </ul>	<ul style="list-style-type: none"> <li>Coordinate work of social and cultural institutions within their competence;</li> <li>ensure procurement of materials and equipment for such institutions;</li> <li>assist in organization of career education and occupational guidance of pupils</li> </ul>
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1	2	3
<p>Undertake measures aimed at the creation of conditions necessary to ensure the functioning of cultural institutions, mass media, development of physical culture and sports, organization of entertainments and performing arts</p>		
<p>Assist residents of rural councils in preparation of documents necessary for state pensions and municipal allowances</p>		<p>Assist residents with respect to assignment of pensions and admission to social welfare institutions</p>
<p>Assist in organization of public works in the sphere of development of territories, construction and repairs of roads, buildings, and facilities aimed at creation of jobs for the population</p>		<p>Organize paid public works in the sphere of development of territories, construction and repairs of roads, buildings, etc aimed at creation of jobs for the population</p>
<p>Assist disabled persons, families, which lost breadwinners, senior citizens in need of home care to improve their housing, material, social, and living conditions; participate in arrangement of admission of citizens in need to social welfare institutions</p>		<p>Undertake measures aimed at the improvement of housing, material, social, and living conditions of the people eligible for social benefits;</p>
<p>Participate in the implementation of district programs of social support of the poor</p>		
	<p>Participate in the measures aimed at the ensuring of the sanitary safety of the population</p>	
	<p>Participate in the measures aimed at protection of the environment</p>	

Exercise control over maintenance of historical and cultural sites situated in the territories of rural councils

- Organize registration of children left without parental custody and non-adults deprived of normal care in their families, undertake measures aimed at the placement of such non-adults in ward, adoption, their transfer to foster families, to care establishments or institutions of the social safety net, carry out monitoring of how well custodians and guardians perform their duties;
- take measures aimed at the maintenance of the living space assigned to orphan non-adults placed in ward and assignment of such living space in the cases stipulated by the legislation of the Russian Federation currently in force

Take measures aimed at the placement of children left without parental custody in orphanages, boarding schools, and foster families; appoint custodians and guardians and monitor how well they perform their duties

*5. In the sphere of law enforcement and protection of civil rights and liberties:*

- Organize the activities of the public commission for juvenile affairs;
- assist the activities of other nongovernmental organizations

Ensure the observance of federal and regional laws, other governmental acts, the charter of the town of Borovichi and the Borovichevsky district, protection of civil rights and liberties in the territories of rural councils; exercise control over the implementation of decisions taken by the Duma of the town of Borovichi and the Borovichevsky district, resolutions and instructions of the administration of the town of Borovichi and the Borovichevsky district on the part of municipal enterprises, institutions, organizations, and citizens

- Ensure the observance of laws, protection of civil rights and liberties;
- exercise control over the implementation of decisions taken by the Duma, the administration of the Zavodoukovsky district on the part of municipal enterprises, institutions, organizations, and citizens

1	2	3
<p>Take the measures envisaged by the legislation with respect to meetings, demonstrations, sports, entertainment, and other public events</p>		<p>Acting within their competence, impose administrative penalties on citizens and officials for administrative offences</p> <p>Take the measures envisaged by the legislation with respect to meetings, demonstrations, sports, entertainment, and other public events</p> <p>Organize reception of citizens, as well as consideration of complaints, applications, and proposals submitted by citizens and take respective appropriate measures within their competence</p>
<ul style="list-style-type: none"> <li>• Assist in the maintenance of law and order;</li> <li>• assist militia, traffic police, fire fighting services in performance of their duties, selection of candidates for posts of district militia officers;</li> <li>• provide premises for reception of citizens to district militia officers</li> </ul>	<ul style="list-style-type: none"> <li>• Participate in the measures aimed at the maintenance of public order;</li> <li>• take measures aimed at the ensuring of fire safety;</li> <li>• resolve issues pertaining to the prevention of emergencies and protection of the population from such emergencies</li> </ul>	<p>Assist militia, traffic police, fire fighting services in performance of their duties</p>
<p>Take appropriate measures envisaged by the legislation in the cases of natural calamities, ecological catastrophes, epidemics, epizootic diseases, fires, and mass riots aimed at the saving and protection</p>	<p>Perform notary functions in accordance with the legislation</p>	<p>Perform notary functions in accordance with the legislation</p>

1	2	3
<p>of lives, protection of citizens' health and rights, maintenance of law and order, ensuring of operation of municipal enterprises, institutions, and organizations; organize fire fighting measures</p>		
<p>Organize preparation for and conduct of meetings of citizens</p>		
<p>Assist law enforcement agencies as concerns control over the observance of the passport and visa regulations on the part of the population, as well as issuance of registration documents for citizens residing in residential localities of rural councils and visitors arriving at the territories in their jurisdiction</p>	<p>Carry out registration of citizens</p>	
<p>Carry out registration of voters residing in the territories of rural councils and present information about voters to the administration of the town of Borovichi and the Borovichesky district Assist district election commissions in the course of elections and referendums</p>		
<p>Keep farm books, annually submit reports concerning livestock owned by citizens, size of the population, availability of the housing stock</p>		
		<p>Lodge claims with courts or arbitration courts as concerns nullification of acts issued by governmental agencies, enterprises, organizations, and institutions infringing on the rights of territorial units, as well as the rights</p>

1	2	3
Hand citizens certificates confirming their identities, family and property statuses, other certificates envisaged by the legislation	Organize registration of births, marriages, and deaths	and lawful interests of citizens residing in the respective territories  Hand citizens certificates confirming their identities, family and property statuses, other certificates envisaged by the legislation
Organize the work of village chairpersons in rural residential localities		
Conduct primary draft registration of citizens, notification of citizens as concerns calls issued by military commissariats and ensure the timely appearance of the draftees	Ensure draft and draft registration	
Conduct registration of births, deaths, and marriages and perform notary functions in accordance with the legislation currently in force;		
Carry out the measures concerning civil defense, mobilization preparedness, reservation for mobilization period, and prevention and liquidation of emergency situations as stipulated by law;		
Resolve other issues in their jurisdiction in accordance with the legislation		



## Annex 6.2. Sizes of the Staffs of Local Administrations in Municipal Entities of the Settlement Type of the Kaluga and Tyumen Oblasts

Municipality	Region	Size of the population, thous. residents	Size of the staff of local administration, persons	Size of the staff of local governments per 1 thous. residents, persons
Knyazhevsky rural council	Tyumen oblast	0.5	6	12.0
Nizhnepysheminsky rural council	Tyumen oblast	1.1	6	5.5
Bebelevsky rural council	Kaluga oblast	1.1	5	4.5
Kamensky rural council	Tyumen oblast	1.6	6	3.8
Andreyevsky rural council	Tyumen oblast	1.7	8	4.7
Ugorskaya volost	Kaluga oblast	2.5	18	7.2
Kulakovsky rural council	Tyumen oblast	3.1	11	3.5
Chervishevsky rural council	Tyumen oblast	4.8	13	2.7
Urban type settlement of Detchino	Kaluga oblast	5.6	14	2.5
Urban type settlement of Polotnyany Zavod	Kaluga oblast	5.6	10	1.8
Town of Zhizdra	Kaluga oblast	6.0	10	1.7
Kaskarinsky rural council	Tyumen oblast	7.9	16	2.0
Town of Yermolino	Kaluga oblast	11.0	14	1.3
Urban type settlement of Vorotynsk	Kaluga oblast	11.7	16	1.4
Town of Kremenki	Kaluga oblast	12.4	17	1.4
Town of Belousovo	Kaluga oblast	12.6	10	0.8
Town of Sosnensky	Kaluga oblast	14.5	19	1.3
Settlement of Borovskiy	Tyumen oblast	15.5	23	1.5
Town of Kondrovo	Kaluga oblast	17.4	15	0.9
Town of Kozelsk	Kaluga oblast	20.7	12	0.6
Town of Balabanovo	Kaluga oblast	21.8	32	1.5
Town of Maloyaroslavets	Kaluga oblast	30.4	48	1.6

## **Chapter 7. Results of the Analysis of Different Models of Territorial Structure and Organization of Public Services Delivery**

### **7.1. Territorial Model of Local Self-Governance and Delivery of Public Services**

The examination of organizational forms and mechanisms of management of public services delivery has not expose a direct connection between the parameters and model of the territorial structure. Thus, the following four models of provision of the housing and communal services (HCS) were singled out:

- Multisectoral HCS enterprises that deliver the whole complex of services related to the housing fund maintenance and repair, water supply and heating, canalization, etc.;
- specialized HCS enterprises whose core operation area is a single service or a complex of inter-related services (heating systems, water supply and canalization, a housing maintenance enterprise, etc.);
- municipal enterprises under local administrations;
- HCS staff in the structure of local administrations.

Interestingly, specialized enterprises appear to the greatest extent characteristic of urban localities, regardless of whether they form an element of the district structure, or exist as independent municipal entities, while multisectoral HCS enterprises are a widespread form in the frame of any type of territorial structure. Municipal institutions under local administrations or the inclusion of the HSC staff in the structure of the administration appear most characteristic of rural administrations, regardless of whether they form independent municipal entities, or structural subdivisions of the district. At this point, it should be noted that there has recently been an increasing number of refuses of the practice of inclusion of the HCS staff into the structure of local administrations, as the public prosecutor's office has began to appeal against such decisions. There also are oblast communal enterprises in some regions. They are established in the form of State Unitary Enterprise (SUE) (such as Oblvodokanal in Kaluga oblast or multisectoral enterprise "Novzhilcommunservic" in Novgorod oblast), or founded as pri-

vate companies, albeit operating under the aegis of the oblast administration. A number of municipalities do not deal themselves with the organization of delivery of a part of housing and communal services, but delegate the functions to the noted companies.

The research has failed to expose a direct proof to the fact that management of HCS in settlement localities is complicated by an insufficient economy of scale. However, there exist indirect indications to the situation. Apparently, that is one of the factors that determine the crisis state of the HCS enterprises in the overwhelming majority of the examined settlement municipal entities. However, as practically all the aforementioned forms of organization of the HCS services delivery may not be considered sufficiently efficient<sup>57</sup>, the question as to whether one can account possibilities for and forms of economies of scale in this particular case remains unanswered. The research has exposed yet another challenge in this area— that is, a stronger pressure regional energy monopolists exercise on settlement municipalities. In their agreements with regional energy and gas companies, local administrations have to assume responsibility for both the timely and full provision of budget subsidies and ensuring the 100% collection of the respective payments from the local population.

As concerns education, health care and culture, providing the institutions that deliver the respective services have the status of independent legal entity, the territorial organization of local self-governance does not exert a substantial influence on their operations. In the examined regions, most such organizations enjoy such a status, while in numerous cases they share a centralized accounting office. This does not mean, nonetheless, that all the regions practice the same system of organization of education and health care. Thus, sources of financing of the services and division of responsibility for that between different levels of the budgetary system substantially vary from region to region.

Such diversity can be exemplified by medical and obstetrical offices (MOF), the structures in an immediate proximity to local residents, that provide medical services on the spot. Notably, while MOFs are dispersed across a region's territory, they exist in practically every municipal entity and do not create the so-called "transfer effects". In the ma-

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<sup>57</sup> This issue is discussed in a greater detail in the next section where we consider the impact the territorial structure has on the HCS reform and the social sphere restructuring.

jority of the examined regions, the settlement tier does not exercise the respective control and financial functions. In Kaluga oblast, MOFs, as a part of the healthcare system, fall under the governmental powers and are funded by districts even when they are located in settlement municipalities; in Tyumen oblast, it is the regional government that has assumed the function of financing their operations. Municipal entities expressed ambiguous opinions about such a centralization. On the one hand, municipal administrations believe this arrangement ensure a better protection of medical attendants and selection of a more qualified staff, while on the other, this compels the MOF staff to solve all the administrative issues at higher-level echelons of power (for instance, in Tyumen oblast, they have to go to the oblast capital) and neglect local residents' needs (the MOFs stop operating much earlier than scheduled. As concerns Novgorod oblast, despite prevalence of the district model there, the organization of MOFs functioning in many cases proved to be more decentralized. In a number of districts, it was rural councils that funded MOFs partly or in full; plus, the councils found themselves in a position to influence decisions on their staffing. In Astrakhan oblast, the organization of MOFs' operations falls under the powers of the settlement level.

It is worthwhile noting that the standardized powers with respect to provision of MOFs' operations were in a fairly substantial conflict with the actual responsibilities of different tiers of power. Numerous settlement municipalities, as well as rural councils, noted that being short of funds transferred "from the top", local authorities in any case had to fund refurbishment of MOFs, buy medicines, even if that did not constitute their formal responsibility. Sometimes, the source of such financing was found in the population's self-taxation.

As far as the accessibility of services to the population is concerned, the analysis of different models of territorial structure equally failed to provide unambiguous results. There is no reason for drawing the conclusion that the settlement model in all the cases results in a greater proximity of the delivery of services to the population, while the district model – to its distancing. This does not happen under the district organization of local power, when the interaction with local residents is dispersed across the district's territory, while the functions not directly associated with the residents (for instance, documents processing) are

centralized. Thus, in a number of districts in Tyumen oblast social assistance officers are in constant presence at every rural administration. In other cases the local administrations are at hand to help the local residents to file documents to receive social assistance, while they have to go to a district center only in the event a disputable situation arises. The same is noted with respect to a number of government powers. Thus, as in Kaluga and Astrakhan oblasts the registration of changes in the civil status was delegated to the district level, in Novgorod oblast this particular function was re-assigned to rural councils (which is stipulated in municipal entities' charters).

It should be emphasized that certain forms of organization of provision of municipal services in the district frame indeed lead to deterioration of their accessibility to the population. To cite a particular example, in Shimsky district of Novgorod Oblast, a multisectoral housing and communal enterprise has its local offices only in 2 rural councils out of 12, with the others being serviced from the settlement of Shimsk, while the housing and communal facilities are located within 70 kilometers around the settlement. It is the factor of territorial dispersion that forms the reason for settlement municipalities in Limansky district of Astrakhan oblast opposing the centralization of the housing and communal sector on the district level. They argue that such an arrangement makes it impossible to ensure the operative control over the situation in every settlement ("they will not make it on time"- argue they). By contrast, in Yalutorovsly district of Tyumen oblast, the establishment of multisectoral HC enterprises has not resulted in liquidation of local HC offices in the settlements.

However, by itself the presence of municipal power on the settlement level does not warrant a greater availability of municipal services to the population. This problem appears particularly dramatic in such areas as public security and fire prevention. For instance, according to information from rural councils of Dzerzhinsky district of Kaluga oblast, there is only one local policeman for 3 rural councils, and, if it were not enough, he spends 3 days a week in the district center. There is no police at all in settlement municipal entity Bogandinsky in Tyumen oblast, while the nearest police office is within 20 kilometers from there, in a neighboring municipal entity. Practically all the districts face a dramatic challenge of fire fighting, for the number of fire brigades is insufficient, they are lo-

cated too far from each other and can hardly be contacted by phone. However, not all the settlement municipalities have found a remedy to the problem: for instance, in the event of fire in Chervishevsky municipal entity of Tyumen district, the fire brigade should be called from as far as the city of Tyumen.

The municipal entities' ability to unite their efforts to ensure a greatest possible effect or contract external service suppliers forms a critical factor that ensures the efficiency of organization of provision of municipal services. This enables municipalities to overcome "constraints of scale" that are in existence in the frame of settlement municipalities and ensure a greater flexibility of services delivery on the district level. The research demonstrated that the regions in question appeared very conservative with respect to practicing these forms, and their potential was clearly underused. For instance, settlement municipalities of Nizhnetavdinsky district of Tyumen oblast had failed to cooperate to build a local morgue and it was built eventually only upon introduction of the district model. In Kaluga oblast, several municipalities for some time had been jointly financing an instant alcoholic rehabilitation facility, but that form of cooperation came to an end rather soon. In Leningrad oblast, the town of Gatchina and Gatchinsky district jointly finance the town hospital in proportion 70 to 30, but both the proportion and following the schedule of financing have always formed a source of permanent conflicts between the town and the district. Furthermore, the inefficiency of such mechanisms had formed an argument in favor of the inclusion, in the municipal reform framework, of the earlier independent town into the composition of the district.

As concerns contracting external service suppliers, in most cases this particular mechanism works steadily, only providing the suppliers are local oblast enterprises, or they have been established under the oblast government's auspices and relations between them and their customers are secured by means of administrative pressure, with formal contractual relations playing no fundamental role. Thus, Valday district of Novgorod oblast once entered in a contract with an oblast ground transportation company that regulates specific routes, fares and extra routes to local residents' summer countryhouse compounds. Notwithstanding the contract, the inclusion of new villages in bus routes implies the process of administrative bargaining, which does not result

in a modification of the contract. The survey failed to find success stories about enterprises of one municipal entity delivering services to another. The mayor of municipal entity "Detchino" of Kaluga oblast was trying to conclude an agreement with a municipal HC unitary enterprise of the town of Maloyaroslavets, but eventually failed to strike the deal. Similarly, examples of attraction of the private sector to provision of municipal services appeared rather unique and will be considered in a greater detail in the next chapter.

Another significant challenge in the area of inter-municipality cooperation and shaping a territorial structure is how to compensate for "transfer effects", i.e. the consumption of services a given municipal entity delivers to residents of others. However, given that the actual formation of the revenue part of municipal budgets takes place on the regional level, this particular problem is not too critical, as the respective additional costs are taken into account in the course of drafting the budget. The survey managed to identify just a solitary case of the local administration's attempt to consider this effect, but that occurred on the rural council area, rather than in the municipal entity frame. There is no school in Polotnyanozavodsky rural council of Dzershinsky district (Kaluga oblast), and children there are compelled to consume services of a school located in another municipal entity – that is, the settlement called "Polotnyany zavod". The rural council practices self-taxation to ensure a small but regular assistance to the school: more specifically, the local administration helps the principal to hold celebrations and paid for sanatorium treatment for one of schoolteachers on Teacher's day.

The analysis conducted in the course of the survey demonstrated that while great hopes were laid on inter-municipality cooperation in the conditions of the municipal reform, it would likely to face serious challenges. The objective conflict underlying the inter-municipality cooperation mechanism, which was exposed on the basis of the analysis and international experiences, high risks associated with honoring contracts so characteristic of Russia's economy on the whole, nascent institutional mechanisms in this particular area do not allow the prognosis of a widespread introduction of inter-municipality cooperation into the municipal entities' operations on implementation of law No. 131-FZ.

## **7.2. Territorial Model of Local Self-Governance and Introduction of New Approaches to Municipal Services Delivery**

In the course of the research, the authors attempted to find a correlation between the territorial structure of local self-governance and the pace and forms of the housing reform, as well as the social sphere restructuring (primarily that of educational institutions).

The territorial structure obviously appears far from being the sole and, perhaps, most critical factor that underlies the momentum and vector of the structural reforms. In this particular area, a lot depends on the regional administration's policy. Thus, the course of the housing and communal sector reform finds itself under a substantial impact of a regional policy, which, by its intensity, vector and other characteristics varies considerably across the regions in question. This issue was considered in a greatest possible detail during the first stage of the research that covered Kaluga, Tyumen and Novgorod oblasts.

*In Kaluga oblast*, the influence the oblast HCS department exerts on the actual functioning of the housing sector was fairly limited and appeared mostly reduced to coordination of tariffs that are set on the local level and control over preparations for the winter period.

*In Novgorod oblast*, the role played by the HCS department was likewise insignificant, but broad powers were mandated to the public oblast unitary enterprise "Novzhilcomservis". Its functions were as follows:

- backing-up the intersectoral cooperation (general supervision, information service, dispatcher service for municipal HCS enterprises);
- control over municipal tariffs at the stage of their formation;
- housing maintenance and provision of communal services in a part of the oblast's territory;
- centralized procurement of fuel and other material resources;
- maintenance of the material reserve;
- manufacturing equipment on the order of the HCS enterprises.

Thus, it is evident that being an economic agent, the enterprise concentrated in its hands both economic and regulatory functions, which clearly conflicts with the prospect for fostering market relations in this particular sector. This conclusion found its proof in the progress in the



situation in this sphere, when in the conditions of preparations for implementation of the municipal reform all the functions associated with the provision of housing and communal services had become concentrated on the oblast level.

In addition, the oblast practiced centralized procurements of fuel, with the respective funds being concentrated in the oblast budget and without being transferred to municipal entities. It was noted "Novzhilcomservis" that procured fuel on the tender basis, while the system of centralized procurements was regulated by agreements between municipal entities, "Novzhilcomservis" and the oblast administration. The agreements are concluded at the stage of the formation of the budget. The advantages of the centralization were seen in the possibility to ensure non-stop fuel supplies during the heating season and stability of payments to suppliers. In the Novgorod oblast, negative effects from the centralized fuel procurement system were somewhat mitigated by the fact that the system *de-facto* was not applicable to economically strong municipalities that were capable of an actual pursuance of an independent policy in this area, as their heating systems ran mostly on natural gas.

It is worthwhile noting at this point that the pilot regions intensively practice centralized procurements of fuel on the regional level, albeit with different mechanisms of their municipal entities' participation in those. Thus, the centralization of fuel procurements apparently appears voluntary in Tver oblast (except for Bezhetsky district that holds tenders on its own) and Leningrad oblast (with the town of Gatchina participating, while Gatchinsky district not participating in centralized procurements) and compulsory in Astrakhan oblast.

In Novgorod oblast, the regional administration seems not to take a pro-active stand with respect to acceleration of the HCS reform. Thus, payments collected from the local residents are fairly poor and in 2002 they covered just as much as a. 60% of the costs of the respective services (with the federal standard of 90%), the collection rate roughly was 87%, with 11.3% of the population receiving housing subsidies. Famous for its successful pro-investment policy, the oblast does not seem equally ambitious to attract investors to its HCS and does not demonstrate any efforts in the area. So, the oblast administration' policy in the HCS area can be labeled as interventionist, rather than pro-reform.

*In Tyumen oblast*, the HCS department established back in November 2001 was vigorously pursuing a reform policy, with the oblast administration clearly favoring the acceleration of all the reform aspects. More specifically, it was pursuing a tough policy aimed at increasing the level of the population's payments for the HCS services, to pursue the goal of accomplishing a two-year transition towards a make-out performance. In 2002, the average oblast-wide level of the population's payments for the housing and communal costs made up 87.4%. The oblast administration coordinated all the tariffs on HCS services and emphasized the task of ensuring a full coverage of the suppliers' respective costs with the tariffs<sup>58</sup>.

Instead of attempts to centralize provision of communal services in the frame of public unitary enterprises, the oblast administration was providing its support to establishment of communal enterprises in the form of joint-stock companies. As of the time of the research, the pioneer enterprise of this type – that is OAO “Vodokanal” in the town of Ishim, had been already established and it had begun entering in agreements with the neighboring rural administrations. It was planned to establish 4 large water-supplying companies in the oblast. The oblast government also encouraged transformations in the management structures of the regional HCS companies, holding tenders on delivery of various services, attraction of the private sector into this particular area, and the rise of condominiums. In some municipal entities, local residents received housing subsidies in the monetary form, and it was intended to accomplish the transition to an analogous system of financing benefits.

In parallel with the comprehensive support to the reforms, the oblast HCS department was holding a serious work on the informational support and monitoring of the situation in the housing and communal sector. More specifically, it was introducing the monitoring system of the financial state of housing and communal companies and reviewing their debts to date.

Yet another function assumed by the oblast administration in the HCS area was the one of investor. The oblast was implementing a large-

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<sup>58</sup> The tariff coordination policy on the oblast level is inherent in many regions, but it often happens that its genuine purpose is opposite – that is, to constrain the rise in tariffs by all means and regardless of economic realities.

scale program of investment in the housing and utility infrastructure. The investments were designated primarily for objects with high costs of provision of services, such as for instance, modernization and replacement of inefficient boiler facilities, which allowed a substantial saving on heating, primarily in the countryside. Underlying each project there was a business plan, while the oblast administration to a certain extent tried to replicate the private investor's behavior, which ensured a serious training effect. Overall, the Tyumen authorities' policy in the HCS area can be characterized as pro-active and focused on acceleration of the reform pace<sup>59</sup>.

The problem of division of factors that affect the HCS reform progress into those determined by territorial structures and factors dependant on other processes has become especially urgent for the Tyumen oblast, as in 2001 it had been undergoing the replacement of the settlement model with the district one, with a concomitant drastic rise of the oblast administration's attention to the HCS reform. According to the oblast and district administrations, the settlement model has created serious barriers to the housing reform implementation, particularly because:

- Being directly dependent on the local population, settlement administrations could and did not want to undertake unpopular measures, such as: raising tariffs and the populations' payments, toughening penalties against those who failed to pay the bill. That resulted in a catastrophic financial position of the HCS;
- Local administrations did not appear qualified enough to pursue a sound tariff policy and the energy-saving one;

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<sup>59</sup> Such a pro-reform behavior of the oblast authorities has a clearly positive effect, but there exists a obvious conflict between the pro-market nature of the reforms underway and an aggressive administrative pressure the administration exercises in this regard which manifests itself, for instance, in the centralization of a number of municipal functions (in particular, it was planned to establish a single oblast tariff agency and control financial flows). This conflict may manifest itself in fairly dramatic forms in the future (for instance, should the ideology of maintaining tariffs on the market level be replaced by the eagerness to decelerate their rise by any means). Thus, while short-term effects from the current HCS policy in the oblast have been fairly successful, its long-term consequences appear rather uncertain.

- The dispersion of funds did not allow a timely preparation for wintertime and capital refurbishment of the housing fund, while HCS resources could be misallocated.

There indeed exist certain proofs to the fact that the settlement model generates less favorable conditions of the HCS reform, albeit the available information appears ambiguous. For instance, in some settlement municipal entities, there existed problems with organization of management of the housing and communal sector that were generated by an insufficient qualification of the executive power, such as, in particular:

- Lack of clarity in identification of the legal form of operations of an organization that delivers the HCS services (a municipal unitary enterprise enjoying the rights of an agency);
- Defects of the tariff regulation mechanisms (a part of costs are not included in the tariff at all);
- Inability to organize collection of payments from the population for the consumption of the HCS services (with payments collected accounting for no more than 10% of the total volume of financing of the sector).

The research exposed analogous problems on the settlement level in other regions, too. Thus, in rural settlement municipalities in Astrakhan oblast, private houses often happen to consume heating generated by a school boiler facility and, as there are no tariffs for this particular service, the residents *de-facto* consume heating for free.

*Table 7.1* displays data on the share of expenditures on HCS in local budgets in Kaluga and Tyumen oblasts. The Table highlights that in Kaluga oblast, in the districts with settlement municipalities in their territory, the respective share of expenditures is substantially greater than under the district model. An analogous situation is noted in Tyumen oblast, where by 2002 settlement municipalities had remained only in the territory of Tyumen district. However, the Table also demonstrates that when the settlement model had dominated the oblast, in the given district the share of expenditures on HCS, anyway, was considerably greater than in other territories and was decreasing at a lower pace. Perhaps, it was affected by some other factors that were not directly associated with the model of territorial organization.

Table 7.1

**The Average Share of Expenditures on HCS in Local Budgets  
by the Sample of Municipal Entities, 2001-2002, as % of Total Amount  
of Expenditures**

<b>Sample of municipal entities</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
<i>Kaluga oblast as a whole</i>	n/a	20.8	18.4
District-level municipalities	n/a	18.2	13.8
Districts with the two-level structure of local self-governance	n/a	22.1	22.4
<i>Tyumen oblast as a whole</i>	17.0	14.4	11.9
All the districts except for Tyumen district	16.7	14.1	11.7
Tyumen district	23.2	21.1	17.8

*Source:* the 2000–2001 reports on execution of budgets of cities and districts, RF MinFin.

The transition from the settlement model towards the district one in Tyumen oblast was indeed accompanied by an improvement of the HCS's performance and acceleration of the housing reform. The population began to increasingly pay for the housing and utility services, the payment discipline was growing, and the financial state of the sector was improving and it was undergoing a vigorous technical reconstruction. Representatives of different levels of government noted the correlation between positive changes and the transition to the district model. Thus, the head of Nizhnetavdinsky rural council (the ex-head of an independent municipal entity) argued that while in the past the money allocated for HCS had been simply thrown away, now there were possibilities for a more sound policy: heating pipelines were being modernized, boiler facilities were fully prepared for the winter, while in the past the preparations had been lasting until the first snow, there were experts that could draft a business plan and provide justification for allocation of funds, while under the settlement model finding qualified staff had always posed a problem. All those improvements have undoubtedly played a positive role, but results of the analysis do not allow arguing that the district model unequivocally secures better conditions of reforming the HCS.

Thus, the research exposed reluctance of administrations of a number of settlement municipalities to increase the level of the population's payments for the HCS services and/or tighten the payment discipline. Interestingly, they appeared equally reluctant to employ the housing subsidy mechanism as the form of assistance to socially vulnerable

strata of the population. The district level also displayed examples of such a policy. Thus, *in Zavodookovskiy district of Tyumen oblast*, the share of the population's payments for the HCS services in 1999–2001 remained fairly low (40% in 1999–2000 and 60% – in 2001), with only 3–5% of families receiving housing subsidies. It was only in 2002 that the respective level of the population's payments increased up to 90%, while the share of those receiving housing subsidies rose up to 13%. Given the background, settlements do not appear unanimous in terms of policy options: for instance, *in municipal entity Borovskoye*, the population covers 90% of costs of the HCS services, with the collection rate being over 90%, while 30% of families receive housing subsidies. However, it should be noted that such trends on the settlement level appear characteristic primarily of urban settlements.

The situation with tariff regulation appears equally unambiguous. There are numerous evidences that settlements indeed undertake measures to artificially inhibit the soaring tariffs: more specifically, for several years they abandoned the tariff revision policy or did not include profit in the composition of a given tariff. The policy of constraining the tariff rise for the HCS services has become widespread and no longer monopolized by the settlement municipalities. Thus, the local administration of *Shimsky district of Novgorod oblast*, where tariff regulation falls within the purview of the municipal council, argued that to have tariffs reach an economically justified level, they had to be doubled, while given that background, as of mid-2003, the local residents covered just as much as 50% of costs of the HCS services. There is information that in some oblasts tariffs are set at a level substantially lower than production costs, even provided they are regulated on the regional level.

Apparently, the transition from the settlement model to the district one has a positive effect on the payment discipline. Numerous settlements are challenged by the problem of organization of collection of payments. Thus, representatives of a settlement municipality argued that their resident mates refused to pay more than 50% of the costs of the HCS services and, upon the transition to the 70% margin, the collection fell drastically, and in 2002 it accounted for between 28 and 42%. There also is information that the situation has improved upon the transition to the district model. Thus, in Isetsk, the collection rate grew from 46 up to 99%. At this point, it should be once again emphasized

that some settlement municipalities appear capable of securing a high collection rate by themselves.

As far as the organization of provision of HCS services is concerned, effects from the transition from the settlement model to the district one appear equally ambiguous. Thus, in *Yalutorovsky district of Tyumen oblast*, the transition took place along with concomitant substantial changes. There were 15 independent municipal entities in the territory of the district. Under the settlement model, the provision of the HCS services was organized within local administrations that effectively failed to keep records of costs for the HCS services, revise tariffs and ensure a better collection of the residents' payments. Once the district was established, a new HCS department was formed in the structure of its administration. The department enjoyed the rights of legal entity and exercised the customer's functions. Today, there are two multisectoral enterprises that provide HCS services: while a private company operates in the northern part of the district, its southern part is the area of responsibility of a municipal enterprise. In parallel with these innovations, the population's payment rates were increased 2-3 times and the department has become keen to increase their collection (albeit with no considerable progress in the area). The administration also undertakes steps to introduce a sound accounting of expenditures on the HCS services and improve tariff regulation mechanisms. However, such an approach is not widely practiced. Thus, once *Golyshmanovsky district* accomplished its transition from the settlement model to the district one, there was no change in the organization of provision of the HCS services – in 16 rural councils (ex-independent municipal entities) the services are still delivered by 2 municipal entities and 15 municipal institutions.

As concerns the change in the number of the HCS staff, in all likelihood, the HCS service delivery reform mostly triggered its rise. While in some regions the growth in the number of employees was insignificant (for instance, in Yalutorovsky – roughly by 10 employees, i.e. by 2% of their original number), it was rather great in other regions.

However, the main challenge associated with the transformation of the organization of provision of HCS services in the frame of the municipal sector lies in the necessity to pick an option from their menu, given all such options appear fairly inefficient. The integration of subdi-

visions that used to deal with the delivery of the HCS services into the structure of local administrations or their organization in the form of municipal institutions takes the housing and communal sector out of the sphere of market relations. Establishment of multisectoral HCS enterprises lowers efficiency of control over the provision of services, its transparency, complicates the accounting of the respective costs and discourages from saving resources. While specialized HCS enterprises lack many of the above deficiencies, they mostly are municipal unitary enterprises and, consequently, face challenges associated with municipal property, administrative regulation and the non-economic intervention in their operations.

The reorganization of the provision of the HCS services in the regions in question in most cases has failed to result in demonopolization of the market for the services and attraction of the private sector. Even if such transformations are underway, they are held primarily in highly urbanized municipal entities, regardless of under which model of territorial organization they fall. Thus, in Tyumen oblast, three towns and Zavodoukovsky district held tenders on attraction of contractors of different property forms to provision of the HCS services. Of 197 condominiums in existence in the oblast, 193 ones were established in urban areas and just 4 – in districts. The attraction of private companies to management and servicing of the housing fund in rural territories was noted only in the aforementioned Yalutorovsky district.

The analogous situation was noted in Novgorod oblast. In the overwhelming majority of its districts there exist multisectoral HCS enterprises, while in single districts there are specialized municipal enterprises (heating companies in 4, water supplying – in 5 districts). In the oblast's territory (exclusive of the city of Novgorod), there are 17 private companies that provide the noted services, while only 5 districts to this or that extent attract private companies. At this juncture it should be noted that in 3 of them the proportion of urban population accounts for over 70%, while in yet another one it is close to 50%. As concerns rural districts, private companies operate only in Novgorod district. The analogous situation is noted with respect to condominiums: they were established in 3 districts, in which the proportion of the urban population exceeds 60%. It should be noted at this point that a high level of urbanization by itself does not warrant the reform success. Thus, while



the proportion of the urban population in Okulovsky and Chudovskiy districts accounts for over 70%, there are no condominiums there and private companies are not attracted to deliver the HCS services.

Plus, not all reform attempts in the area of provision of HC services have proved to be a success. For instance, in Vyborg district of Lenin-grad oblast, the private sector showed no interest in operating on the market for the HCS services, which is why a rural council tried to organize the servicing of a local boiler facility by hiring its staff as individual entrepreneurs. The 5-year contracts were concluded with 5 employees, but because of their negligence, in two years the facility got broken.

So, it can be argued that the problem of the efficient organization of provision of the HCS services in low-urbanized territories is very pressing, while approaches to remedying it are not tangible. Meanwhile, effects from the use of these or those territorial models appear greatly dependent on to what degree mechanisms of provision of municipal services allow to fully capitalize on their positive potential and abandon the frame of their immanent constraints. Given that, in compliance with the new law “On general principles of organization of local self-governance”, the housing and communal services remain under the competence of municipal entities and particularly their “grass-root” level – that is, settlements, the urgency of the problem is yet more dramatic than ever and requires a more detailed and comprehensive analysis in the course of a further research.

As concerns the budgetary network restructuring in the education area, it can take various forms, particularly:

- Decrease of the number of educational institutions;
- Consolidation of several such institutions under the same roof;
- Changing the volume of functions assigned to them;
- Commercial use of a part of facilities they occupied earlier.

The most radical form is diminishing the number of educational institutions by closing down a part of them. This process to a various degree is underway in all the regions in question, albeit at a different pace. Like the aforementioned processes, this one finds itself seriously affected by the oblast administration’s stance on the issue, which seems to form even a greater important factor in this respect than in HCS. Thus, in Kaluga oblast, the governor believed that schools must not have been closed, while parents should have the right to select a school for their

school for their children (which is back-upped by the “School bus” program). As a result, there practically were no school closures in the municipal entities covered by the present research. By contrast, Tyumen oblast displayed a different ideology that was based upon the belief that better staffed and in possession of a more developed material base, large schools could provide a higher-quality education. Basing on such premises, the budgetary network restructuring in the oblast has been far more vigorous than in Kaluga oblast. The Tver oblast administration, too, was far more pro-active in this respect vis-à-vis their counterparts in Kaluga.

The scope of the research has been insufficient to fully confirm or refute the thesis of the territorial structure affecting the process of school closures, while the research made it possible to identify some tendencies characteristic of this particular sphere. Thus, representatives of district administrations in Tyumen oblast claimed that it would have been harder to close schools in the conditions of the settlement model. Indeed, the overwhelming majority of school closures in the frame of the present research fell on districts, however the size of the sample does not allow ambiguous conclusions. The information on Novgorod oblast shows a greater pace of the ongoing restructuring in highly urbanized Borovichi and Starorussky districts. While between 1999 and 2002 of 7 major schools 5 were closed in the former, in the latter the same was done with 4 out of 7 primary schools. However, in this particular case the data are too scarce to consider the tendency to be universal, albeit it can be suggested that a higher quality of education in urban centers helps accelerate the restructuring process. The data on Tver oblast allows assumption that a faster restructuring process appears characteristic of monocentric districts, while this process seems to be more complex in polycentric ones, even provided they find themselves in a harder financial state. As concerns kindergarten closures, this process seems to occur at a pace faster than that of schools closures and it does not depend on the type of the municipal entity.

The research allows identification of challenges and complexities associated with schools closures. The problems also inhibit a more vigorous restructuring. At this juncture the most visible problems arise with respect to transportation. While many regions are introducing “School bus” programs, not all of them have succeeded to have them fully cover

their territory. Plus, as far as school buses are concerned, there is an urgent problem of an efficient logistics. The respective approaches vary from region to region: sometimes the buses are assigned to schools that arrange logistics by themselves, while in some regions the buses are given to rural administrations or transportation companies. These models require a study into their relative economic efficiency and social consequences. In the absence of special school buses, a municipality and a transportation company jointly coordinate a regular bus schedule, which consequently allows transportation of students, or rural councils assume this particular function. However, in addition to transportation challenges which appear merely technical, there exist yet more fundamental problems, primarily social and ethnic ones.

Thus, the administration of *Vorotynsky settlement in Kaluga oblast* considers it appropriate to close a rural school with just a few students located within 7 km. from the settlement. The head of the municipality believes that in this case some students will discontinue attending classes, because some of them are not in a position to go to the settlement-based school, while some parents cannot provide others with decent clothing. Thus, last year, six families residing in the settlement expressed their wish to send their children to a rural school. In Tyumen oblast, the problem is associated with the existence of the Russian and Tatar ethnic schools. Their integration may trigger ethnic and religious conflicts. While some districts there conduct experiments on integration of such schools, this particular problem demands a thorough monitoring and evaluation of the respective effects.

The available information proves that the opportunity for receiving a higher quality education in the educational institutions students begin to attend after the closure forms a critical factor that accelerates school closures.

In any case, for the local administration the closure of an educational institution involves a great deal of work with the population. Its representatives are challenged by the necessity to hold meetings with parents, explain reasons for the closure and, sometimes, organize the parents' visits to the school where children are supposed to be transferred to. However, it is not clear whether or not the decision is indeed made at the local residents' meeting and to which extent the meeting convened

on the issue is representative, for the information on the problem is based on various sources and appears contradictory.

Municipal entities falling under different models of territorial structures also practice other forms of restructuring that are not directly associated with closure of educational institutions. Thus, rather traditional is the combination of school and kindergarten under the same roof. Obstacles to such a combination emerged under the two-tier system of local self-governance that existed in Kaluga oblast. In *Ugorsky volost*, the kindergarten was the *volost* property, while the school - the district one, which made the combination impossible, despite the fact that the two-storey school building was used to provide tuition to just 10 students. Commercial use of a part of a facility forms another solution. In *municipal entity "Bibirevsky rural council" in Kaluga oblast*, a part of the local kindergarten was leased to the post office and the one of the Federal Agency for Media, while in *Shimsky district in Novgorod oblast* the kindergarten restructuring is associated with their transformation into half-day (operating until noon) children care centers.

Other sectors of the social sphere likewise see the emergence of new approaches to provision of services. Thus, *Bezhetsky district in Tver oblast* has managed to retain the number of rural cultural centers, which allows to continue providing the local residents with cultural services, but those facilities are keen to identify ways to survive and extend provision of paid services. In the 3<sup>rd</sup> quarter 2004, the proportion of their extrabudgetary revenues accounted for 19%.

The analysis of implementation of structural reforms in various types of municipal entities allows some conclusions that at the present state of research are hypothetical:

First, the progress in structural reforms finds itself under a fundamentally important influence on the part of an oblast administration;

Second, there exist factors that decelerate the progress in the HCS reform area at the level of settlement municipalities (primarily rural ones), albeit the effect from such factors does not appear universal. The district structure eliminates a part of objective constraints to the transformation of the sector that are characteristic of the settlement model, but that does not warrant an automatic acceleration of the reforms.

Third, it is highly urbanized municipal entities, no matter under which model of territorial structure they fall, that most vigorously implement the structural reforms. However, that does not mean that a high level of urbanization *per se* guarantees the reform implementation. The information on Novgorod oblast (see *Annex 7.1*) illustrates this thesis.

Fourth, specifics of implementation of the structural reforms in low-urbanized municipal entities have been studied rather poorly, and the most efficient ways of their restructuring are not always understood even on the conceptual level. This issue requires a serious additional study.

### **Annex 7.1. Characteristics of District Municipalities of Novgorod Oblast in 2002**

	The proportion of urban population in the total district population ( as %)	Housing fund (condominiums and housing cooperatives (as. m <sup>2</sup> Thos.)	The number of private companies that provide HCS services (as units)	Change in the number of schools (as units)	
				primary	basic
<i>Batesky district</i>	0.0			-2	
<i>Borovichsky district</i>	74.9	51.0	7	1	-5
<i>Valday district</i>	62.7	8.8			-1
<i>Vlotovsky district</i>	0.0				
<i>Demyansky district</i>	35.5				
<i>Ktestetsky district</i>	65.4				
<i>Lyubytinsky district</i>	57.8			-1	-1
<i>Malovichsky district</i>	75.7		1	-1	
<i>Marevsky district</i>	0.0				
<i>Moshenskoy district</i>	0.0			-1	-1
<i>Novgorodsky district</i>	33.6		2	-1	1
<i>Okulovsky district</i>	70.8			-1	-1
<i>Parfinsky district</i>	48.1		4	-1	
<i>Pestovsky district</i>	67.2			-1	
<i>Poddorsky district</i>	0.0			1	-1
<i>Soletsky district</i>	64.8			-1	-1
<i>Starorussky district</i>	70.4	31.8	3	-4	

	The proportion of urban population in the total district population ( as %)	Housing fund (condominiums and housing cooperatives (as. m <sup>2</sup> Thos.)	The number of private companies that provide HCS services (as units)	Change in the number of schools (as units)	
				primary	basic
<i>Khvoyninsky district</i>	38.6				
<i>Kholm sky district</i>	55.6			-2	-1
<i>Chudovsky district</i>	74.9			1	-1
<i>Shimsky district</i>	29.6				

Source: the 2001 RF Goskomstat data on the population; the oblast Administration data on the number of educational institutions.

## **Chapter 8. An Analysis of the Progress in Preparation for Implementation of the Newly Amended Law “On General Principles of Organization of Local Self-Governance in the Russian Federation”**

### **8.1. Legal Regulation of Transformations**

The newly amended Law “On general principles of organization of local self-governance in the Russian Federation” (131-FZ) was passed in October 2003 and should become fully effective as of January 1, 2006<sup>60</sup>. Chapter 12 of the Law entitled “Transitional provisions” highlights on specifics of local self-governance in the transition period and operations by different tiers of government with respect to preparation for the comprehensive implementation of the municipal reform. More specifically, in compliance with the Law, the year 2004 should have seen the following actions on ensuring implementation of provisions stipulated in the new version of the Law:

At the level of Subjects of the Federation it was intended to demarcate municipal entities’ borders and grant them with the status of urban, rural settlement, urban okrug, municipal district, respectively. The deadline of the mission was set as January 1, 2005. As evidenced below, this process appeared fairly complex and pregnant with conflicts (of which experts had long forewarned the government) and it consequently required a complementary legal regulation. In December 2004, the Duma passed Law 186-FZ “On introducing amendments to the federal law “On general principles of organization of local self-governance in the Russian Federation” and ruled that the deadline for setting borders and granting municipal entities with the noted statuses should be moved to March 1, 2005.

The need for solving a number of issues with respect to the re-assignment of powers, property, etc. between the regional and municipal levels in 2004 was associated with provisions of Law No. 95-FZ “On introducing amendments to the federal law “On general principles of organization of local self-governance in the Russian Federation” that

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<sup>60</sup> In two Subjects of the Federation- that is, Stavropol krai and Novosibirsk oblast, the law became effective as of January 1, 2005.

had come in effect on January 1, 2005 (a year earlier than the law on local self-governance).

On the level of the RF Government it was intended:

- until June 1, 2004, to approve the list of territories with a high and low population density;
- until January 1, 2005, to approve procedures of property reassignment between the Russian Federation, Subjects of the Federation, municipal entities, as well as procedures of division of municipal property between different types of municipal entities;
- until January 1, 2005, to submit to the State Duma draft federal statutes on amending the federal laws that regulated granting of local self-governance bodies with individual government powers, as well as the powers they exercise with respect to issues of local significance and those providing local self-governance with the right for judicial protection;
- until January 1, 2005, to approve procedures of and deadlines for producing a transfer (assignment) act that would formulate obligations of the local self-governance bodies arising due to the succession.

The government Resolution of March 3, 2004, approved a timetable of drafting legal statutes needed for implementation of the federal law “On general principles of organization of local self-governance in the Russian Federation”, which provided for the implementation of nine positions in 2004 and particularly drafting two federal legal statutes. The latter implied introducing amendments to federal laws due to the enactment of the new laws on Subjects of the Federation, local self-governance and the public registration of municipal entities’ charters, as well as a series of RF government Resolutions on qualification requirements to heads of municipal financial agencies, relations between tax offices and municipal financial agencies, among others. It was intended to complete the drafting of a Resolution on singling out territories with a high and low population density by April 2004, while that on property division and regulation of succession issues – by November 2004. The government recommended to Subjects of the Federation to approve similar plans, and most of them followed the recommendation.



In practice, however, not all the items of the action plan were implemented, even though most respective legal acts had already been adopted by the time or were nearly completed by late 2004.

Thus, August 2004 saw the adoption of federal Law No. 122-FZ “On introducing amendments to legal acts of the Russian Federation and on recognition of invalidity of some legal acts of the Russian Federation due to the adoption of the federal laws “On introducing amendments to the federal law “On general principles of organization of legislative (representative) and executive bodies of the government power in the Russian Federation ” and “On introducing amendments to the federal law “On general principles of organization of local self-governance in the Russian Federation”. The newly adopted law provided for amendments to more than 150 legal acts of the Russian Federation, while the regulation of a range of issues in the law does not correspond to provisions stipulated in 95-FZ and 131-FZ. For instance, the new law contains amendments to the law ‘On education”, in compliance with which the provision of government guarantees of the citizens’ rights for the public and free pre-school general education, as well as complementary education by means of allocation of subventions to local budget in a volume necessary for the implementation of basic general educational programs falls under the competence of Subjects of the Federation. By contrast, 131-FZ attributes the organization of provision of complementary education and the public free pre-school education to the group of issues of local significance. It should be noted that by contrast to the primary, basic and secondary general education, the law does not provide a reservation about powers on funding the educational process being excluded from the noted group of local issues.

Plus, during the year 2004 the RF government passed another four resolutions: “On procedures of interaction of the state government bodies of the RF Subject and local self-governance agencies with territorial bodies of the federal body of executive power authorized in the area of taxes and levies” (August 2004), “On qualification requirements to the head of the financial agency of the Subjects of the Russian Federation and the head of the financial body of the local administration” (November 2004); “On the authorized federal body of executive power on setting borders of municipal entities” (December 2004) and “On approving procedures of the division of obligations of municipal entities

and completing the transfer (division) act) (December 2004). The government Resolution of May 25, 2004, began to regulate issues of singling out territories with a high and low population density. The Resolution approved the list of RF Subjects and individual districts of the RF Subjects (in their current borders) that fell under the group of territories with a high population density and the list of RF Subjects and their single districts (within their current borders) that were attributed to territories with a high population density.

The bill on the public registration of municipal entities was completed in 2004, but it has not been yet submitted to the State Duma for the approval.

The absence of a legal act that should regulate procedures of property re-assignment between the regional and municipal levels has most heavily derailed progress in the transformations, while in 2004, in the light of preparations for implementation of FZ-95 the process in question was implemented with much gusto.

The critical legislative innovation that substantially affect the preparation for a full-scale enforcement of 131-FZ became adoption of amendments to the Tax and Budget Codes. These statutes regulate such issues as assignment of revenue sources to municipal entities of different types (including the list of local taxes), possible mechanisms of formation of interbudgetary relations, introduction of a temporary financial administration, among others. The laws have changed the concept of the local budget dramatically. Today, it is defined as the form of generation and spending of financial resources over the financial year. The resources are designated not just for securing fulfillment of tasks and exercising of functions that fall under the local self-governance's mandate, but for exercising specific expenditure obligations of a respective municipal entity. The expenditure obligations arise from legal acts and agreements passed on the municipal level. Local self-governance bodies are bound to conduct the register of their expenditure obligations.

However, the new version of the Budget Code has fallen short of specifying all the financial issues stipulated in 131-FZ. Thus, the Budget Code failed to provide adequate forms of inclusion of funds generated by the citizens' self-taxation in local budget revenues.

## **8.2. Demarcating Borders and Designing Municipal Entities' Status: Practices and Challenges**

While setting their municipal entities' borders and status, regions began to face a series of challenges that arose from deficiencies in regulation of these provisions by 131-FZ, as well as objective contradictions between different types of municipal entities. The challenges began to emerge yet at the stage of the formation of municipalities. The transformations to the least extent affected the system of municipal districts – the district structure remained unchanged practically everywhere. Rather, the problems were mostly associated with the formation of two specific types of municipal entities- that is, rural settlements and urban okrugs.

As of the start of the municipal reform, in the overwhelming majority of Russia's regions there were no full-fledged municipalities on the settlement level. In most RF Subjects where the district structure of municipal entities had emerged by the time, this particular niche was occupied by sub-municipal structures – that is, settlements, rural councils, rural okrugs, *volosts*, etc. Given that the head of such a structure was appointed by the district administration and it was funded according to its estimate, as noted above, the actual position of these structures varied substantially from region to region. In some RF Subjects they held a specific intermediate position between subdivisions under the district administration and independent municipal entities, because the appointment of heads of such sub-municipal structures was made upon the local residents' consent, while their powers (fairly broad ones) were stipulated in the municipal entities' charters. Plus, heads of such structures enjoyed a certain liberty with respect to control over financial resources, including both a part of the estimate (when it contained a reserve fund, in this or that form) and funds from self-taxation (where they played an substantial role). In some RF Subjects, on the settlement level there formally existed municipal structures, but in most cases they had no budget of their own and were funded according to the estimate.

In the course of the reorganization of the territorial structure of local self-governance and, particularly, under the development of the system of rural settlements, regions must have considered the following conditions and constraints that took their roots in 131-FZ:

- all the territory of the Subject of the Federation, except for territories with a low population density whose list is subject to the RF Government's approval, is to be divided between settlements;
- the administrative center of the settlement should be located within a day-walking distance from any inhabited location included therein;
- the population, as a rule, should account for over 1,000, while for territories with a high population density rate it should make up over 3,000, provided, however, these conditions are not applicable to independent municipal entities in existence as of the moment of adoption of the Law;
- the list of issues of local significance is stipulated in the law.

As early as at the initial stages of the territorial structure reform had it been understood that the landmarks stipulated in the law were fairly vague and hardly compatible. For instance, it has remained unclear as to how the day-walking distance should be measured and which categories of residents were to be taken into account in the circumstances. By itself this particular criterion was harshly criticized as archaic, plus the requirement to ensure the walking distance in many cases appeared mismatching the necessity to focus on criteria associated with the number of residents in rural settlements. Some regions proposed to replace the walking-distance requirement with the one involving means of transportation. The proposal was rejected, but passing the December 2004 amendments to 131-FZ allowed to somewhat soften the requirement.

Additional complexities in the course of formation of settlements were associated with the fact that the law provided an ultimate centralization on the level of the RF Government of the issue of identification of territories to be included in the list of those with a low population density, thus not being subject to the principle of division of the whole territory between settlements. Notably, the given list could comprise only the Federation's Subjects as a whole or districts within them. Meanwhile, the rural population density rates may vary not only from district to district, but within a given district as well. In some districts, there are territories with localities with just a few residents. Furthermore, even in very populated districts there are practically unpopulated enclaves (reserves, forests, etc.). In such conditions it appears fairly difficult to en-

sure division of the whole territory between settlement municipalities. Plus, such a division appears unsound, as a great part of the territory of single localities appears unpopulated. However, since 2004 the government has undertaken no steps to extend the regions' possibility to identify territories with a low population density rate, in which establishment of settlements is not mandatory.

In addition to the contradictions associated with landmarks for shaping the territorial structure as per the law, the process has exposed yet more fundamental challenges. The fixing with settlements of a certain list of issues suggested the ability of municipal entities of that particular level to exercise the functions delegated to them. However, the number of residents or the walking-distance accessibility *per se* does not create such preconditions. At this juncture, there are other factors that matter: namely, the existence of the respective infrastructure, economic base, etc., though their mandatory presence is not stipulated in the law. The importance of such factors is also intensified by the fact that the country has no record and traditions of organization of an inter-municipal cooperation, while municipal entities treat this particular option of solving issues of local significance with much caution. As noted above, the present research highlighted on attempts of organization of an inter-municipal cooperation. They either proved to be transient and futile, or bore such a degree of conflict that the parties involved were at great pains to find other options of providing their local residents with municipal services.

In the circumstances, while shaping the territorial structure of rural settlements, regions, by and large, adhere to one of the below strategic options:

The first strategy implied retaining the district structure of municipal entities unchanged, regardless of innovations dictated by the new law. The solution was found in forming urban okrugs that completely included the respective district's territory, even when the given district was mostly rural. Thus, for instance, in Sakhalin oblast there appeared 19 urban okrugs that substituted for 19 rural districts.

Not violating the letter of the law, such an approach evidently conflicted with the concept for the municipal reform. That is why amendments to 131-FZ specified the definition of the urban okrug in such a manner, so that to put an end to its "extended" interpretation. In com-

pliance with the amendments, the territory of an urban locality (including urban okug, among others) may comprise territories, including rural ones, which, according to the general plan, are designated for the development of its social, transport and other infrastructure. In the event the city (settlement), which should be granted with the status of urban locality, does not have a general plan set according to standard procedures, or its current territory abandons the city boundaries, as well as in the event there are territorial disputes between the city (settlement) and other municipal entities, the composition of territory and borders of the respective urban locality is set:

On the basis of the historically emerged territory of the city (settlement), as well as according to borders of land lots allocated for urban development and territories designated for the development of the social, transportation and other infrastructure of the city (settlement).

According to borders of territories and land lots that were set by legal acts which read that the disputed territories and land lots belonged to the territory of the city (settlement).

The regions covered by the present research did not adhere to this particular strategy. However, the noted amendments generated trials in other regions, with lawsuits filed on the approaches used not matching the effective law. The final outcome of such trials has not been tangible. The situation proved to be especially complex in the event a new structure was fixed by means of referendum (as occurred, for instance, in Moscow oblast).

The second strategy implied shaping rural settlements on the basis of the already existed sub-municipal structures – that is, rural councils. As far as the studied regions are concerned, Novgorod oblast can exemplify the use of such an approach as a basic one. In Novgorod oblast, settlement municipalities arose on the basis of sub-municipal structures. In that case there was no trouble with ensuring the walking-distance accessibility, however the pre-set population standards were not always observed with. Such an approach formally meets the legally set requirements and considers historically emerged bonds. That said, however, it may trigger dire consequences, should the Law be implemented in full, because its framework does not take into account an actual capability of newly created structures to solve issues of local significance fixed with them, nor it would succeed in considering their

cadre, infrastructure and economic capacity. Plus, given other conditions being equal, this approach is associated with the most considerable rise in administrative costs and administrative staff.

The third strategy proceeded from the need to take into account the whole complex of factors that would ensure the most favorable starting conditions for rural localities' operations. It took into account both the noted formal criteria as per the law and transportation accessibility, the existence of infrastructure, and economic base. As a result, the number of settlements in regions that promoted this particular strategy proves to be considerably less than the number of the pre-reform sub-municipal structures. In the circumstances the localities' capacity to solve local issues grows, while their expenditures on the administrative and management staff rise to a lesser degree, but the principle of walking-distance accessibility falls a prey to the above, for single localities can find themselves located within more than 30 km from the administrative center. Thus, a possible effect from this approach can be a distancing of the power from the population, rather than its proximity, as it was proclaimed in the course of adoption of 131-FZ. In such conditions, a special mission will be to provide municipal services to residents in the territories of earlier existed rural councils that, according to the current reform, are subject to liquidation.

Tver oblast exemplifies rather a sound implementation of this strategy. The process of development of the territorial structure of local self-governance in the oblast's territory was as follows.

Seeking the implementation of the local-self governance reform, the oblast administration formed a Task Force on designing proposals on the legal regulation in the local self-governance area. The group was led by the oblast deputy governor, and it consisted of representatives of the oblast administration (more specifically, the territorial and legal departments under the oblast governor, and department of finance), deputies of the oblast parliament, and consultants. The group dealt, in particular, with the issues of territorial structure of local self-governance.

Proposals on setting localities' borders were formed on the municipal district level. In addition to the population and distance between localities and the respective central locality, the justification for a given territorial structure should have comprised issues of transport

accessibility, sufficiency with infrastructure, and the existence of the economic basis, as well as the account of historically emerged ties.

On the district level, heads of rural okrugs contributed to the work on designing a new territorial structure. Different districts arranged for a different manner of work with local residents. In some regions, residents' meetings were convened only in the event of a conflict situation (for instance, in villages that neighbored the town of Bezhetsk whose population was to get deprived of benefits they had been eligible for as rural residents). By contrast, other districts held such meetings to debate practically ever decision on transforming their territorial structure. Thus, by contrast to a number of other Subjects of RF, Tver oblast kept local leadership and activists informed and even had them contribute to a certain extent to the decision making with respect to the implementation of the new municipal laws, albeit it was district administrations that designed basic options.

The ultimate decision implied the establishment of 362 municipalities on the settlement level, of which 44 were supposed to be urban. The decision fell short of observing with the requirement of the walking-distance accessibility, as the focus was made on the existence of preconditions of the settlements exercising their mandates – that is, the social infrastructure and economic basis. The authorities were keen to consolidate rural okrugs that lacked an economic basis with those that had preconditions of economic development.

Meanwhile, it is not clear how governance should be organized in the territories where rural okrugs were liquidated. Some districts have already made a preliminary decision that there would remain experts on the spot who would continue working with local residents. Such an option was debated at residents' meetings. Other districts consider various options, including the use of objects of the social sphere (schools, medical-obstetrical facilities) as communication centers between the population and the local administration and regular visits of representatives of the latter to the former rural okrugs, among other options.

The number of municipal entities of the settlement level in Tver oblast has fallen as much as twice vis-à-vis the number of sub-municipal structures, and roughly the same picture is noted in a number of regions that pursued this particular strategy.



Evidently, each of the above strategies of shaping the territorial structure in the countryside bears immanent contradictions, which, anyway, will manifest themselves in the course of a full-scale implementation of the municipal reform, thus complicating governance processes in new conditions.

While shaping their territorial structures, many regions faced an equally pressing challenge with respect to urban okrugs. The initial situation with urban localities that do not fall under the category of regional capitals or large research towns differed from region to region and emerged rather chaotically. While in some Subjects of the Federation such localities mostly were independent towns of the so-called "oblast significance" (for instance, in Leningrad oblast), in other Subjects their overwhelming majority formed a part of a district (Novgorod oblast). There also were regions where being practically equal in terms of population and economic capacity (including those with the population between 80,000 and 100,000), towns in some cases formed independent municipal entities, while in other cases were a part of a district. And if the confusion was not complete enough, relatively small urban settlements with up to 20,000 residents could form independent municipalities (for instance, in Kaluga oblast). In the event a town was a part of a district, there usually were no special sub-municipal structures in its territory, with the district administration directly exercising the town management functions.

Provisions that regulate the establishment of urban okrugs caused heated debates on the respective clauses of the law on local self-governance. The provisions underwent numerous modifications in the course of the designing of the law. As a result, the text of the statute has no longer contained any references to the population quantity criteria of formation of urban okrugs, while the statute reads that an urban locality that appears a valuable municipal entity should form an urban okrug, if the law of the RF Subject enacted until February 1, 2005 (in compliance with recent amendments, the deadline now is March 1, 2005) does not state otherwise. While making its decision on the issue, the region was bound to follow two provisions: first, both the urban locality and the territory of the neighboring district must have had the social, transport and other infrastructure necessary for their independent solving of issues of local significance and exercising individual government mandates.

Second, local residents should give their consent to granting or canceling the status of urban okrug to their locality. The situation was further complicated by the fact that the clause of the Law in compliance with which it is mandatory to request the population's consent should come in effect only as of January 1, 2006.

Plus, the granting of urban localities that were not valuable municipal entities with the status of urban okrugs required both the mandatory account of the aforementioned infrastructure factors and mobilization of the consent of residents of both the urban locality and the municipal entity, of which the former was a part.

The situation with granting urban localities with the urban okrug status progressed as follows: as of today, the authors are unaware of a single case when, not forming an independent municipal entity, an urban locality was ever granted with the noted status, even providing a mature infrastructure allowed both the urban locality and the neighboring district to solve issues of local significance. The procedure has proved to be overly sophisticated and costly to be implemented. As concerns independent municipal entities, the situation emerged in different ways there. In some regions, for instance, Tver oblast, they were automatically granted with urban okrug status, while other regions practiced their mass inclusion in the district structures, even when those were fairly large cities with the long-standing tradition of autonomy. Thus, in Lenigrad oblast, at the previous stage of development of local self-governance, in compliance with the local law, localities enjoyed the possibility for forming independent municipal entities. It primarily was urban localities with a high level of budget sufficiency that seized on the opportunity.

Following the new law, the local self-governance reform attempts have resulted in the situation in which practically no urban okrugs were formed in the oblast's territory, while ex-independent municipal entities were included in the district structures as urban localities. The oblast authorities seemed not care of to the local *vox populi* on the issue.

As in the first case, both decisions obviously bear seeds of future conflicts. Once an urban okrug is created on the basis of an urban location that has played a role of the district center, the district finds itself deprived of any serious revenue sources, while there arise challenges associated with the joint use of social infrastructure objects located in

the urban territory. However, the alternative – that is, inclusion of towns in the district structure as urban localities appears equally pregnant with problems. In this particular case it is not hard to predict inevitable conflicts and competition between the district head and the one of the district center, which can affect decision-making and implementation processes that require their cooperation, rather than tense relations.

Different variants of solving the problem of urban localities can also entail contradictory consequences for municipal entities' investment attractiveness. Thus, the existence of an additional, namely district level of conciliation may discourage investors to invest in the city's objects. Plus, lacking the culture of inter-municipal cooperation, in certain cases the city finds itself having no territory to organize new production, while the district – the necessary infrastructure, but both subjects of municipal power are still unable to agree with each other. This situation is characteristic of, for instance, the town of Gatchina and Gatchinsky district in Leningrad oblast.

The practice of granting urban localities with the urban okrug status gave a rise to a particular problem associated with the idea that does not directly derive from the text of 131-FZ – that is, the urban okrug may not form an administrative center of the district around it. It is not accidental then that some regions saw the rise of optional reorganization of the territorial structure of local self-governance that provided for granting the urban okrug status to all independent municipal entities of urban type, except those falling under the category of district centers, i.e. the largest ones and those having real reasons for pretending for the status. Consequently, amendments to 131-Fz comprised a special interpretation that reads that “a town (settlement) that has the status of urban okrug and is located in the borders of a municipal district may be considered the administrative center of the municipal district”.

As far as effects from making 131-FZ effective are concerned, the approach that had been practiced yet under the shaping of the territorial structure of local self-governance gains a particular importance. Most regions employed a mechanism similar to the one used by Tver oblast, with the district-level municipalities playing a major role in setting borders, for it was the municipalities which dealt with the blueprint of the new territorial structure. While working on that, they also got heads of sub-municipal structures involved, while the residents' meet-

ings were convened in conflict situations (but in some regions they were held in every locality). Then the complete draft project was submitted to the oblast administration to become subject to a special commission. In most cases it was approved, but sometimes was returned for revision. However, there existed different approaches to the problem, with the oblast leadership, together with district heads, blueprinting the draft project of a new territorial structure. Meanwhile, sub-municipal structures were ignored, as well as residents' meetings. Such an approach was characteristic of Leningrad oblast, for example.

In the former case the process of formation of the territorial structure evidently implied coordination of various players' interests and their interaction, with heads of sub-municipal structures playing not just a formal role of staffers of the district administration, but the actual role they have to play in most cases – that is, organizers of a local community. While in this case the process of formation of the structure of municipal entities by itself could become more complex and conflicting, the social adaptation of the given structure should appear less painful, given other conditions being equal.

The other approach appears completely resting upon the formal structure of power, and in many aspects it takes the procedure of shaping the territorial structure to the sphere of administrative decisions. It evidently requires less time costs and fewer organizational efforts vis-à-vis the first one. However, benefits it ensures at the stage of formation of the territorial structure may turn into additional complexities and challenges when it comes to organization of solving issues of local significance. Without passing the procedure of social adaptation among the population, having been built without regard to information available on the level of sub-municipal structures, the new territorial structure may well become socially and politically vulnerable. It can be suggested that, for instance, in Leningrad oblast, such an approach blocked optimization of the territorial structures, as it has failed to consider locality-specific situations understandable only to the grass-root level specialists. Thus, representatives of single *volost* administrations proposed territory consolidation options other than those stipulated in the law, but they had no institutional opportunities to express and justify for their opinion. That is why their voice was heard of only when they managed to personally submit their proposal to the oblast administration.

The problem of reorganization of the territorial structure in the regions in which settlement municipalities had been already formed in the frame of the settlement or two-level models appeared somewhat different. That was noted, for instance, in Astrakhan oblast. In Tyumen oblast, the settlement municipalities were formally liquidated everywhere in just early 2000, except for Tyumen district. That is why it was not an exhaustive exercise to restore them. However, implementation of the local self-governance reform in these oblasts is not an easy walk either, and displays the existence of certain conflicts. The problem is, in the past settlements' borders were set in substantially different conditions, when powers and sources of financing were not divided as strictly as in the new law. That is why the population of many localities there fails to meet the threshold of 1,000, and the localities' financial and cadre bases are insufficient to exercise the mandate as per the law. However, under the existing structure changing their borders is a very challengeable mission from the political and organizational perspective. That is why, though at the reform preparation stage they do not face such grave complexities with transforming their territorial structure as the regions with the district structure do, once the new law comes in effect, problems in this particular area may become fairly serious.

In Kaluga oblast, the territorial structure reform has undergone a remarkable development: as noted above, a number of relatively small municipal entities separated themselves from the district structure. By contrast to other regions in question (except for Leningrad oblast), such a separation was voluntary and based on objective prerequisites – that is, the existence of a cadre and economic basis, and a sufficient maturity of the local community. In the course of the reform the municipalities raised debates in which different parties suggested transformation options. In addition to the traditional approach – that is, to include the municipalities in the district structure as urban localities, it was also proposed to establish urban okrugs on their base by enlarging their area at the expense of the neighboring districts' territories. The preference was granted to the traditional variant. As in Leningrad oblast, the unification of the territorial structure likewise led to the lowering of the status and limiting of powers of the most active municipal entities, which at the previous stage of the development of lo-

cal self-governance had been given an opportunity to a maximum degree realize their potential.

It was the setting of borders and identifying of the municipal entities' statuses that formed the substance of operations on preparation for the municipal reform on the regional level in 2004. By contrast, other reform aspects were tackled to a far lesser degree. However, it is impossible not to focus on, at least, two groups of issues, ways of solving which will be having a fundamental impact on the municipal entities' functioning post-January 1, 2006. Those are reassignment of powers and property between different tiers of power – both between the regional and municipal levels and between districts and settlements; designing financial mechanisms that should be in line with the newly amended versions of the Tax and Budget codes.

### **8.3. Re-Assigning Powers and Property: New Approaches**

The year 2004 saw rather a vigorous reassigning of powers between the regional and municipal levels. That was happening due to preparations to making Statute 95-FZ effective. The most substantial modification in this respect became centralization on the regional level of functions associated with the social protection of the population. Regions adhere to different tactics of exercising the social functions delegated to them: while some of them are inclined to further re-assign those to municipal entities as public powers, others are centralizing them on the regional level and create sub-divisions of oblast structures with municipalities.

Heads of numerous municipal entities seem to be rather insulted by the delegation of social mandates to regions. It is believed that on the local level one is far greater aware of the local residents' needs, while once the social assistance is delivered from the regional level, it would result in the rise of red-tape arrangements. Meanwhile, one considers variants as to how the local level would be able to retain certain powers in the social policy area on the grass-root level under the new law. Thus, a number of municipal programs in the social support area may be "re-qualified" into programs in the health care or education areas without a dramatic modification of their substance.

Delegating the social mandate to the regional level is accompanied with the transfer of property objects needed to exercise the noted pow-

ers. Underlying conflicts that arise in the process of property reassignment are, by and large, two reasons: first, municipal entities would invest considerable funds out of local budgets (and sometimes even residents' funds) in a number of such objects, and they conceive the non-redemption transfer an unjust deal. Second, complexities arise in the course of division of office facilities and a number of other property objects needed for administering the social sphere.

As concerns the allocation of powers between districts and localities, at this point it should be considered that despite a strict separation of issues of local significance on the district level from those on the locality level, the law provides for the possibility of delegating powers from localities to districts and vice versa. Such a procedure should be exercised on the basis of agreements concluded for a certain term. The delegated powers should be funded from subventions allocated, accordingly, either from localities' budgets to those of municipal districts, or vice versa.

Most regions are still pondering on the options and discussing only approaches to the division of powers between the two levels of municipal entities. Meanwhile, there gains strength and outspreads a stand according to which, whereas the locality level lacks the necessary cadre and organizational capacity, localities *en mass* and everywhere should delegate their functions, along with the respective financial resources, to districts. That de-facto means the reproduction of the former, pre-reform model of organization of municipal entities.

Meanwhile, some regions have already undertaken the first steps to implement the model. Thus, in April 2005 a referendum was held in rural localities of Tyumen oblast on the following issues:

- approval of the structure of local-self-governance bodies;
- approval of the charter of municipal entity;
- delegation of a part of issues of local significance of the locality to the municipal district.

As far as the third block of issues is concerned, local residents were proposed to agree with the local self-governance bodies delegating to the municipal-district bodies of local self-governance the exercising of their powers on solving 16 (out of 27) issues of local significance (pp. 4–7, 11–15, 18–20, 22–25). The question suggested agreement or disagreement with all the 16 points at once, thus leaving residents no op-

portunity to agree with some and disagree with others. There was no differentiation by types of rural localities, their population, economic and cadre capacity.

Other regions and, particularly, Novgorod oblast, are going to solve the problem of delegation of powers in an analogous fashion, i.e. by means of local referendum. At this juncture it should be noted that the centralization on a number of powers ultimately may just grow, rather than diminish. Thus, it is planned to exercise powers associated with the housing and communal sector by consolidating individual municipal enterprises, most of which currently face financial hardships, in a single oblast communal company with district branches.

This system obviously conflicts with the spirit of the law, albeit formally can meet its letter. However, the employed mechanism of introduction of the model – namely, referendums – makes it fairly complex to preclude it from outspreading by means of amending the federal law. At this point it should be taken into account that this approach that on the surface leads to a mere restoration of the pre-reform situation in reality is pregnant with intense conflicts. The law provides for the existence of elected bodies of power on the locality level, and they will see their mission in advocating interests of the population that has elected them. Should the locality-level administrations be *de-facto* deprived of powers and resources that enable them to solve their population's urgent needs, they will concentrate their efforts on securing their population's interests on the district level, which will inevitably entail problems and conflicts. Under such circumstances the conflict nature originally inherent in the two-level model (as emphasized many times by foreign and domestic experts on municipal issues) may intensify considerably, and the experience of Astrakhan oblast cited in this paper proves that such forecasts are realistic.

The option that provides for a more selective approach to the problem of division of powers between the district and locality levels seem more productive. Thus, from this perspective it is possible to single out four groups of localities, as follows.

- Localities that receive additional powers from the district level, primarily those in the health care and education areas. Such an assignment allows to ensure the uniformity of development of the housing and communal and social infrastructure on the localities'



territories, and optimization of the use of municipal real estate. As far as medical and obstetrical offices (MOF) and pre-school institutions are concerned, such an assignment appears appropriate practically everywhere, while as for other powers in the noted spheres, the problem is urgent primarily in urban localities.

- Localities that independently solve issues of local significance legally assigned to them.
- Localities that delegate to the district level issues associated with organization of the communal services to the population. It is this very complex of issues of local significance that generates the greatest problems localities face, for in this particular case economies of scale can be fairly considerable. Given the absence of traditions of inter-municipal cooperation (as noted above), individual localities are most likely to suffer losses associated with an insufficient scale of operations, which can trigger the price rise for and decline in the quality of provision of the respective services. With account of the above, it is appropriate to leave the issues of organization of maintenance of the housing fund to the locality level, which would enable localities to gradually begin to take part in the organization of provision of the HCS services. They would start up with the simplest (housing) services, while the noted arrangement would help ensure an organizational breakdown of the services in question into housing (potentially competitive) and communal (natural monopoly) ones. The latter would form a step forward, as the services are currently combined in the frame of multi-sectoral HCS enterprises that operate on the district level. That leads to an insufficient transparency of financial flows within the HCS, decline in manageability in the sphere of services rendered by natural monopolies, and an artificial monopolization of potentially competitive markets for services.
- Localities that delegate most of their powers with respect to solving issues of local significance to the district level. Clearly, this implies the smallest localities that appear incapable of exercising even the simplest functions assigned to them.

While, in compliance with the law, every locality is bound to have its local administration, it may appear appropriate for a number of them to unite their forces to exercise a number of specialized functions. This to

a certain degree can mitigate the intensity of the problem of a poor cadre and organizational capacity and lower municipalities' administrative costs, without resorting to the delegation of the bulk of their major powers to the district level. It is worthwhile noting that it may not be necessary (and, perhaps, may be totally inappropriate) to organize such cooperation on the district level.

### 8.4. Casting New Financial Mechanisms

The newly amended Tax and Budget Codes mirror principal elements of organization of financing on the municipal level. The laws provide for assigning to municipal entities both local taxes (land tax and personal property tax) and deductions from the federal taxes or those imposed under special tax regimes (from the personal income tax, presumptive tax, single agrarian tax). The list of revenue sources the federal law assigns to every type of municipal entities is given in *Table 8.1*.

*Table 8.1*

**Tax Revenues Assigned to Local Budgets (as %).**

Tax revenues	Contributions to budgets:		
	urban okrugs	municipal districts	settlements
<i>Local taxes and levies</i>			
Land tax collected in the territories of settlements and urban okrugs	100	0	100
Land tax collected in the inter-locality territories	0	100	0
Personal property tax collected in the territories of settlements and urban okrugs	100	0	100
Personal property tax collected in the inter-locality territories	0	100	0
<i>Federal taxes and levies, including those provided by special tax regimes</i>			
Personal income tax	30	20	10
Single presumptive tax	90	0	0
Single agrarian tax	60	30	30
State fee due to be paid at the place of registration	100	100	0

Source: the Budget Code of RF of 31 July 1998, № 145-FZ (amended on 20 August 2004).

It is possible on the regional level to fix with municipal districts' or localities' budgets set on the permanent basis uniform rates of deduc-

tions from regional taxes or federal taxes assigned to Subjects of the Federation. In addition, the RF Subject should make a decision as to which of interbudgetary relations instruments whose menu is given in the Budget Code will be used in the region.

In 2004, most regions started working out approaches to shaping the system of interbudgetary relations in new conditions and by today have completed preliminary computations (with some regions even identifying the level of suggested localities). Today, regions discuss solutions to individual issues of a new mechanism of funding municipal entities, in particular:

- the possibility for fixing uniform rates of deductions on the district level (while some regions do not provide for fixing additional standards and other debate, for instance, fixing a part of the corporate property tax with municipal districts);
- organization of financial equalization between localities (with some regions intending to do it from the regional level, while other being more inclined towards establishment of district funds of financial support to the population);
- the need to employ negative transfer<sup>61</sup>.

The present research implied an examination of effects from the introduction of new financial mechanisms in three regions – that is, Kaluga, Astrakhan and Leningrad oblasts, with an emphasis made particularly on consequences of their introduction on the locality level. Plus, in the regions that employed district model revenues and expenditures were assessed on the level of then existing sub-municipal structures<sup>62</sup>. The research allowed the following conclusions:

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<sup>61</sup> Negative transfer (a subvention transferred from the municipal entities' budgets in favor of those at whose expense the financial equalization of municipalities of the respective type is made) may be introduced by a law of the Subject of RF for the localities whose level of reference budget sufficiency is not less than twice over the average one by localities in the given region. The amount of the negative transfer may not exceed the 50% difference between the reference budget sufficiency of a given locality and the double average budget sufficiency by localities of a given region in the last reported year. Today, experts and policy makers debate an appropriateness of amending the Budget Code so that to broaden the practice of collection of negative transfer and boost the respective revenues.

<sup>62</sup> The assessment of potential revenues of local budgets was carried out on the basis of actual data on sets of taxes collected in the territories of the existing sub-municipal structures. While assessing locality municipal entities' expenditures, the authors considered

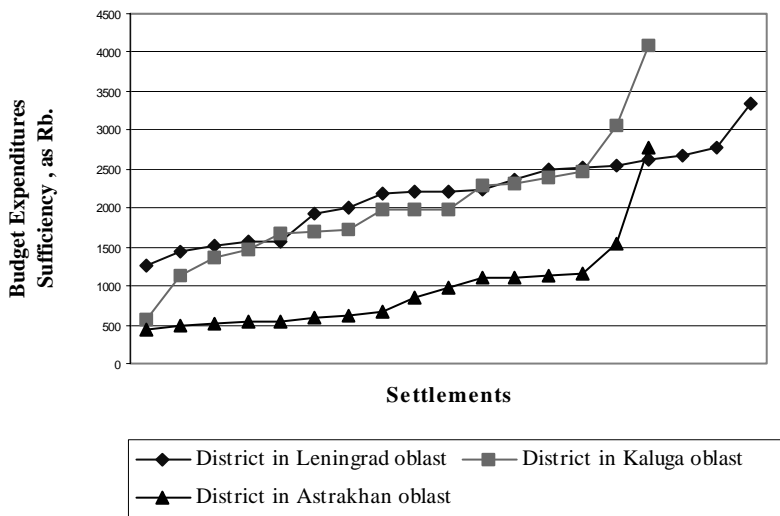
1. The budget sufficiency in terms of expenditures varies fairly substantially from one municipal entity to another both on the district and locality level. As *Fig. 8.1.* shows that, as far as the latter type of municipal entities is concerned, the difference can be 3-7-fold. This seriously complicates the employment of mechanisms aimed at equalization of revenue budget sufficiency as provided for by the newly amended Budget Code.

2. The revenue sources assigned to municipal entities as per the Budget Code enable their overwhelming majority to cover just a meager part of their expenditures, as displayed by *Fig. 8.2.* Nonetheless, practically in every district in question there can be found localities or sub-municipal structures with a substantially greater budget sufficiency than that of the district on the whole. Thus, given that 15 out of 16 localities in Limansky district use the revenue sources fixed at the federal level to fund less than 30% of their expenditures, the level of expenditures' coverage in the settlement of Liman exceeds 80%, which is explained both by a high revenue level and low per capita budget expenditures. Similarly, a fairly high revenue level is likewise noted in the consolidated administration of Gatchinsky district, however per capita expenditures in that structure prove to be yet higher and record-breaking throughout the district.

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actual spending on maintaining the municipal entities' administrative staff, HCS and expenditures on maintaining the budgetary network (cultural facilities, libraries). While computing the costs of maintenance of the administrative staff, the authors increased them 1.5 times vis-à-vis the actual expenditures, for once local administrations' powers are extended, they will find themselves in need for extra staffers. The main indicators used for the sake of computation were as follows:

- *Budget sufficiency in terms of expenditures* – municipal entities' per capita expenditures.
- *Budget sufficiency in terms of revenues* – municipal entities' per capita revenues, provided the respective tax revenues are assigned to them, as per the federal law.
- *The expenditure coverage level* – the proportion of municipal entities' expenditures that can be covered by municipal revenues.



Source: the authors' calculations.

*Fig. 8.1.* Budget Expenditures Sufficiency of Locality Municipalities Exemplified by Settlements in Three Regions (by One in Astrakhan, Kaluga and Leningrad Oblasts), Estimated Data, as Rb.

3. Only one out of the three regions displayed objective grounds of using the mechanism of negative transfer. In one of the districts of Astrakhan oblast, the budget revenue sufficiency is extremely high (4.5-fold greater than the average one), and the employment of the negative transfer mechanism allows an additional fixing of tax contributions with municipal entities. In other cases there exist broad possibilities for an additional fixing of revenue sources, at least, on the level of municipal districts, even without introducing negative transfer. Thus, in Kaluga oblast it is possible to additionally fix with municipal entities 30% of the personal income tax and 50% of the corporate property tax<sup>63</sup>.

<sup>63</sup> See: E. Markwart, O. Savranskaya, I. Stariodubrovskaya. Rekomendatsii po formirovaniyu ekonomicheskikh i finansovykh osnov mestnogo samoupravleniya. – Moscow, 2004, p. 110.

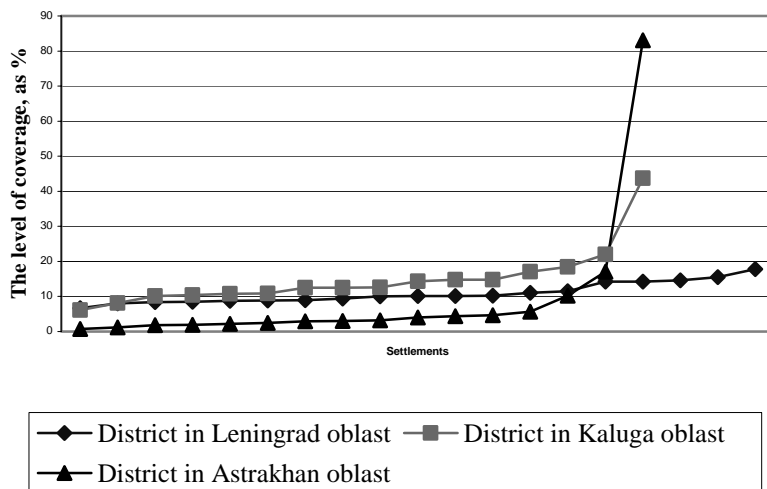


Fig. 8.2. Levels of Covering Expenditures from the Revenue Sources Assigned by the Federal Level Exemplified by Settlements in Three Regions (by One in Astrakhan, Kaluga and Leningrad Oblasts), Estimated Data, as Rb.

4. The present research also considered the capacity of such an instrument of financial equalization as per capita transfer. The research demonstrated that its employment allows a fairly substantial decrease in the variation of expenditures coverage vis-à-vis the fixing of tax contribution rates. The use of such a mechanism, nonetheless, appears clearly insufficient both on the district and locality levels. Given that the Budget Code provides for the possibility of financial equalization of localities from the regional level only by means of per capita transfer mechanisms, regions that have opted for this particular mechanism may be challenged by the necessity of meeting localities' financial needs.

Keen to ensure a prompt introduction of the municipal reform or its individual elements, in 2004 some regions designed valuable methodologies of financial equalization that based upon new principles. Tver oblast is one of the regions that have started introducing the new finan-

cial principles since early 2005. The financial mechanism is being fine-tuned on the level of districts and towns (i.e. the municipal entities existing as of today).

According to the new approach, municipal entities are assigned with revenue sources that to a maximum degree comply with recent amendments to the Tax and Budget Codes. The solitary difference is arrangements associated with fixing the personal income tax: given that the Codes provide for the fixing with municipal entities of 30% of it, while the region's obligation is to fix another 10% in the form of uniform or additional standards, since 2005 Tver oblast provides for 25% of the personal income tax and allocation of its another 15% in the form of per capita transfer. The allocation of the financial assistance is made on the basis of equalization of budget sufficiency, and such an approach has already resulted in rather a dramatic financial progress: for instance, the city of Tver foresees the boost in its budget by 44% this year.

Meanwhile, the oblast has formed its 2005 stabilization fund, which covers 90% of the municipal entities' losses resulting from the modification of the methodology of allocation of the financial assistance. It is planned to continue forming the Fund for 5 years, with the size of compensations being gradually reduced. However, the timetable of such a reduction has not been worked out as yet. In addition, the oblast decided to form the municipal development fund and the fund for co-financing social expenditures. The latter can potentially become an instrument helping mitigate problems associated with the transition to the new financial equalization system. Possibilities for spending its resources appear fairly great (the oblast provides for 11 areas of co-financing expenditures), but the attraction of resources to the fund implies that municipal entities should also contribute to it with their own budget funds. That is why it appears doubtful that the poorest municipalities would be able to fully resort to this instrument.

The employment of mechanisms analogous to the stabilization fund can be noted in other regions that introduce new financial mechanisms in 2005. The efficacy of this particular innovation may be yet greater, should it be coupled with the formation and implementation of special programs pursued on the level of municipal entities. Such programs should provide for avenues that would ensure boosting budget revenues and enhancing the efficiency of budget spending, with the ulti-

mate goal to have, by the end of the transitional period, expenditure obligations correspond to revenue sources in the conditions of equalizing budget sufficiency (rather than funding actual expenditures) and ensure that issues of local significance are solved on the level that meets the local community's needs.

## **Conclusion**

In the beginning of the present research, the evaluation of main arguments used in international and domestic practice for justification for the selection of this or that model of territorial structure of local self-governance, as well as the analysis of the most urgent challenges associated with the implementation of the local self-governance reform in compliance with the newly amended Law "On general principles of organization of local self-governance in RF" allowed formulation of a number of hypotheses. They were further tested by means of quantitative and qualitative analyses, and some of them were proved, while others presumably appeared erratic, or there was ambiguous information on them and they thus require further testing.

Hypothesis 1 on the presence of both objective and subjective factors in the course of selection of the territorial structure in this or that region was tested while conducting the respective quantitative analysis. The analysis has failed to identify any linear correlations between the territorial structure and objective characteristics of the situation in a given region. The absence of clearly identified criteria of the selection of a territorial model also manifested itself in the course of the studying into the situation in the pilot regions, where a low population density rate in Tyumen oblast serves as an explanation to its opting for the settlement model, while in Novgorod oblast – for the district one. Thus, it can be assumed that subjective factors play a greater role in selecting a territorial model of local self-governance than objective ones.

Hypothesis 2 on the rise in the capacity of the local self-governance once the municipal administration getting closer to the basic, locality level was tested in the course of studying the situation in the pilot regions. This hypothesis has equally failed to find its proof. This particular conclusion appears fairly extravagant, as the hypothesis in question mirrored the common view and exerted a substantial influence on outlining the municipal reform avenues. Notwithstanding that, in the course of the research a considerable part of heads of settlement



of the research a considerable part of heads of settlement municipalities lamented about the population's passiveness and alienation from the local power. Notably, the local residents remained passive both in everyday life and in times of crises.

Meanwhile, the rural councils that exist in the frame of the district model in the regions that pursue the decentralization policy and grant them with fairly broad powers without insisting on their receiving the formal status of municipal entities present shining examples of a positive development of local self-governance. Their powers in particular are: organization of actually operating voluntary fire brigades that are financed from self-taxation funds; road repair by means of mobilizing the local community's financial and organizational resources; operative liquidation of damages in the water supply system using the population's loan. The self-governance framework also allows to tackle some economic issues, such as hiring the shepherd, re-demarcation of hayfields, the sequence of plowing of vegetable gardens using the community's horse, etc.

It appears that the explanation of the noted paradox lies with peculiarities of the organization of municipal administration on the whole and primarily with regulation of financial and economic fundamentals of municipal life. In settlement municipalities, with their municipal budgets and administrative staff available to exercise municipal functions, the population does not find it necessary to organize themselves to solve local issues, while the local administration's priority mission is to be an efficient lobbyist of its own interests in the regional structures, rather than to encourage the grass-root initiatives. The absence of such a critical form of contribution to the governance as funding of the delivery of municipal services from local taxes inevitably results in the alienation between residents and the local administration, the population's consumerism towards the local budget, on formation of which they exert no substantial influence. By contrast, rural councils have to exercise quite a vast array of powers with minimum financial and administrative resources on hand. In such circumstance the residents to a far lesser degree believe that their problems can be solved without their contribution, while the administration have no one else to lean on but the residents' self-organization.

The only exposed example of an active participation of the local community in solving issues of local significance on the settlement level proves the above conclusion. In that case, the municipality was in such a critical condition that formal administrative mechanisms practically were out of operation. Thus, the sole way to ensure the population's survival lay with organization of informal mechanisms of the local community's self-mobilization. That became possible, provided the settlement head was a strong leader. He proved to be capable of operating in the frame of both formal and informal arrangements.

Hypothesis 3 on the existence of a correlation between the number of administrative staff and expenditures on its maintenance and territorial structure, which is explained by the rise of economy of scale in that area, was tested both by quantitative methods and analysis of the situation in the pilot regions. The testing provided mixed outcomes:

- The analysis of the number of administrative staff in settlement municipalities in Tyumen and Kaluga oblasts, as well as the examination of effects from the transition from the settlement model to district one in Tyumen oblast exposed clear signs of the existence of economy of scale. In the latter case there was noted a rise in spending on administration on the municipal level (with the downsizing of administrative staff in municipalities vis-avis the creation of district administrations), cutting down the respective expenditures on the regional level (with the liquidation of territorial public administration bodies on the district level) and an overall saving of administrative expenditures across the region on the whole.
- The proportion of administrative expenditures across Russian regions on average proved to be greater in regions with the two-level structure with budgets on the both levels of municipal self-governance. However, the regression analysis has failed to expose any strict correlations, which, perhaps, can be attributed to the fact that for the purpose of the quantitative analysis we combined the regions with the two-level structure with budgets on the settlement level with those without them.
- In Kaluga oblast, the comparison of expenditures on administration in district-level municipalities with those in districts with the two-level structure exposed better results under the latter model. This can be explained by the fact that settlement municipalities in the

oblast were voluntarily created in localities where the respective organizational and financial prerequisites had emerged. That allowed employment of additional factors of increasing the efficiency of administration that were not associated with economy of scale.

Hypothesis 4 of the correlation between the structure and volume of powers on the municipal levels was tested in the course of the quantitative analysis. The results of the regression analysis demonstrated a considerable impact of the settlement model on the decline of the decentralization index and on a greater centralization of expenditures in the HCS and education areas, while the analysis failed to expose an impact of other models on expenditure assignments between the region and municipal entities.

Hypothesis 5 of greater possibilities for municipalities on the district level to affect economic development was tested in the course of the analysis of the situation in the pilot regions. The research allowed collecting a fairly strong evidence in favor of the hypothesis, as it demonstrated both positive and negative influences the district administrations exerted on economic development. The positive examples are associated with a sound policy aimed at attracting investment (preparation of investment sites, a sound information policy), measures on lowering administrative barriers to businesses, and fostering an inter-regional cooperation. The district-level administrations, as a rule, have more qualified staff to tackle these issues. Plus, the district is considered as a more serious partner for organization of cooperation. The negative examples are associated with the deceleration of processes of changing an owner at large enterprises and placing overly great requirements to investors. The research also exposed individual cases of the positive impact on prospects for economic development on the settlement level (the so-called “economic miracle” in the settlement of Detchino in Kaluga oblast), albeit settlements appear capable of attracting micro-businesses (companies with 10–20 employees).

Overall, proceeding from the research, it can be concluded that once the district administration deliberately sets the task of establishing a favorable milieu for businesses, it enjoys a far greater opportunity than its counterparts on the settlement level. However, if such a task is not on its agenda, the existence of the district administration can even hamper economic development, as it does not allow to capitalize on the

capacity of the settlement model, which is formed by its proximity to local residents and the necessity to focus on their interests.

While testing hypotheses 6 and 7, the authors found out that in addition to the structure of municipal entities, the mechanisms of delivery of municipal services and implementation of structural reforms on the local level are affected by other factors of which critical ones are:

- The oblast administration's policy, and
- The urban or rural nature of a given locality, regardless of which territorial model framework it operates.

Thus, the greatest pace of structural reforms was noted in highly urbanized territories. By contrast, the reform pace in the countryside is very slow and avenues of possible transformations are not always clear even on the conceptual level. Thus, the research has failed to expose a single efficient mechanism of organization of the delivery of the HCS services beyond the urban locality's borders. Notwithstanding that, factors associated with the territorial structure also play a certain role in this respect.

The research has failed to prove a widespread idea of the settlement principle always meaning getting the provision of services closer to the population, while the district model implies the opposite. The organization of services under which the work with the local population is dispersed across the territory of the district, while other functions are concentrated in a single center, suggests the remedy to the problem. Meanwhile, settlement municipalities do not always appear capable of securing the provision of the full complex of municipal services.

The most tangible factors that inhibit structural reforms expose themselves on the settlement level in the case of the HCS reform. The fundamental factors of this type are:

- As the municipal administration operates on the grass-roots level and directly depends on the population, it is reluctant to opt for unpopular measures, such as raising the HCS tariffs and charges and exercise toughness to those who fail to pay those;
- The settlement level often lacks a qualified staff to ensure a sound tariff setting, pursuing an energy saving policy, etc;
- The dispersion of budget funds entails the impossibility of ensuring a normal financing of capital expenditures;

- The narrow market generates problems with attraction of private contractors.

The research has allowed to prove to a certain extent the presence of these factors and their impact on the pace of the HCS reform. However, while their impact, on the one hand, does not appear universal, their absence does not warrant an acceleration of the reforms, on the other. While the district structure eliminates a part of objective constraints to implementation of transformations in the sector for housing and communal services that are inherent in the settlement model, it does not mean that the HCS reform should be a greater success otherwise. Thus, in Tyumen oblast, the transition from the settlement model to the district one was accompanied by a serious breakthrough in accomplishment of the transformations. That, however, happened against the background of a considerable rise in the vigor with which the oblast administration pursued its policy of support of the reforms. By contrast, with the district model dominating the Novgorod oblast, the pace of the HCS reform is fairly slow there.

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## **Part 2. Organization and Financing of Local Self-governance: Foreign Experience**

## Introduction

Interest in cities around the world has increased significantly over the last decade. This interest has arisen in part because more and more people are living in cities and, in part, because it is increasingly understood that large cities and city-regions<sup>64</sup> are the major drivers of economic prosperity for the countries in which they are located.

Globalization has fundamentally changed the role of cities. In the new knowledge-based economy, knowledge and learning are key determinants of economic success. Firms are no longer competing only on the basis of achieving the lowest cost, but they also are competing on the basis of their ability to innovate: to come up with new products and to deliver them in a timely manner<sup>65</sup>. Cities are key to innovation – they are places where workers, capital, institutions and infrastructure come together to provide the foundation for economic activity. The concentration or proximity of people and firms in cities increases social and economic interaction and results in the exchange of ideas among people working in different fields in the same location. This exchange of ideas is essential for innovation.

To attract businesses, cities not only have to ensure access to skilled labour and transportation and communications infrastructure but they also have to provide those services that attract and retain highly trained human capital. According to Richard Florida<sup>66</sup>, the knowledge workers are attracted by quality of life factors such as diversity, tolerance, a lively arts scene, recreational opportunities, high quality public schools, strong neighbourhoods, and safety from crime. As Savitch and Kantor note: “where you live and work matters more than ever in accessing jobs, income, public amenities, schools, and green space”<sup>67</sup>.

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<sup>64</sup> City-regions generally refer to a defined urban centre with smaller adjacent urban and rural areas.

<sup>65</sup> See Gertler, Meric S., Richard Florida, Gary Gates, and Tara Vinodrai. “Competing on Creativity: Placing Ontario’s Cities in North American Context.” A report prepared for the Ontario Ministry of Enterprise, Opportunity and Innovation and the Institute for Competitiveness and Prosperity, Toronto, 2002.

<sup>66</sup> Florida, Richard, *The Rise of the Creative Class*. New York: Basic Books, 2002.

<sup>67</sup> Savitch, H.V. and Paul Kantor, *Cities in the International Marketplace: The Political Economy of Urban Development in North America and Western Europe*, Princeton, New Jersey: Princeton University Press, 2002, p. 16.

In this context, local governments have an important role to play. Not only do they have to ensure access to skilled labour and transportation and communications infrastructure but they also have to provide those services that attract and retain highly trained human capital. This means that cities need the financial resources that will enable them to build and maintain the infrastructure and to deliver the services that will attract skilled individuals and firms. The appropriate local government structure will help them to do this.

Good local governance also has a role to play. The main contribution of local governance is to the livability of cities in terms of health and safety, recreational opportunities, environmental health other factors that contribute to the quality of life. The type of government structure for cities will have an effect on the efficiency with which services are provided and on the ability to share the costs throughout the entire region in a fair and efficient way. Governing structure also has an impact on citizen access and government accountability for the expenditure and taxing decisions it makes.

The purpose of this study is to compare different models of government structure at the local level and to evaluate their advantages and disadvantages. The study will focus mainly on government structures in large cities but will also look at governance in smaller, remote communities. Examples of different cities around the world will be used to illustrate how different government structures work in practice.

The outline of the paper is as follows:

- The ninth part sets out the standard public finance criteria for designing government structure: subsidiarity and local responsiveness, economies of scale, externalities, equity, access and accountability. Some of these criteria call for large government units to deliver services; others suggest small government units would work better.
- The tenth part discusses the application of the above criteria to communities of different size and location. In particular, the circumstances of large metropolitan areas on the one hand and small remote communities on the other hand are considered.
- The eleventh part describes and reviews the advantages and disadvantages of four models of government structure: two-tier

governments, one-tier governments, voluntary cooperation (including inter-municipal agreements) and special purpose districts. It also considers the role of senior levels of government. As part of the discussion, examples are provided from different cities around the world.

- The twelfth part provides more in-depth descriptions of how different models work in four cities: Toronto (Canada), Vancouver (Canada), London (England), and Minneapolis-Saint Paul (USA). It also provides one example of governing communities in remote areas: Ontario (Canada). Although these examples are in now way intended to be comprehensive, they do illustrate some interesting experiments with different types of structures.
- The last part draws some general conclusions about governing structures around the world.

It should be noted at the outset that the discussion of government structure around the world makes clear that different structures have worked in different places at different times. Indeed, individual cities have tried different structures at different times. It is thus very difficult to generalize from the examples provided because there is not one model that stands above the rest. The appropriate governing structure in any one municipality will depend on its specific characteristics – the nature of the services it provides, the revenue sources available to it, the size and location of the municipality, the size of the municipality relative to the state/province or country as a whole, the nature of intergovernmental relations, the history of cooperation with neighbouring municipalities, and other factors.

## **Chapter 9. Models of Government Structure at the Local Level**

### **9.1. Criteria to Evaluate Different Models of Government Structure**

In terms of economic theory, the major role assigned to regional or local governments is to provide goods and services within a particular geographic area to residents who are willing to pay for them<sup>68</sup>. If the benefits of particular services are confined to local jurisdictions (in other words, the benefits do not spill over into neighbouring jurisdictions), efficiency is enhanced because the mix and level of services can vary according to local preferences. Local officials are in a better position to respond to local tastes and preferences than are officials of senior levels of government<sup>69</sup>.

According to this theory, the main objective in designing the optimal government structure is to maximize the welfare of individuals. The welfare of individuals is assumed to depend, at least in part, on the satisfaction they receive from local public goods and services. The optimal level of government is that which provides the desired level of local public goods and services at the least cost. Within this general framework, several criteria can be used to design government structure: subsidiarity and local responsiveness, economies of scale, externalities, equity, access, and accountability.

#### *9.1.1. Subsidiarity principle and local responsiveness*

The efficient provision of services requires that decision-making be carried out by the level of government that is closest to the individual

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<sup>68</sup> Bird, Richard M. and Enid Slack, *Urban Public Finance in Canada*, Toronto: John Wiley and Sons, 1993, p. 16.

<sup>69</sup> The provision of local services does not mean that the municipality has to produce the goods and services themselves, however. Rather, the role of local government is to make decisions about which services to provide and how to provide them. Municipalities could, for example, contract out service delivery to another government or to the private sector. See in David Osborne and Ted Gaebler, *Reinventing Government – How the Entrepreneurial Spirit is Transforming the Public Sector*, Reading, Mass.: Addison-Wesley Publishing Co. Inc., 1992.

citizen. This is known as the “subsidiarity principle”<sup>70</sup> and is needed for the efficient allocation of resources, accountability, and responsiveness. As long as there are local differences in tastes and costs, there are clear efficiency gains from delivering services at the local level.

According to this principle, expenditure responsibilities should only be assigned to a higher level of government if it can be demonstrated that it can carry out the function more efficiently than the lower level. With few exceptions (such as national defence and services that involve redistribution), almost all public services should be provided at the local level with local policy-makers making decisions about what services to provide, how much to provide, and who should pay for them.

Public choice theory argues that small-scale, fragmented local governments have special advantages for local democracy because they maintain a quasi-market. The proliferation of small government units in a metropolitan area results in competition among them. Tiebout, for example, suggested that people “vote with their feet”, meaning that they move to the jurisdiction with the tax and expenditure package that most closely resembles what they want<sup>71</sup>. This competition benefits citizens through increased efficiency in service delivery or in terms of finding the municipality that has the basket of goods and services that most closely meets their tastes<sup>72</sup>. In this framework, a large urban government will be less efficient in meeting the demands of its residents because it will tend to provide a uniform level of public services to people who have different preferences for those services.

The Tiebout model is based on a number of assumptions. For example, it assumes that there is a large number of small, homogeneous local governments; the cost of mobility is zero; there are no externalities;

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<sup>70</sup> The subsidiarity principle was included in the Treaty of the European Union in 1992 in the context of the division of powers and responsibilities between European governmental bodies and their member countries. The principle has also been applied to the role and structure of government at all levels. See Barnett, Richard, R., “Subsidiarity, Enabling Government, and Local Governance,” in Hobson and St-Hilaire (eds), *Urban Governance and Finance: A Case of Who Does What*, Montreal: The Institute for Research on Public Policy, 1997, p. 59.

<sup>71</sup> Charles Tiebout, “A Pure Theory of Local Government Expenditures.” *Journal of Political Economy*, Vol. 64, 1956.

<sup>72</sup> George Boyne, “Local Government Structure and Performance: Lessons from America?” *Public Administration*, Vol. 70, 1992, p. 338.

no externalities; and other assumptions. The model has been criticized on a number of grounds: first, there is a cost to mobility that makes this adjustment less than automatic. This is particularly true in countries where mobility is spatially limited<sup>73</sup>. Second, the model excludes any discussion of externalities (see below for a definition of externalities), and third, the model does not consider that people will vote other than with their feet. In other words, people can vote out the local politicians at the next election if they do not like their policies rather than moving out of the local community.

### 9.1.2. Economies of scale

Economies of scale occur where the per-unit cost of producing a particular service falls as the quantity of the service provided increases. In the context of local government, this means that the cost of providing a service falls as the number of people being served increases.

There are problems with economies of scale as a criterion for designing government structure, however. First, each urban service will likely achieve the lowest per unit cost at a different scale of production. For example, the optimal size of government may be different for fire services than for solid waste management. These differences mean that it can be extremely difficult to draw boundaries for general-purpose local governments.

Second, the jurisdiction that provides the service is not necessarily the one that consumes it. If consumers are located in adjacent jurisdictions, then the producing jurisdiction could sell output to them. The producing jurisdiction could benefit from economies of scale in production without having to be part of a larger jurisdiction, that is, without requiring the larger population to be located within its own boundaries. A larger government jurisdiction is not necessarily required to achieve economies of scale because the demand and supply of local government services can be separated; economies of scale can be achieved even in a fragmented system.

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<sup>73</sup> Swianiewicz stresses this point for Central and Eastern European countries where the ability to migrate in response to variation in local taxes is limited. See Swianiewicz, Pawel, *Consolidation or Fragmentation? The Size of Local Governments in Central and Eastern Europe*, Budapest: Open Society Institute, Local Government and Public Service Reform Initiative, 2002, p. 21.

Third, there is some evidence of higher costs from larger government units because of problems delivering services to remote areas within large jurisdictions or because of “bureaucratic congestion”<sup>74</sup>.

### 9.1.3. Externalities

The provision of some services results in externalities (spillovers) whereby the benefits (or costs) of a specific service in one local government jurisdiction spill over on to residents of another jurisdiction. For example, a road in one municipality can provide benefits to residents of neighbouring municipalities who also drive on it. In this case of an external benefit, the local government of the municipality in which the road is located has no incentive to provide services to residents of other jurisdictions and is thus unlikely to take account of the external benefits when deciding how much to invest in the road. The result is an under-supply of the service that generates an external benefit.

One way to remove the resulting inefficiency is to design government jurisdictions large enough so that all of the benefits from a particular public service are enjoyed within the boundaries of that jurisdiction. Such boundary readjustments would “internalise” the externalities (ensuring that those who benefit from the service also pay for it).

As with economies of scale, the optimal sized jurisdiction will be different for different services. Furthermore, the optimal jurisdiction from the point of view of internalising externalities may conflict with the optimal size required to achieve economies of scale. Other ways to address externalities include intergovernmental transfers<sup>75</sup> and voluntary cooperation among municipalities (see below).

### 9.1.4. Equity

When there are many local government jurisdictions, there are likely to be some rich communities and some poor communities. In these circumstances, the rich communities will have a more adequate tax base with which to provide services and may not have very great demands for

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<sup>74</sup> See Boyne, George. 1992, p. 336.

<sup>75</sup> The transfers would have to be conditional, matching transfers. They would be conditional on being spent on the service that generates external benefits. The matching rate would reflect the amount of the externality. In other words, if 30 percent of the benefits spilled over into neighbouring municipalities, the appropriate matching rate would be 30 percent. For more information on intergovernmental transfers, see *Bird and Slack, 1993*.



services (such as education or social services). The poor communities, on the other hand, may require more services but have only a small tax base on which to levy taxes. The more municipalities within a metropolitan area, the greater will be this problem.

One solution is to consolidate the two (or more) areas into one jurisdiction, in effect taxing the rich municipalities and using some of the proceeds to subsidize the poor municipalities. An alternative approach is to shift the redistributive function to a senior level of government or for the senior level of government to provide transfers to municipalities based on need and fiscal capacity.

#### 9.1.5. Access and accountability

This criterion suggests that citizens should have access to local government so that they can influence government policy. This is done through public meetings, hearings, elections, and direct contacts with officials<sup>76</sup>. Smaller government units can provide the average citizen with greater “access” to local decisions: “As the levels of consolidation and concentration in the local government system rise, so the capacity of the public to monitor policy makers’ behavior falls”<sup>77</sup>. The larger the local government, the more likely it is that special interest groups will dominate citizen participation<sup>78</sup>.

Accountability is closely related to access: the more accessible politicians are to their constituents, the more easily they can be held accountable for their actions. A more fragmented system of local governments should increase public scrutiny and accountability and result in lower service costs. Accountability also requires a link between expenditure and revenue decisions: the body making the decisions about how much to spend should be responsible for raising a large portion of the revenues it requires: “the costs of local decisions should be fully borne by those who make them”<sup>79</sup>. If there is no accountability in decision-making, there is no incentive to allocate resources efficiently

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<sup>76</sup> Bish, Robert L., *Local Government Amalgamations. Discredited Nineteenth-Century Ideals Alive in the Twenty-First*, Toronto: C.D. Howe Institute, 2001, p.7.

<sup>77</sup> George Boyne, 1992, p. 338.

<sup>78</sup> See *Bish, Robert L., 2001, p. 7.*

<sup>79</sup> Bird, Richard M. “Setting the Stage: Municipal and Intergovernmental Finance,” in Freire, Mila and Richard Stren (eds) *The Challenge of Urban Government: Policies and Practices*. Washington, D.C.: The World Bank Institute, 2001, p. 117.

making, there is no incentive to allocate resources efficiently across the different services. Local governments must also be accountable to the central government to the extent that they receive transfers from them.

### *9.1.6. Summary of Criteria for Designing Local Government*

The optimal design of government structure depends on which criteria are to be satisfied. Three criteria (economies of scale, externalities, and equity) lend themselves to large government units over an entire metropolitan area; other criteria (subsidiarity and local responsiveness and access and accountability) point towards smaller government units. The challenge is to find the right balance among these criteria in a way that meets the specific challenges faced by each community.

## **9.2. Application of Criteria to Communities of Different Size and Location**

The criteria described in the previous section can be applied to communities of different size and location. The relevance and importance of each of these criteria may be different for different-sized municipalities and for municipalities in different locations, however. In particular, the application of the criteria may be different for large metropolitan areas than for small, remote communities<sup>80</sup>.

Large metropolitan areas or city-regions are different than other urban or rural areas in large part because of the size of and concentration of their population. Not only do large cities and city-regions make expenditures on a wider range of services than do smaller cities and urban areas, expenditures per capita are generally higher in large cities and city-regions<sup>81</sup>. For example, large cities spend more on transportation because they are more likely to have an integrated transit system with subways, light rail lines, and an extensive bus network. Urban densities

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<sup>80</sup> A more detailed discussion of the differences between large metropolitan areas and small remote communities can be found in two papers: Slack, Enid "Fiscal Aspects of Alternative Methods of Governing Large Metropolitan Areas," a report prepared for the World Bank Institute, October 2001 and Slack, Enid and Harry Kitchen, "Providing Public Services in Remote Areas," a report prepared for the World Bank Institute, December 2001.

<sup>81</sup> At the same time, there may be opportunities for lower expenditures per capita for services in large cities to the extent that the local government can take advantage of economies of scale in service provision.

are not sufficient in smaller cities to make public transit economically viable. The higher concentration of people means more specialized police services; higher densities means more specialized training and equipment for fire fighters. Cultural facilities (such as opera houses or art galleries) are only economically viable in large cities because they require a minimum size to make provision possible.

In terms of the criteria for designing government structure, externalities are more relevant in large metropolitan areas than they are in smaller, remote communities. The benefits of roads, water treatment, cultural facilities and other services spill over municipal boundaries within a large metropolitan area. The prevalence of these types of spillovers necessitates some form of metropolitan or regional government to ensure that the appropriate amount of service is being provided and to ensure that those benefiting from the service pay for it. A region-wide authority is also needed to ensure that all municipalities are able to provide a reasonable level of service at a reasonable tax rate, especially those municipalities that have high needs and a small fiscal base. With respect to other criteria, economies of scale are much more likely to be reaped in a large metropolitan area than in a small community.

Governing smaller, remote communities raises different issues than governance of large urban areas because of the small size of the population, the lack of concentration of population, and the high cost of living. These characteristics mean that expenditures per capita are often higher in smaller areas than in urban areas and they are particularly higher in remote communities. At the same time, the fiscal base tends to be smaller because levels of employment and income are lower.

On the expenditure side, low population density often means very high per capita expenditures. For example, local governments in small, remote communities are unable to take advantage of economies of scale in administration<sup>82</sup>. Expenditures on roads, water and sewers are often higher because of the harsh climatic conditions and terrain. Expenditures on recreation and culture are considerably higher on a per

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<sup>82</sup> Swianiewicz provides an example of basic administrative services in Bulgaria. He argues that, although Bulgaria has fairly large local government units, travelling between settlement units to take advantage of these services is extremely difficult. See Swianiewicz, *Supra*, 2002, p. 19.

capita basis because each municipality has a community centre and recreational programs even where the population is limited. Fire expenditures tend to be lower, however, because fire protection equipment is much less sophisticated than in more urbanized areas (no high rise buildings and a relatively small geographical area to cover). The response time cannot compare with that in urban areas because of the distances and there are no externalities because the properties are so far apart.

On the revenue side, small rural and remote areas do not generally have sufficient capacity to finance local expenditures. In theory, the sources of revenue available to local governments in remote and rural areas are the same as local governments elsewhere. In reality, however, the characteristics of the population and the tax base in remote areas restrict the use of many of these revenue sources.

Among the criteria for designing government structure, externalities are less likely to be an important consideration for remote areas where municipalities are isolated from each other. Distances are such that the benefits or costs of services provided by one municipality are unlikely to spill over into adjacent municipalities. Similarly, distances between municipalities and their isolation from each other prevents them from benefiting from economies of scale in the provision of services whose costs per unit decline as the number of residents served increases.

In terms of access and accountability, the lack of mobility for some segments of the population in remote communities brings into question the role of local government. If residents are not mobile, then they are unlikely to respond to taxes and expenditures by moving to other communities. To the extent that the efficiency of local government relies on it being responsive to local citizens, its role in remote areas is more complicated than in urban areas because less proximity means less access to the local government<sup>83</sup>.

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<sup>83</sup> See Litvack, Jennie, Junaid Ahmad and Richard Bird, *Rethinking Decentralization in Developing Countries*. Washington, D.C.: The World Bank 1998, p. 2 for a discussion of the limitations of “voice” and “exit” in smaller municipalities and rural areas in developing countries where mobility is limited.

### 9.3. Models of Government Structure

This section reviews four models of government structure – two-tier governments, one-tier governments, voluntary cooperation (including inter-municipal agreements), and special purpose districts – and presents the advantages and disadvantages of each. It also considers the role of senior levels of government in the provision of services.

Once again, it should be noted that the structure that may work best in large metropolitan or urbanized areas where there are a number of contiguous municipalities (cities, towns, villages, and townships that are adjacent to each other) providing a wide range of services will likely differ from the structure that will work best in municipalities in remote areas which are far apart and deliver few services.

#### 9.3.1. Two-Tier Model

The two-tier model consists of an upper-tier governing body (usually region, district, metropolitan area) encompassing a fairly large geographic area and lower-tier or area municipalities (including cities, towns, villages, townships etc.). The upper tier provides region-wide services characterized by economies of scale and externalities whereas the lower tiers are responsible for services of a local nature. In this way, two-tier models help to resolve the conflict among the various criteria for designing government structure – economies of scale, externalities, and redistribution on the one hand and access and accountability on the other<sup>84</sup>.

Redistribution throughout a city-region is achieved at the upper-tier level through a combination of tax and spending policies. On the tax side, tax rates are generally levied at uniform rates across the region and the contribution of each lower-tier municipality to the upper-tier municipality depends on the size of its tax base. The larger the tax base in any one municipality, the larger is its contribution to the upper-tier government.

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<sup>84</sup> See Max Barlow, “Centralization and Decentralization in the Governing of Cities and Metropolitan Regions.” In Bennett, Robert J. (ed.) *Local Government and Market Decentralization: Experiences in Industrialized, Developing, and Former Eastern Bloc Countries*, Tokyo: United Nations University Press, 1994 for a discussion of centralization and decentralization arguments in metropolitan areas.

On the spending side, the upper-tier government makes expenditures on region-wide services. These expenditures benefit the entire city-region and are not necessarily distributed among the lower-tier municipalities in the same way as the tax revenues are collected. The result is that a uniform tax (property, income, sales, etc.) at the upper-tier level, combined with region-wide expenditures, serves to redistribute resources from the relatively large tax base municipalities to the relatively small tax base municipalities. There will still be differentiation in service levels and tax rates for services provided by lower-tier municipalities.

With two-tier governments, it is necessary to allocate functions among the tiers. To do this, the criteria for governing structure can be applied. The upper tier should be responsible for services that provide region-wide benefits, generate externalities, entail some redistribution, and display economies of scale. Services that provide local benefits should be the responsibility of the lower tier. *Table 9.1* applies the criteria above to the various public services provided at the local level to determine the appropriate level of government to provide them.

Two-tier systems have potentially important advantages in terms of accountability, efficiency, and local responsiveness. Critics of the two-tier model, however, argue that costs are higher because of waste and duplication in the provision of services by two levels of government. Furthermore, two-tier levels of government are less transparent and more confusing to taxpayers who cannot figure out who is responsible for what services. Finally, two municipal councils are said to lead to considerable “wrangling, inefficient decision-making, and delays in implementing policies”<sup>85</sup>.

Most of the literature on two-tier systems applies to large metropolitan areas. As noted earlier, in remote areas where municipalities are isolated from each other, distances are such that benefits or costs of services provided by one municipality are unlikely to spill over into adjacent municipalities. Similarly, distances between municipalities and their isolation from each other prevents them from benefiting from economies of scale in the provision of services whose costs per unit decline as the number of residents served increases. Hence, the ra-

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<sup>85</sup> Kitchen, Harry, M. 2001. *Issues in Municipal Finance: Spending, Revenues, Governance, and Administration*. Toronto: Canadian Tax Foundation, 2002, p. 312.

tionale for a two-tier structure at the municipal level in remote areas is somewhat less compelling than it is for larger metropolitan areas.

Table 9.1

**Allocation of Expenditure Responsibilities  
in a Two-Tier Model**

Function	Upper Tier	Lower Tier	Justification
Social services:			
Welfare assistance	X		Income redistribution; externalities
Child care services	X		Income redistribution; externalities
Social housing	X		Income redistribution; economies of scale; externalities
Public health	X		Income redistribution; economies of scale; externalities
Land ambulance	X		Economies of scale; externalities
Roads and bridges	X	X	Local versus regional roads
Public transit	X		Externalities; economies of scale
Street lighting		X	No externalities
Sidewalks		X	No externalities
Water system	X		Economies of scale
Sewer system	X		Economies of scale
Garbage collection	X		Economies of scale; externalities
Garbage disposal	X		Economies of scale; externalities
Police protection	X		Externalities; economies of scale
Fire suppression		X	Local responsiveness; scale economies for specialized services
Fire prevention/training	X		Economies of scale
Local land use planning		X	Local access, responsiveness
Regional land use planning	X		Externalities
Economic development	X		Externalities
Parks and recreation		X	Local responsiveness
Libraries		X	Local responsiveness

There are a number of examples of two-tier systems at the local level around the world, notably Toronto, Canada (which was a two-tier system from 1954 to 1998) and London, England (which recently returned to a two-tier system). These two models are described in detail in section four below.

There are also examples of two-tier governments in France. Paris, with a population of 2.2 million people, is both a commune (a designa-

tion given to every city, town or village in France) and a departement (one of 96 administrative units in the country). It is divided into 20 arrondissements (districts) each with an elected mayor and council. In addition, residents elect a 163-member Council of Paris. The Council chooses the mayor of Paris who is assisted by several deputy mayors. The Council of Paris meets as General Council when dealing with the affairs of the departement and as Municipal Council when dealing with the affairs of the commune.

Marseilles moved from a model of voluntary cooperation to two-tier government in 2000<sup>86</sup>. The three municipalities of Marseilles, Marignane, and Saint Victoret created a public corporation (the *Communaute de Communes Marseilles Provence Metropole*) in 1992. At the time, it focused on a few minor projects such as roads and traffic<sup>87</sup>. In the following year, thirteen other cities joined this consortium of municipalities and four more joined in 1998–99. The metropolitan region of Marseilles levied a uniform business tax at a city-wide level.

In 2000, the *Communaute Urbaine* of Marseilles (a metropolitan organization comprising eighteen cities and one million people) was created. A common regional body comprises mayors and councillors of the constituent municipalities and is responsible for regional economic development, transportation, land use and housing, crime prevention, waste disposal and environmental policies. The localities within the *Communaute* have adopted tax-sharing agreements whereby the *Communaute Urbaine* collects a common tax on business, thereby eliminating tax competition among the local municipalities.

### 9.3.2. One-Tier Model

Under the one-tier model of urban governance, a single local government is responsible for providing the full range of local services and has a geographic boundary that covers the entire urban area. Large single-tier governments have generally been formed by *amalgamation* (merger of two or more lower-tier municipalities within an existing region) or by *annexation* (appropriation of a portion of a municipality by an adjacent municipality). Since there is only one level of government

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<sup>86</sup> Klink, Jeroen, "Recent Perspectives on Metropolitan Organization, Functions and Governance," A Study presented to the IADB, October, 2002, pp. 14–15.

<sup>87</sup> Savitch and Kantor, 2002, p. 332.



providing all municipal services, there is no need to allocate expenditures among levels of local government (as in the two-tier model). There is also only one political body to make taxing and spending decisions. One-tier governments could provide a wide range of services. These could be financed from a variety of user fees and tax sources that would be levied across the metropolitan area in the same way that the upper tier municipality would finance services in the two-tier model.

One-tier cities can mean that uniform services are provided throughout the metropolitan area but this is not necessary. Particularly where the one-tier municipality has been created from the amalgamation of several municipalities, there is the option of maintaining differential services and service levels that existed in different parts of the city-region prior to the creation of one tier. For example, rural residents will probably not necessarily receive all of the services available to urban residents.

For services financed by user fees, those who benefit from a service pay directly for it. Where taxes are used to finance services, special area rating can be used for those services where beneficiaries are restricted to specific areas. For example, if garbage collection is only provided in the urban parts of the municipality, then a special area rate for garbage would be levied on urban residents. All residents would pay the same general tax rate; those in urban areas would pay the general rate and the special area rate.

In short, since services are not necessarily standardized across the new municipality, tax rates should also not be standardized. There is an opposing argument, however, that one of the reasons for amalgamation is to create one jurisdiction that encompasses the entire city-region and that differences in service delivery and tax rates should not be maintained past a short transition period.

The main advantages that have been cited for one-tier governments include: better service coordination, clearer accountability, more streamlined decision-making, and greater efficiency<sup>88</sup>. Furthermore, there is funding fairness in the provision of services because there is a wider tax base for sharing the costs of services that benefit taxpayers across the region. The larger taxable capacity of the one-tier govern-

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<sup>88</sup> *Boyne, George. 1992, p. 333.*

ment increases its ability to borrow and to recover capital and operating costs from user fees<sup>89</sup>.

There is little dispute over the advantages of better service coordination, streamlined decision-making, and funding fairness. From an efficiency perspective, municipal amalgamations have the potential to internalise externalities. For example, rural residents outside of the original municipal boundary would now pay for urban services that they use<sup>90</sup>. Large one-tier governments can also take advantage of economies of scale in service provision.

There is some debate, however, over the success of a large one-tier government at achieving accountability and efficiency (in terms of cost savings). In terms of accountability, it has been argued that a large-scale one-tier government reduces access and accountability because the jurisdiction becomes too large and bureaucratic. In some cases, community committees are established to address local issues or satellite offices are distributed across the municipality where people can pay tax bills, apply for building permits, etc. These committees and satellite offices likely increase accessibility but it is less clear how they impact on accountability. Furthermore, they remove any potential cost savings that might result from a larger government unit.

In terms of efficiency, evidence from municipal amalgamations suggests that cost savings are elusive<sup>91</sup>. There tends to be a reduction in duplication when several municipalities are amalgamated – in particular, the number of politicians and bureaucrats is reduced. There is also a tendency for expenditure increases, however, when municipalities with different service levels and different wage scales merge.

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<sup>89</sup> Bahl, Roy and Johannes Linn. 1992. *Urban Public Finance in Developing Countries*. New York: Oxford University Press, p. 415.

<sup>90</sup> Municipal restructuring is only the first step in linking taxes to service benefits by ensuring that the beneficiaries are located within the jurisdiction providing the services. The second step is to identify the benefits received by residents and to tax them accordingly. For example, while it is fair to charge rural residents for their use of urban services such as recreation facilities and libraries, it is not fair to charge them for garbage collection if they do not receive it. See Vojnovic, Igor, "Municipal Consolidation, Regional Planning and Fiscal Accountability: The Recent Experience in Two Maritime Provinces," *Canadian Journal of Regional Science*, Vol. XXIII, No.1, 2000, p. 54.

<sup>91</sup> Slack, Enid. 2000. "A Preliminary Assessment of the New City of Toronto." *Canadian Journal of Regional Science*, Vol. XXIII, No.1, p. 24.

As an example, when the fire departments of several municipalities are amalgamated, it is possible to eliminate a number of fire chiefs (and maybe some deputy fire chiefs as well). There will be cost savings from eliminating these positions. However, there will be, thousands of fire fighters in the newly amalgamated municipality who will now all be doing the same job, working for the same employer – the newly created city – and they will want to be paid comparable salaries and benefits. There is thus a tendency for salaries and benefits to equalize up to the highest expenditure municipality. Although there are potential cost savings from amalgamation, the harmonization of wages and salaries will likely outweigh the savings.

Similarly, amalgamations result in the harmonization of service levels across the new municipality, and again, these will equalize up to the highest service level enjoyed before the amalgamation<sup>92</sup>. The harmonization of service levels will also increase costs. These higher costs are not necessarily a bad thing. If some municipalities cannot afford to provide an adequate level of service because they do not have adequate resources, amalgamation allows them to provide a comparable level of service as other municipalities in the region. Such an amalgamation increases equity within the region.

A review of the empirical evidence in the U.S. on fragmented versus consolidated local governments concludes that lower spending is a feature of fragmented local government systems; consolidated structures are associated with higher spending<sup>93</sup>. One of the reasons is that amalgamation tends to reduce competition between municipalities because there is less incentive to be concerned with efficiency and less incentive to be responsive to local needs. The lack of competition reduces efficiency in the delivery of services and results in higher costs.

In remote areas, there may be advantages from small annexations in cases where properties are located just outside municipal boundaries and residents of these neighbouring communities are using services within the municipality without paying for them. There is less justifica-

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<sup>92</sup> Slack, Enid. 2000, p. 24.

<sup>93</sup> Boyne, George pp. 344–6. Also, Sancton reviewed municipal consolidations in three Canadian provinces and concluded that the evidence does not support the view that consolidations result in cost savings. See Sancton, Andrew. 1996. "Reducing Costs by Consolidating Municipalities: New Brunswick, Nova Scotia, and Ontario". *Canadian Public Administration*. Volume 39.

justification, however, for large-scale amalgamations of several small, isolated communities since the externalities are unlikely to extend that far and there are no economies of scale to be gained. The combination of higher per unit costs and lower fiscal capacity, however, raises questions about how to provide services in a less costly fashion within a single-tier structure and whether they should be funded differently than larger metropolitan areas. Some of these options are considered below under the role of senior levels of government.

One-tier governments are common in the United States which, as one author notes, is characterized by fragmentation, decentralization, and income polarization<sup>94</sup>. Houston, Texas, for example, has been described as a model of “fragmented single tiers”<sup>95</sup>. Houston is a city surrounded by 790 governments and special districts whose jurisdictions frequently overlap and who frequently compete for industry. The state permits cities to annex unincorporated areas and Houston has taken advantage of this legislation to blunt some of the competition. The city now covers over 600 square miles.

A number of large cities in Canada are also one-tier. These include, for example, Ontario cities such as Toronto (discussed in more detail in section IV below), Ottawa, Hamilton, and Sudbury, all of which were created through the amalgamation of upper and lower tier municipalities. One-tier governments have also been created in cities in other Canadian provinces:

- In Nova Scotia, the Halifax Regional Municipality (HRM) was created through the amalgamation of the Cities of Halifax and Dartmouth, the Town of Bedford, and Halifax County in 1996. Because services are provided at different levels in different parts of the new municipality (especially between the urban and rural areas), there are base property tax rates (urban, suburban, and rural), two additional customized rates for the two former cities, and over 60 area rates in the new municipality<sup>96</sup>.

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<sup>94</sup> Orfield, Myron, *Metropolitics: A Regional Agenda for Community and Stability*, Washington, D.C.: Brookings Institution Press and Cambridge, Mass.: The Lincoln Institute of Land Policy, 1997.

<sup>95</sup> *Savitch and Kantor, 2002, p. 69.*

<sup>96</sup> The urban suburban rates are differentiated by the lack of public transit, sidewalks, and fire hydrants in the suburban parts of the municipality. Rural rates do not include services such as public transit, streetlights, sidewalks, crosswalk guards, and recreation services.

- In Manitoba, the City of Winnipeg and its twelve area municipalities were amalgamated to form a single city in 1971. Originally, residents' advisory groups (RAGs) were part of the City but it was felt that these did not improve responsiveness or accountability. These groups were subsequently abolished<sup>97</sup>.
- In Quebec, the City of Montreal with a population of 1 million and 27 other municipalities on the island of Montreal (with a total population of 800,000) was merged on January 1, 2002. The new city is divided into 27 boroughs, each responsible for local services such as garbage collection, swimming pools, snow clearing, and libraries. Nine of the boroughs are located in the central city where none existed previously. Thus, although residents of the ex-suburbs lost control over some municipal services, residents of the former City of Montreal gained more autonomy.

### 9.3.3. Voluntary Cooperation

Voluntary cooperation has been described as “minimal” government restructuring in which there is an “area-wide body based on voluntary cooperation between existing units of local government in the agglomeration with no permanent, independent institutional status”<sup>98</sup>. These are very common in the U.S. and France. Voluntary cooperation is popular, in part, because the area-wide bodies are easy to create politically and can also be disbanded easily. Voluntary cooperation is also common where local autonomy is highly valued: municipalities can retain independence while reaping the benefits of cooperation.

The voluntary model is included under governance of metropolitan regions even though it does not include an elected, area-wide govern-

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The 60 different area rates in the rural areas reflect the different standards of service in the various districts in the new municipality. For a more detailed description of the Halifax amalgamation, see Vojnovic, 2000. *Supra*, pp. 64–70.

<sup>97</sup> See Smith, Patrick, J., “Governing Metropolitan Change: Public Policy and Governance in Canada’s City Regions,” in Lightbody, James (ed.) *Canadian Metropolitcs: Governing Our Cities*, Toronto: Copp Clark Ltd., 1995, p. 168 and Sancton, Andrew. 2000. *Merger Mania: An Assault on Local Government*. Westmount, Quebec: Price-Patterson Ltd., pp. 62–3.

<sup>98</sup> L.J. Sharpe, “The Future of Metropolitan Government,” in Sharpe, L.J. (ed.) *The Government of World Cities: The Future of the Metro Model*, Chichester: John Wiley and Sons, 1995, p. 12.

ment. It is included because it recognizes the inter-relationship of cities within the region with some form of area-wide arrangement.

Cooperation can take different including consortia, communities of communes, urban communities (France), joint inter-municipal authorities (Spain and Belgium), public bodies, joint agency and core cities (the Netherlands)<sup>99</sup>. These forms of cooperation include administrative and political integration in that there is some form of representation on the boards from the member local governments. These organizations can levy taxes or collect contributions from the municipalities or they can levy user fees to pay for services.

Voluntary cooperation is an alternative way of providing services across a region without resorting to amalgamation. Municipalities can retain their autonomy with respect to expenditure and tax decisions but, at the same time, achieve economies of scale in service delivery and address externalities associated with service provision<sup>100</sup>. There can be problems of accountability, however, when services are provided by another jurisdiction. Redistribution throughout the metropolitan area is not automatic in a system of voluntary cooperation but could be agreed upon by the municipalities involved.

Notwithstanding the weakness of voluntary cooperation, this form of local governance has steadily grown around the world. One explanation is that voluntarism “is incremental, non-threatening, and capable of growing by trial and error”<sup>101</sup>. The voluntary model can work well when policy objectives are shared by all policy-makers in the various local governments. Thus, there would be no need for any additional institutional arrangements. It may not work so well, however, when there are divergent objectives. Cooperation usually involves bargaining and some municipalities may not have anything to bargain with. The problems faced by metropolitan areas are significant – global competition, fiscal disparities, urban sprawl – and the solutions may require them to rely on a structure that has a permanent institutional status.

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<sup>99</sup> Hermann, Zoltan, M. Tamas Horvath, Gabor Peteri, and Gabor Ungvarim *Allocation of Local Government Functions: Criteria and Conditions – Analysis and Policy Proposals for Hungary*, Washington, D.C.: The Fiscal Decentralization Initiative for Central and Eastern Europe, 1999, pp. 29–30.

<sup>100</sup> Sharpe, L.J., 1995, p. 13.

<sup>101</sup> Savitch and Kantor, 2002, p. 329.

Although voluntary cooperation is used by some local governments in parts of Central and Eastern Europe, it is not widespread. Where local governments are too small to provide services efficiently and effectively, they sometimes cooperate with neighbouring municipalities. For example, the central government in Poland and Bulgaria have encouraged voluntary cooperation for solid waste disposal.<sup>102</sup> There are also examples of cooperation in local economic development and environmental protection. Typical areas for inter-municipal cooperation in Slovakia include solid waste disposal, sewage treatment, environmental protection, economic development, infrastructure projects, education, and social welfare<sup>103</sup>.

Inter-municipal agreements are formal or informal agreements between municipalities to provide services. They are a type of voluntary cooperation but are less structured in that an official area-wide body is not generally set up to oversee the arrangements. An example of an inter-municipal agreement is the contract services plan in Los Angeles where Los Angeles County provides some services on behalf of municipalities in the Los Angeles metropolitan area on a contract basis. A city-county link occurs in other U.S. jurisdictions as well<sup>104</sup>. In the Czech Republic, one municipality may deliver a service to its own residents as well as to those of neighbouring villages. Those villages do not contribute to the costs nor do they have a say in how the service is delivered.

These types of agreements have generally been effective for services such as fire fighting and emergency dispatch, maintenance of boundary roads, purchasing in bulk, and issuing debentures. Agreements are generally entered into as a way of reducing costs or to set out joint obligations for different municipalities.

Although inter-municipal agreements are successful in achieving coordination and efficiencies for specific services, they are not suitable for achieving region-wide coordination. Furthermore, inter-municipal agreements provide no accountability except through the contract or agreement. If something goes wrong, it is difficult for citizens to know where to complain. Is it to their local government or the local government that has been contracted to provide the service? Inter-municipal

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<sup>102</sup> *Swianiewicz, Pawel, 2002, p. 312.*

<sup>103</sup> *Ibid, p. 313.*

<sup>104</sup> *See Sharpe, L.J. 1995, p. 13.*

agreements also increase the likelihood of inter-municipal litigation and conflicts<sup>105</sup>. Inter-municipal agreements have been described as second-best solutions to reorganization that can lead to “an impenetrable jungle of *ad hoc* commissions and complex arrangements that even the most conscientious municipal voter will never understand”<sup>106</sup>.

Although these agreements have been used for a long time in many smaller contiguous municipalities, they are less likely to work or be appropriate where municipalities (such as those in remote areas) are isolated from each other. The reason is that a municipality is unlikely to benefit from buying services from other municipalities where distances between them are large.

#### 9.3.4. *Special Purpose Districts*

Special purpose districts to deliver services that spill over municipal boundaries provide another alternative to altering municipal boundaries. Single-purpose special districts provide similar municipal services for several municipalities or manage regional services with externalities. This form of cooperation among municipalities for region-wide services is used in countries where there is a history of strong and autonomous local governments. In the U.S., for example, one third of local governments are special districts or school districts providing education, transportation, water and waste management, economic development, and other services. Joint boards of the special districts are responsible for the management of these services as well as taxing, price setting, and other policy-making. These districts are indirectly controlled by the individual municipal councils.

One of the advantages of special purpose districts is that each service spillover can be addressed on an individual basis. Since it is unlikely that the spillover boundaries are the same for each service, separate districts could be established such as a region-wide transit district or hospital district. Other advantages include<sup>107</sup>: the delivery of services by professionals with decision-making somewhat removed from political influence; services can be provided using more profes-

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<sup>105</sup> GTA Task Force. *Greater Toronto*, 1996, p. 163.

<sup>106</sup> Andrew Sancton, “Local Government Reorganization in Canada Since 1975,” Toronto: Intergovernmental Committee on Urban and Regional Research, 1993. pp. 33–34.

<sup>107</sup> *Bahl, Roy and Johannes Linn. 1992, p. 407.*



sional expertise than may be available to the municipal government; and dedicated revenues from user fees could be used to finance capital expenditures.

Several problems with special purpose bodies have been identified. First, each body has responsibility for a single service and is not required to make the tradeoffs between, for example, expenditures on transit and expenditures on water and sewers. Second, the proliferation of decision-making bodies has “created a diffuseness of government organizations that is difficult for citizens to understand”<sup>108</sup>. There is no citizen control and confused accountability. Third, there is no direct link between the expenditure decisions made by the special purpose agencies and the local council which collects taxes to fund them. The absence of a link between expenditures and revenues reduces accountability. Fourth, where accountability is lacking, there is no incentive to be efficient. Fifth, when there is a large number of independent special purpose bodies, it is difficult to coordinate interrelated activities.

Three ways have been suggested to address the problems of coordination<sup>109</sup>. The first is to have overlapping membership so that some of the same people are on a number of district boards. The second is to encourage districts with multi-functions instead of single-purpose districts. The third is to control the operations of the districts so that they remain separate authorities but are still subject to political considerations in the decision-making process.

There is a proliferation of special purpose districts in the United Kingdom. As part of the process of decentralization, and in order to make the public sector more efficient, the UK central government has for some time turned over the delivery of certain public functions to non-governmental organizations. These have become widely known as quasi- autonomous non-government organizations, or QUANGOs, or more recently they have simply been called extra-government organizations or EGOs. There are an estimated 5,500 of these organizations in the UK, of which over 4,700 operate at the local level,

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<sup>108</sup> Harry Kitchen, “Efficient Delivery of Local Government Services,” Government and Competitiveness Project, School of Policy Studies, Queen’s University, 1993.

<sup>109</sup> *Bahl, Roy and Johannes Linn. 1992, p. 419.*

the UK, of which over 4,700 operate at the local level, and they are said to manage nearly one-third of all government expenditures<sup>110</sup>.

### 9.3.5. Role for Senior Levels of Government

Another option to meet the criteria for local government structure is for the national or provincial/state governments to take over the provision of local services. For example, a senior level of government could take over functions such as regional planning and regional economic development. They could also facilitate inter-municipal agreements to improve the coordination of services such as water, waste management, and transit. This coordination function could be done through a national or provincial/state ministry or department.

This option may also have merit for smaller communities that are typically unable to take advantage of economies of scale in service provision and that have a smaller and less diversified tax base. Senior governments can also ensure that a uniform, minimum standard of service is provided across their jurisdictions.

Although provincial/state or national takeover of regional services may effectively address the provision of services that exhibit externalities, it violates the principle of subsidiarity which suggests that services are more efficiently and effectively delivered by the level of government closest to citizens. Based on this principle, regional coordination would be more effective and more accountable than provincial/state or national coordination.

The provision of services by a senior level of government also raises concerns about local responsiveness. It may be less appropriate for a senior level of government to provide services because it is further removed from local residents, making it difficult to determine the quality and quantity of output to provide in each municipality. Senior levels of government are likely to be less responsive and less accountable to local residents than a local government.

Another option is for senior levels of government to provide grant assistance to small communities and have the municipalities deliver and fund local services themselves. This option is often raised in the context of smaller communities. If service provision is considerably more ex-

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<sup>110</sup> See Amos, F.J.C., "Urban Management and Factional Government," *Progress in Planning*, 46 (3), 1996.

pensive and considerably higher levels of financial assistance are required, there is a question about the use of senior government resources to foster communities artificially in remote areas<sup>111</sup>. An important issue of debate is whether communities that cannot survive in the absence of disproportionate senior government funding (when compared to other urban areas) should exist at all.

The argument against subsidizing remote areas is based largely on efficiency criteria. Reliance on grant funding reduces the incentive for residents of these municipalities to leave and move to areas where there are greater employment and educational opportunities. If efficiency is an important objective, then encouraging mobility of labour out of remote areas may be more appropriate than providing subsidies which encourage them to stay.

## **9.4. Case Studies**

The previous section described a number of different models of government structure and provided some examples from different countries. This section provides a more in-depth description of the different types of government structure in four large cities (two in Canada, one in the U.K. and one in the U.S.) and in one area of smaller, remote communities (in Canada). These case studies are illustrative of the different types of local government structures that have been used.

### *9.4.1. Toronto: One-Tier to Two-Tier to One-Tier*

Toronto has been widely studied because of its successful experience with two-tier government. Although studies confirm that this early experiment with two-tier government was an important model of local government structure, it has subsequently been disbanded and Toronto is now a one-tier city.

Metropolitan Toronto was created by provincial legislation on January 1, 1954. It was a two-tier government structure with a metropolitan tier that encompassed thirteen lower-tier municipalities<sup>112</sup>. The two-tier

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<sup>111</sup> The issue is not whether taxpayers in remote communities should be excluded from paying for municipal services. Clearly, they should pay at least some of the costs of services if accountability, fairness, and efficiency are to be achieved.

<sup>112</sup> In 1967, the number of municipalities in Metropolitan Toronto was reduced from 13 to 6 through amalgamations.

government structure was created for three reasons. First, the creation of a metropolitan level of government allowed for the relative wealth of the central city to be used to pay for services in the suburbs. By the mid-50's, the central city had no vacant land for development. The suburban municipalities did not have sufficient resources to provide the infrastructure required for new development – educational facilities, roads, water, and other services. The creation of a metropolitan tier of government allowed the wealth of the central city (measured by the size of its property tax base) to be redistributed to the suburbs to provide needed services.

Second, the metropolitan government could coordinate land use planning and transportation across the city-region. Fragmented local governments had meant that services such as transportation and land use planning were not coordinated across the city-region. Since the benefits of these services spilled over into other jurisdictions, there was increasingly a need for a governing body with wider jurisdiction to coordinate the provision of these services.

Third, at the same time that the metropolitan government could be used to address issues of redistribution and spillovers, the lower tiers could provide the local services that they could afford. These lower tiers could be more responsive to local needs than could a large metropolitan government that provided uniform services across a broader area. Smaller governments also provided easier access for residents.

In the two-tier government structure in Metro Toronto, both levels of government were involved in providing services<sup>113</sup>. The metropolitan level was responsible for borrowing, transit, police services, social assistance, traffic control and operations, licensing, conservation, waste disposal, and ambulance services. Lower-tier governments were assigned responsibility for fire protection, garbage collection, licensing and inspection, local distribution of hydro-electric power, public health,

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<sup>113</sup> Municipal services at the local and metropolitan levels were provided by municipal departments or by municipal agencies, boards and commissions. Agencies, boards, and commissions operate the transit system, oversee the police, deliver electricity, run the public library system, operate public housing, and perform other functions. These bodies were created to deliver a specific service on behalf of the municipality. They have some autonomy from the municipality because of their basis in provincial or municipal legislation. In all cases, however, they retain a link to the municipal council through policy relationships, funding arrangements and/or municipal appointments to their boards.

recreation and community services, and tax collection. Both tiers shared responsibility for parks, planning, roads and traffic control, sewage disposal, and water supply.

Redistribution within the metropolitan area was achieved through a combination of tax and spending policies. On the tax side, the main source of local revenue to the metropolitan government was the property tax levied on residential, commercial, and industrial properties<sup>114</sup>. Since it was levied at a uniform rate across the metropolitan area (the rate was different on each class of property but the same across the metropolitan area), the contribution of each municipality to the metropolitan government depended on the size of its property tax base. About one half of the property tax for municipal purposes was returned to the metropolitan government; the other half was kept at the local level<sup>115</sup>. This means that about one half of municipal property tax revenues were redistributed throughout the metropolitan area.

On the spending side, the metropolitan government made expenditures on region-wide services as listed above. A uniform property tax at the metropolitan level, combined with metropolitan-wide expenditures, redistributed resources from the relatively rich municipalities to the relatively poor municipalities.

Early reviews of the two-tier government in Toronto applauded its success at meeting its intended objectives: spillovers of benefits from transportation and planning were contained within the metropolitan area; redistribution from the central city to the suburbs allowed the latter to provide needed infrastructure; and lower-tier municipalities retained the ability to differentiate local services. More recently, however, concerns were expressed about the ability of the Metro government to address issues arising from growth outside its borders. Concerns were also expressed about overlapping responsibilities, confusion, and uncertain accountability in a two-tier structure.

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<sup>114</sup> The revenue sources for both levels of government were similar: property taxes, provincial grants, user fees, and other miscellaneous revenues.

<sup>115</sup> Property taxes are used for municipal and education purposes. About 60 percent of total property tax revenues in the metropolitan area were used for education which was historically provided by local school boards. One education tax rate was levied across the metropolitan area. The remaining 40 percent was split roughly equally between the metropolitan government and the lower-tier municipalities.

On January 1, 1998, the new City of Toronto came into being by replacing the former metropolitan level of government and its constituent lower-tier municipalities (Toronto, Etobicoke, North York, Scarborough, York, and East York) with a single-tier city<sup>116</sup>. This restructuring was not initiated by local initiative but by the provincial government through the passage of Bill 103, the *City of Toronto Act, 1996*. Indeed, opposition to the proposed amalgamation came from many different quarters, centred on the loss of local identity and reduced access to local government.

None of the studies of governance in the Greater Toronto Area (GTA) commissioned by the provincial government in recent years emphasized problems within Metropolitan Toronto or the need to create a megacity. Rather, these studies identified problems with the coordination of transportation, planning, water provision, and waste management among the regions within the GTA and focussed on the need for a GTA governing body to address these service coordination issues.

The stated rationale for creating a megacity was to achieve cost savings by avoiding waste and duplication. To the extent that two levels of government were involved in the provision of services, there was the potential for confusion and a lack of accountability but, as noted above, it was not clear that the new city would result in cost savings. Other reasons for the creation of the new city could have included: the ability to coordinate services across municipal boundaries, the need to spread the costs of local government in general and the costs of downloading in particular across a broader tax base, and equalization of service levels. These were not mentioned at the time of the implementation of the megacity, however.

In terms of redistribution, the new City levies property taxes city-wide to fund city-wide services. The rates of property tax on residential, commercial, and industrial properties are uniform across the new City. In those former municipalities that had a low tax base and high tax rate, a uniform rate across the new City has resulted in a property

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<sup>116</sup> The new City of Toronto is contained within the Greater Toronto Area (GTA) which is comprised of the City of Toronto plus the two-tier regions of Durham, Halton, Peel, and York. The population of Toronto in 1999 was 2,385,421. Populations of the other regions of the GTA are: Durham B 452,608; Halton B 329,613; Peel B 869,219; and York B 618,497. These estimates, which were taken from the 1999 Ontario Municipal Directory, show that the population of Toronto represents about half of the population of the GTA.

tax reduction. Similarly, for those municipalities with a large tax base and a low tax rate, a uniform rate has resulted in a tax increase. This result is similar to the kind of redistribution that occurred with the metropolitan portion of the property tax under the two-tier system. Now, however, 100 percent of the municipal property tax is pooled instead of only 50 percent.

Following the amalgamation of Toronto, the Province also established the Greater Toronto Services Board (GTSB)<sup>117</sup>. The GTSB was given no legislative authority except to oversee regional transit. It was not designed to be a level of government nor was it given direct taxing authority. The GTSB was comprised of elected officials from each of the municipalities in the GTA. It has since been disbanded, however, with the important function of regional transit being taken over by the provincial government.

Within the GTA, the costs of social services and social housing are pooled across the city-region through an equalization formula which measures the capacity of each municipality to contribute to these costs. Pooling means that the entire city-region is sharing the costs of these region-wide services. Each municipality that is part of the pooling, however, does not have a say over how the other municipalities spend their money on these services. Furthermore, the contributions of each municipality is uncertain from year to year because the service costs in other municipalities are beyond the control of any individual municipality.

The major concern about governance in the GTA has been coordination of service delivery across the region. Neither the creation of the new City of Toronto nor the former GTSB has adequately addressed these fundamental regional problems. It is probably too early to evaluate the megacity in Toronto. Nonetheless, some have argued that it is both too small and too big. It is too small to address region-wide spillovers related to transportation and planning and it is too big to be locally responsive and accessible<sup>118</sup>. Amalgamation has probably not resulted in cost savings but it has resulted in a fairer sharing of the tax base and equalizing up of local services so that everyone can enjoy a similar level of services across the city-region.

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<sup>117</sup> The *Greater Toronto Services Board Act, 1998* set out the structure and responsibilities of the Greater Toronto Services Board (GTSB) and the Greater Toronto Transit Authority.

<sup>118</sup> *Slack, Enid, 2000, p. 28.*

#### 9.4.2. *The Greater Vancouver Regional District: Voluntary Cooperation within a Two-Tier Structure*

The Greater Vancouver Regional District (GVRD) is a model of voluntary cooperation within a two-tier structure. There are just over 1.8 million people in the GVRD. It comprises 18 municipalities as full members and three unincorporated areas.

Prior to 1965, inter-municipal services in metropolitan Vancouver were largely handled by special-purpose bodies such as the Joint Sewerage and Drainage Board, a Greater Vancouver Water District, various health and hospital boards, a Lower Mainland Regional Planning Board, and an Industrial Development Commission of Greater Vancouver<sup>119</sup>. These single-purpose bodies were completely voluntary.

The Greater Vancouver Regional District was created in 1967 as part of a system of regional governments being created by the provincial government in the province of British Columbia at that time. The newly created GVRD took over the functions of the special-purpose bodies. It was originally responsible for hospitals and planning but has grown to include the following functions: borrowing for municipalities, air pollution control, parks, solid waste disposal, public housing, collective labour relations, and public transit (in 1999). The GVRD was created to increase municipal cooperation but not to introduce a new level of government.

The GVRD differs from regional government in a number of respects: member municipalities can opt out of many district functions; districts provide different functions for different areas within their boundaries especially for unincorporated areas; and all municipal representatives on the district board of directors are elected to their municipal councils and appointed by their respective governments to serve on the Board.

GVRD funds come from the member municipalities by billing them for services rendered. The cost of most services is apportioned among member municipalities on the basis of the property assessment base. Other regional costs are contained in municipal charges for water, sewer, and solid waste. GVRD services account for 12 percent of a

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<sup>119</sup> Sancton, Andrew, *Governing Canada's City-Regions: Adapting Form to Function*, Montreal: Institute for Research on Public Policy, 1994, p. 65.



property owner's tax bill, on average. The bulk of GVRD expenditures (90 percent) are for capital costs of hospitals, water, sewerage, and solid waste disposal.

Regional organization in the Vancouver area has always been characterized by voluntary participation of individual municipal governments and an approach of consensus building. As one author notes, "...metropolitan governance has emerged in place of metropolitan government in the Vancouver region; that is, metropolitanwide services and their spatial implications are managed regionally in the absence of metropolitan government"<sup>120</sup>. The difference between regional governance and regional government is that a government has the following characteristics: representation, revenue-raising capacity, autonomy, authority, and the capacity to coordinate multiple functions<sup>121</sup>.

The advantages of the Vancouver model are that it preserves local autonomy, diversity, and the distinct identity of its member municipalities. Problems have arisen, however, because of the lack of authority to implement policies. In the area of planning, for example, the master plan in 1994 promised to slow down the disappearance of farmland, concentrate housing and build rapid transit. But none of the municipalities are obligated to respect the plan. Another disadvantage is that it is ineffective in ensuring that regional concerns are taken into account in local decisions. No one speaks for the region,<sup>122</sup> it can only do what is delegated to it by its member municipalities.

If a distinct upper-tier government directly accountable to residents is the goal, then the Vancouver model does not work as well as regional government. If on the other hand, the goal is to have a flexible institution to assist municipalities in doing things they cannot do themselves, then the voluntary cooperation model along the lines of the GVRD has some advantages. It has been argued that the "inter-municipal confedera-

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<sup>120</sup> Oberlander, H. Peter and Patrick J. Smith, "Governing Metropolitan Vancouver: Regional Intergovernmental Relations in British Columbia." In Rothblatt, Donald, N. and Andrew Sancton. (eds.) *Metropolitan Governance: American/Canadian Intergovernmental Perspectives*. California: Regents of the University of California, 1993, p. 333.

<sup>121</sup> *Ibid*, p. 367.

<sup>122</sup> The Chair and the board members are part-time regional politicians.

tion” works best for consulting on goals and visions but does not work so well for implementing those goals<sup>123</sup>.

A further problem with voluntary cooperation in Vancouver is the inequitable sharing of costs and benefits. Although the GVRD has developed a fair system for services such as water and sewers which are charged for on the basis of the level of service provided, the same is not true for cultural and recreational facilities and municipally-funded social services. These services in the urban core are funded entirely by taxpayers in the core (the City of Vancouver) even though the benefits of these services spill over to residents throughout the region.

#### *9.4.3. London, England: Two Tiers Restored*

The Greater London Authority Act was proclaimed in 1999 and the new Greater London Authority with a directly elected Mayor came into being on July 3, 2002. Greater London comprises 32 boroughs and the Corporation of London. The population of Greater London is 7.4 million.

From 1964 to 1986, London was governed by a two-tier structure: the Greater London Council and 32 boroughs (each with its own mayor and council). In 1986, then Prime Minister Margaret Thatcher abolished the Greater London Council but left the 32 boroughs in place. London’s governance became a direct responsibility of the government ministers (coordinated by a Cabinet sub-committee headed by a Junior Minister for London) and joint agreements. Since there was no metropolitan authority, ad hoc arrangements were used for regional planning. In 1994, the Government Office for London (GOL) was established to allow the central government to act as a strategic authority. It brought together the regional offices of line ministries, 32 lower tiers of local government, the boroughs, and agencies with London responsibilities.

The new Greater London Authority Act created two new elected bodies – the 25-member Assembly elected from two different electoral bases (14 on a constituency basis and 11 London-wide) and the Mayor (who is not a member of the Assembly). Together, the Mayor and the Assembly constitute the GLA. This system of governance is unique in England.

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<sup>123</sup> Artibise, Alan, F.J. “Regional Governance without Regional Government: The Strengths and Weaknesses of the Greater Vancouver Regional District.” Report prepared for the Regional Municipality of Ottawa-Carleton, p.4.

The Mayor appoints the Chief Executive, sets the administration budget and ensures proper management of funds from the central government. The Assembly's powers, on the other hand, are limited to scrutiny of the Mayor. The Assembly has no service responsibilities.

The GLA's principal purpose is to promote economic development and wealth creation, social development, and the environment. It is not permitted to spend directly on any function that is assigned to the boroughs (such as housing, education, social, or health services). There are four functions that are separate from the Assembly but accountable to it through the Mayor.

- Transport for London (TFL) is responsible for roads, buses, trains, subways, traffic lights, regulation of taxis (metered) and mini-cabs (unmetered and unmarked). The Mayor appoints the commissioner. The Mayor chairs the board and appoints 15 non-executive members.
- The London Development Agency (LDA) coordinates economic development and regeneration. It promotes business and works in partnership with industry, public and voluntary sectors. The Mayor appoints the 17-member board and the Chief Executive.
- The Metropolitan Police Authority (MPA) has 23 members of which 12 are Assembly members, one is appointed by the Home Secretary, four magistrates, and 6 independent Londoners. The police commissioner is appointed by the Queen on advice of the Home Secretary who shall have regard for any recommendations by the MPA, the Assembly, and the Mayor.
- The London Fire and Emergency Planning Authority (LFEPA) has responsibility for fire and emergency services. The Mayor appoints the Chair and 17 members of which 9 are Assembly members (including the Chair). The other 9 members are nominated by the boroughs and appointed by the Mayor.

The boroughs retain primary planning responsibility as the local planning authority. If the Mayor considers an application for a large-scale development to be in contravention of his London-wide strategy, however, he can direct a borough to reject the application. He cannot direct them to approve an application, however.

Because the creation of the Greater London Authority is fairly recent, there has been little written on it that evaluates its advantages and dis-

advantages. What has been written focuses on the role of the mayor in what is considered to be a strong mayor system.

#### *9.4.4. Minneapolis-Saint Paul: Voluntary Cooperation through Regional Property Tax Base Sharing*

As noted earlier, many U.S. metropolitan areas are characterized by fragmented local government structures. Minneapolis-Saint Paul provides an interesting example of voluntary cooperation in one specific area – tax base sharing. In the early 1990s, Saint Paul had to raise its taxes dramatically and cut services because of increasing social responsibilities. At the same time, some of the richer suburbs were reducing taxes and maintaining high levels of service. The idea behind regionalizing the property tax base was to make the growing property wealth available to all parts of the region to meet social needs.

Under this system, each city contributes 40 percent of the growth in its commercial and industrial tax base acquired after 1971 to a regional pool. On an annual basis, this amounts to about 20 percent of the regional tax base. Money is distributed from this pool on the basis of inverse net commercial capacity. This method reduces the tax base disparities on a regional level from 50 to 1 to 12 to 1<sup>124</sup>.

Property tax base sharing also reduces the fiscal incentives towards exclusionary zoning and urban sprawl. In the absence of sharing, communities have an incentive to increase their tax base and limit social expenditures by using exclusionary zoning. One way to achieve this objective is to encourage low-density development because it requires large lots and thus expensive housing. Regional sharing of taxes on expensive houses weakens local fiscal incentives to create this type of housing.

Although tax base sharing can decrease intra-metropolitan competition for tax base, apparently there still is a lot of competition for tax base in the region<sup>125</sup>. Furthermore, cities with a higher than average commercial base but with low-valued home and increasing social need, contribute tax base. Cities with high-valued homes and little commercial development receive money from this system.

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<sup>124</sup> Orfield, Myron, *Metropolitics: A Regional Agenda for Community and Stability*. Washington, D.C.: Brookings Institution Press and Cambridge, Mass.: The Lincoln Institute of Land Policy, 1997, p. 87.

<sup>125</sup> *Ibid*, p. 87.

#### *9.4.5. Northern Ontario: Government Structure in Small, Remote Communities*

Each of the above case studies of governing structure applies to large cities. Much less has been written about governing smaller communities, especially in remote areas. Northern Ontario provides an example of governance that entails a modified two-tier structure with significant provincial government involvement.

The population of Northern Ontario is approximately 840,000. Population density is very low: the population of northern Ontario represents 7.4 percent of the provincial population but the land area represents 89 percent of the provincial total. Municipalities in Northern Ontario are located in one of 11 territorial districts. Territorial districts exist only for judicial<sup>126</sup> and administrative purposes and, with the exception of one, not as municipal government units. They are simply geographic areas, the boundaries of which are set out in provincial legislation. They have no governing structure (provincial or local) attached to them. Municipalities located within territorial districts are single-tier municipalities (cities, towns, townships, and villages).

In Northern Ontario, there are 155 municipalities, 104 First Nations, and over 150 unincorporated communities. Unincorporated communities (also known as unorganized territories) are communities without municipal organization. They are not subject to the provisions of the Municipal Act (provincial legislation governing municipalities). Services in these unincorporated communities are provided by local services boards, local roads boards, or by district boards (see below). The provincial government may also provide services directly to these communities, including, for example, public health, education, airports, policing, land use planning, and waste management. Property owners in these communities pay a Provincial Land Tax (PLT) to the provincial government but this amount does not cover the cost of service delivery.

Unincorporated communities can establish a Local Services Board (LSB). Any ten property owners (18 years of age or older) that are Canadian citizens may establish an LSB by calling a meeting and giving proper notice of the meeting. The LSB includes a Chair and a Secretary and recommendations are conducted by a majority vote. The powers to

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<sup>126</sup> The court structure follows these boundaries.

provide, maintain, and improve services in the Board area by the LSB are designated by the provincial government.

LSBs, of which there are 45 in Northern Ontario, can be established for the following services: water supply, fire protection, garbage collection, sewage, street lighting, recreation, roads, and public library service. The provincial government levies the tax rates (which have to be approved by a majority vote of the inhabitants) as part of the provincial land tax (PLT). The provincial government provides funds to the Board, based on the Board's budget. Other revenue sources include fees for the provision of services and other amounts raised or granted to the Board.

Unincorporated communities can also establish Local Roads Boards (LRBs). Ten or more landowners that wish to establish an LRB must write a proposal outlining the local roads area and give proper notice of the first meeting. A majority vote of landowners who attend the first meeting determines the area to submit a petition to the provincial government requesting approval of the area. The provincial government ultimately determines the area. The duties of the Board include road inspections, determining the necessary work to be performed on the roads and entering into contracts for the performance of the work. The LRB levies property taxes to pay for running the operation of the Board. The provincial government provides additional funds.

There are no upper-tier governments in Northern Ontario. There are, however, district-wide boards that act in some ways like an upper-tier government but they do not necessarily provide all local services. For example, District Social Services Administration Boards (DSSABs), of which there are eleven, are the delivery agents for social services and social housing. The boards include municipalities and unincorporated communities. For the unincorporated communities within DSSABs, the provincial government pays their share of the costs of delivering services. The boundaries of the DSSABs are coterminous with the geographic boundaries of the territorial districts.

One or more municipalities or local services boards or the residents of an unincorporated community may establish an Area Services Board (ASB) for the purpose of consolidating service delivery. There are currently no ASBs in Ontario, however, because their creation is dependent on the reform of the PLT which has not yet been implemented.

An ASB would consist of members appointed by participating municipal councils and by members elected by residents of the unincorporated communities in the board area. ASBs are similar to DSSABs but can manage and deliver a broader range of services. ASBs would be responsible for social welfare, child care, social housing, ambulance, public health, and homes for the aged. They may also choose to deliver optional services such as police services, waste management, economic development, airports, roads and bridges, emergency preparedness and response, land use planning, and any other service requested by the ASB and agreed to by the provincial government. The Board may charge fees for the services it provides and it may make investments, incur debts, and establish reserve funds in the same way as can a municipality. ASBs may also levy property taxes. If ASBs were implemented, they would be similar to an upper-tier government in Northern Ontario because they would provide a wide range of local services.

The advantage of special purpose boards is that the cost of services is shared among the communities. In the case of DSSABs (or ASBs), the costs are shared among municipalities and unincorporated communities in the board's geographic area. In the case of LSBs and LRBs, the costs are shared among residents in the unincorporated areas. LSBs and LRBs also ensure that the specified services are provided in these communities. Where costs are shared among municipalities and/or unincorporated communities, it is less clear if economies of scale are achieved or whether there are any spillovers being internalized.

## 9.5. Conclusion

The governing structure for local governments affects their ability to provide services and raise revenues in a fair and efficient way. Having said this, however, it is difficult to conclude what is the best model of governance. Out of the wide variety of existing local government structures ".... no model stands out as clearly superior in all respects"<sup>127</sup>. Application of the criteria for designing government structure to the various models presented, however, suggests the following.

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<sup>127</sup> McMillan, Melville, "Taxation and Expenditure Patterns in Major City-Regions: An International Perspective and Lessons for Canada," in Paul A.R. Hobson and France St-Hilaire (eds.) *Supra*, 1997, p. 39.

- For large metropolitan areas and city-regions, some form of regional structure which encompasses the entire city-region is needed to address problems of a region-wide nature such as fiscal disparities among municipalities and problems associated with externalities in service provision. Although the need for a regional structure is clear, the form it takes will vary with local circumstances (e.g. one-tier or two-tier). Inter-municipal agreements for the provision of services are effective for a small number of services but do not provide a solution to the need for regional cooperation.
- A one-tier structure is simpler to understand and more transparent than a two-tier structure. For that reason, it does appear to enhance political and fiscal accountability. Two-tier structures, on the other hand, are inherently more complex and may result in undesirable duplication, overlap, and general confusion among citizens as to who is responsible for what and who is paying for it. A one-tier structure for a very large municipality, however, may compromise access and accountability.
- Redistribution can be achieved within a one-tier or a two-tier structure. In a one-tier structure with uniform tax rates across the city-region, all taxes are made available for redistribution. In a one-tier structure with special area rates or in a two-tier structure, less than 100 percent of tax revenues will be available for redistribution.
- A two-tier structure may achieve greater efficiency than is likely to be attained in a more centralized one-tier structure. Desirable economies of scale and scope can be realized at the upper tier level while at the same time the lower tier permits more responsiveness to local variations in preferences and it maintains the close linkage between local financing and spending decision.
- Where local autonomy is paramount and where objectives are shared by policy-makers in various local governments, voluntary cooperation can work. It works less well when objectives are different among local governments and when it comes time to implement those goals.

What works best in terms of governing structure in particular circumstances depends on policy priorities, the scope and type of local responsibilities, the instruments of local finance, and the degree and na-



ture of central/provincial/state presence in the area in terms of service provision and financial support. As one author has noted: “any attempt define one ideal size of a city-region or one ideal form of governance would be doomed to failure”<sup>128</sup>.

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<sup>128</sup> Sancton, Andrew, *Merger Mania*, Westmount, Quebec: Price-Patterson Ltd., 2000, p. 7.

## **Chapter 10. Local Taxation in Selected Countries: A Comparative Examination**

Over the past decade, local governments everywhere have faced a similar pattern – declining grants from senior governments, devolution of additional funding responsibilities, and a limited tax base that may not be sufficient to meet future fiscal challenges and objectives. This, in turn, has raised a number of issues around local taxation. Some of these issues are discussed in this paper.

*Part 10.1* consists of an international comparison of local taxes. In particular, it reviews the pattern of local taxation in OECD countries and comments on the fiscal autonomy that local governments have in making their own tax decisions.

*Part 10.2* outlines a financing model that is generally used for evaluating local tax issues. Using this model, the paper attempts to answer the following two questions. What is the appropriate role for local taxes? Of all the taxes used by local governments, is there one that is more desirable or appropriate than others in funding local services or should a mix of taxes be used?

*Part 10.3* examines a number of issues in local taxation; specifically, what should local government be expected to fund from their limited tax base? Is one tax preferred over another? Who should set local tax rates? Should these rates be uniform or differentiated across a taxing jurisdiction? Should local tax rates be regulated? Should local government tax businesses? Are local taxes currently sufficient to ensure local fiscal sustainability?

*Part 10.4* summarizes the paper.

### **10.1. Local Taxation – An International Comparison**

Since most locally generated revenues come from local taxes (user fees are the other major source of locally generated revenue), the following two sections provide data on a number of features of local taxation in federal (three levels of government) and unitary (two levels of government) OECD countries. The next section briefly outlines the taxes that are available to local government along with their relative importance. This is followed by a section that comments on the fiscal

autonomy and discretion that local governments have over their tax base and rate structure.

#### *10.1.1. Pattern of local taxation*

*Table 10.1* illustrates the relative importance of a range of local taxes in OECD countries. From this table, the following may be noted.

1. Income taxation (corporate and personal) is the most important source of local tax revenues in fourteen countries (column 2). In Denmark, Finland, Norway, Sweden, Luxembourg, and the Czech Republic, it accounts for more than ninety percent of local revenue. In Australia, Canada, Mexico, France, Greece, Hungary, Ireland, Netherlands, New Zealand and the United Kingdom, by comparison, local governments do not have direct access to income tax revenue.
2. Local sales taxes (in various forms but referring generally to taxes on goods and services that are sold) generate between 20 percent and 76 percent of total local tax revenue in ten countries (column 3). At the other extreme, local sales taxes are non-existent in five countries and produce less than ten percent of local revenue in another twelve countries.
3. Property taxes (column 4) account for more than ninety percent of all local tax revenue in five countries (Australia, Canada, Ireland, New Zealand, and the United Kingdom). By contrast, local governments in ten countries get less than 10 percent of their tax revenue from the property tax.
4. Local governments in France, Italy, Greece, and Turkey rely fairly heavily on other local taxes (column 5), mainly on businesses.
5. Column 6 of *Table 10.1* provides information on the relative importance of local taxes by calculating local taxes as a percent of gross domestic product (a measure of the level of national income generated in each country). In federal countries, local government taxes varied from a low of 0.1 percent of GDP in Mexico to a high of 5.0 percent in Switzerland with the unweighted average for federal countries being 2.9 percent. For unitary countries, local government's tax share of GDP ranged from a low of 0.4 percent in Greece to a high of 16 percent in Sweden and 15.9 percent in Denmark with the unweighted average for unitary countries being 4.8 percent.

Table 10.1

**Relative Importance of Local Taxes in Selected OECD Countries, 2001**

Countries (1)	Tax sources as a percent of total local tax revenues				Local taxes as a per- cent of GDP (6)	Local Taxes as a per- cent of all taxes <sup>5</sup> (7)
	In- come <sup>1</sup> (2)	Sales <sup>2</sup> (3)	Prop- erty <sup>3</sup> (4)	Other <sup>4</sup> (5)		
Federal:						
Australia	0.0	0.0	100.0	0.0	1.0	3.0
Austria	55.3	29.7	9.9	5.1	4.4	10.1
Belgium	86.5	13.2	0.0	0.3	2.1	4.7
Canada	0.0	1.9	91.3	6.8	2.9	8.1
Germany	78.0	6.0	15.8	0.2	2.6	7.5
Mexico	0.0	2.6	86.7	10.8	0.1	0.8
Switzerland	84.4	0.3	15.3	0.0	5.0	14.0
United States	6.5	21.8	71.8	0.0	3.5	11.5
Unweighted average	38.8	9.3	48.8	2.9	2.9	7.5
Unitary:						
Czech Republic	90.8	4.2	4.6	0.4	4.8	12.4
Denmark	93.4	0.1	6.5	0.0	15.9	32.9
Finland	95.4	0.0	4.4	0.1	9.9	21.2
France	0.0	11.5	48.2	40.4	4.4	9.7
Greece	0.0	46.3	0.0	53.8	0.4	1.0
Hungary	0.8	76.2	22.5	0.4	2.0	5.2
Iceland	78.0	7.6	14.3	0.0	8.3	22.4
Ireland	0.0	0.0	100.0	0.0	0.6	1.8
Italy	12.2	8.6	18.6	60.6	4.8	11.4
Japan	47.4	20.7	30.9	1.0	7.0	25.6
Korea	16.6	26.5	53.3	3.6	3.9	15.1
Luxembourg	92.9	1.3	5.6	0.3	2.4	5.9
Netherlands	0.0	44.0	56.0	0.0	1.4	3.4
New Zealand	0.0	9.7	90.3	0.0	1.8	5.8
Norway	89.9	2.2	7.9	0.0	6.5	16.3
Poland	78.4	1.8	19.8	0.0	5.7	16.3
Portugal	21.6	33.7	44.5	0.2	2.3	6.3
Slovak Republic	59.9	11.8	28.2	0.1	1.5	4.0
Spain	25.2	36.1	37.3	1.4	5.9	16.9
Sweden	100.0	0.0	0.0	0.0	16.0	29.8
Turkey	24.7	31.5	6.5	37.3	4.3	13.0
United Kingdom	0.0	0.0	99.5	0.5	1.5	4.1
Unweighted average	38.0	16.8	31.6	9.1	4.8	12.7

<sup>1</sup> Includes individual and corporate income tax plus payroll tax.

<sup>2</sup> Includes general consumption taxes, taxes on goods and services (fuel taxes, hotel and motel occupancy) and taxes on use on goods or on permission to use goods or perform activities.

<sup>3</sup> Taxes on property including recurring taxes on net wealth.

<sup>4</sup> Includes social security contributions in Austria and some residual taxes mainly on business (Austria, Canada, and Germany) and miscellaneous taxes everywhere.

<sup>5</sup> Total includes central government, state government, local government and social security funds.

Source: OECD, *Revenue Statistics 1965–2001* (Paris: OECD, 2002), Tables 135 to 168.

6. Column 7 looks at the relative importance of local taxes in the entire tax system in each country. When local taxes are calculated as a percent of total taxes (central government, state government, local government and social security funds), they range widely in relative importance. For example, in federal countries, local taxes account for less than 1 percent of all taxes in Mexico (the lowest) and 14 percent in Switzerland (the highest) with the unweighted average being 7.5 percent. For unitary countries, the range extends from a low of 1 percent in Greece to a high of almost 33 percent in Denmark with the unweighted average being 12.7 percent.

The above points lead to a number of observations including the following.

1. Since the level of local taxation is primarily driven by expenditures, local governments in those countries (federal and unitary) where local taxes are a relatively small percentage of total taxes generally have fewer expenditure responsibilities.
2. The relative importance of local taxes in a country's tax system is generally less in federal countries than in unitary countries – federal countries have a middle (state) level of government that collects taxes, some of which are in the domain of local government in unitary countries.
3. Local property taxes play a more important revenue role (almost 50 percent of all taxes on average) in federal countries than in unitary countries (almost 32 percent of total local taxes, on average). By comparison, local income taxes, on average, are equally important in both unitary and federal countries – around 38 to 39 percent of all revenues. Local sales taxes are relatively less important in federal countries (slightly more than 9 percent) than they are in unitary countries (almost 17 percent). This difference generally exists because the state level of government collects considerable sales tax revenue in federal systems; whereas, this source of revenue is more likely to be available to local governments in unitary countries.
4. At the local government level, there is heavy reliance on income taxes in the Nordic countries whereas heavy reliance is placed on property taxes in countries that, in the past, were part of the British Commonwealth or significantly influenced by it.

5. Where local taxes are a comparatively higher percentage of total tax revenue and GDP, local governments tend to rely more heavily on local income taxes.
6. Local governments in some countries only have access to one tax (property or income) whereas local governments in other countries have access to two or three local taxes.
7. Where local taxes account for more than 10 percent of all tax revenue, there is no common pattern. Local governments in some of these countries have access to a wide range of taxes (Austria, some states in the United States, Italy, Iceland, Japan, Korea, Spain, and Turkey). In other countries where local government taxes are equally important, (Nordic countries and the Czech Republic), local governments are restricted to only one tax of any significance.

From the information provided in *Table 10.1*, there are no definitive conclusions that can be drawn about patterns of local taxation across OECD countries nor can anything be concluded about the appropriateness of one tax over another tax. There is nothing in the data to suggest that local government is more or less efficient, effective and accountable if it has access to a range of taxes as opposed to only one major tax. Local government access to a specific tax or taxes is dependent on a number of things including the local government's capacity to administer the tax; the types of expenditures that local government must fund; the willingness of a senior level of government to assign taxes to local government; constitutional and legislative requirements; and a variety of other factors.

### *10.1.2. Fiscal autonomy in local taxation*

International experience tells us that an essential ingredient in creating a good local public sector is a responsive and responsible local government. A necessary condition for such a government is that it possesses the fiscal capacity to provide required and desired levels of public infrastructure and services<sup>129</sup>. In other words, local governments carrying out their expenditure responsibilities are likely to be more efficient, responsible and accountable if they are required to raise the

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<sup>129</sup> Jonathan A. Rodden, Gunnar Eskeland, and Jennie Litvack, eds, (2003), *Fiscal Decentralization and the Challenge of Hard Budget Constraints*, (Cambridge: MIT Press).

revenue that they spend<sup>130</sup>. Furthermore, this is dependent on the fiscal autonomy or fiscal discretion that local governments have in determining their tax base and setting their tax rates. Fiscal autonomy, in theory, is greatest when local governments are free to determine both the tax base and tax rates without senior governments imposing limits on either of these. Fiscal autonomy is least when both the tax base and tax rate are set or controlled by senior levels of government. Of these two possibilities, permitting local governments to control their own tax base is often administratively costly and can give rise to innumerable economic inefficiencies when local government deliberately distorts its tax base to satisfy some constituency or other. A preferred option is one where local governments simply piggyback onto an existing state tax base with locally determined rates – this is administratively inexpensive and minimizes the potential for inter-municipal distortions in the tax base.

Tax sharing arrangements between different levels of government also lead to different levels of tax autonomy. Here, the degree of autonomy will depend on whether or not local government consent is required before any change can be made in the tax sharing formula<sup>131</sup>.

*Table 10.2* offers a thumbnail sketch of the kinds of autonomy and its relative importance in a number of OECD countries. As with reliance on local taxes, there is considerable variation across countries. In particular, the following may be observed.

1. Local governments set both the tax base and tax rate in very few countries (column 3). Furthermore, where both are at the discretion of local governments, local taxes tend to be a very small percentage of overall taxes. For example, in New Zealand, local taxes account for less than 6 percent of all taxes and almost all of this is from the property tax where local governments have the power to control both the base and rate. Similar comments may be made for local governments in Portugal and Spain where local governments also rely heavily on property taxes.
2. Local governments in every country, except for Mexico, have some control over local tax rates. In countries such as Belgium, Switzer-

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<sup>130</sup> Richard Bird (2001), "Subnational Revenues: Realities and Prospects", (Washington: World Bank Institute), p. 3.

<sup>131</sup> OECD, (1999) *Taxes Powers of State and Local Government*, OECD Tax Policy Studies No. 1, (Paris: OECD), p. 10.

land, Denmark, Finland, Iceland, Japan, Netherlands, Sweden and United Kingdom, 84 percent or more of local tax revenue is obtained from local taxes where local governments have control over local tax rates. While not included in Table 2, it could also be noted that local governments in Canada, the United States and Australia have considerable control over local tax rates and in a few cases over the local tax base. At the other extreme, less than 45 percent of local tax revenue comes from local government's ability to set tax rates in Austria, the Czech Republic, Hungary, Norway, and Poland (and Mexico, as noted above).

3. In many countries, there exists a form of revenue sharing between local and state (federal), or local and central (unitary) governments for a portion of local tax revenues. In none of the countries is the revenue sharing split determined by local governments.
4. In four countries, the split set out in the revenue sharing arrangement may be changed only if local governments consent to it; for example, in Austria, this revenue sharing arrangement accounts for over 80 percent of local tax revenue; in Germany and Poland, for around 50 percent; and in Spain, for 16 percent.
5. The split in the revenue sharing arrangement is fixed in legislation in seven countries but the fixed portion is really only significant in the Czech Republic (90 percent of local tax revenues) and Mexico (74 percent of local tax revenues).
6. The central government is responsible for determining the central-local split in revenue sharing arrangements in Hungary and Norway. In the former country, this split accounts for 70 percent of local tax revenue and in the latter country, for 95 percent.
7. The central government solely determines the tax base and sets the tax rate for some local taxation in four countries but in only two of them does it amount to anything of substance. In Portugal, 37 percent of all local tax revenues come from taxes of this type and in Mexico, the comparable percentage is 26 percent.

This broad brush summary illustrates the range of local taxes and the extent to which local governments have some control over rates and base. To expand on the local tax system and fiscal autonomy in slightly more detail, the following section describes the local tax system in a few countries.



Table 10.2

**Local Government Taxes by Type of Tax Autonomy  
in Selected OECD Countries**

Country (1)	Extent of Tax Autonomy							Senior govt. sets lo- cal rate and base (10)
	Local government sets			Revenue split under tax sharing arrangements				
	tax rate and base (3)	tax rate only (4)	tax base only (5)	Set by local govt. (6)	Only changed with consent of local govt. (7)	Fixed in legis-lation (8)	Determined by central govt. (9)	
	Percentage distribution of local taxes							
Federal:								
Austria	9	11			81			
Belgium	13	84				2	1	
Germany	1	52			47			
Switzerland		97				3		
Unitary:								
Czech Republic	2	5	3			90		
Denmark		96				4		
Finland		89				11		
Hungary		30					70	
Iceland	8	92						
Japan		94						6
Mexico						74		26
Netherlands		100						
New Zealand	98							2
Norway		5				1	94	
Poland		45	1		54			
Portugal	49	14						37
Spain	33	51			16			
Sweden	4	96						
United Kingdom		100						

Source: OECD (1999) Taxing Powers of State and Local Government, (OECD: Paris), Table 10.1.

### 10.1.3. Local tax systems in more detail

The discussion here includes one country (Canada) where local governments have direct access to only one tax (property) and one

country (United States) where local governments may have access to as many as three local taxes. As well, it describes some potentially interesting features of local tax systems in a few other countries. The discussion is not intended to be comprehensive (this would require a much more voluminous paper); rather, it is designed to highlight some of the nuances of local tax systems in a few countries.

**Canada:** Local governments are creatures of the province and as such, are permitted to use only one tax – the property tax<sup>132</sup>. Although free to set their general property tax rate, municipal governments face a significant number of provincial rules and regulations with respect to their tax base and rates. While some of these restrictions and constraints may be necessary to satisfy a variety of broader social and economic objectives, the point is they do restrict municipal fiscal autonomy. Examples of these restrictions and controls are described here.

In all ten provinces and the three territories, real property is the tax base. Its principal components include land, buildings and structures and in some provinces, machinery and equipment. Provincial government's legislation/regulations exempt certain properties from property taxation, however. These include colleges and universities, churches and cemeteries, public hospitals, charitable organizations, and so on. Under the Constitution, provincial and federal owned properties are also exempt from property taxation. For federal and provincial properties including colleges, universities and public hospitals, grants-in-lieu of taxes (based on number of students or number of beds) are paid to the municipality. As well, provincial legislation/regulations require special treatment for other types of property – agricultural land and managed forest properties receive favourable property tax treatment in every province. Favourable treatment takes the form of exemptions, lower property tax rates, or assessment on the basis of the land's current use rather than its market value.

For all taxable properties, every province has legislation that calls for the assessment of real property at some value. In some provinces, this is called "real and true value", "current value", or "fair value". In practice, these terms refer to market value. To avoid unintended variation in provincial assessment practices and to achieve intended variation,

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<sup>132</sup> In some provinces, the provincial government also imposes a property tax.

every province has established a central assessment authority and has moved recently to more updated and frequent reassessments.

Although municipal governments are responsible for setting their general property tax rate without restriction, provincial rules and regulations control the rate structure across all properties. For example, some provinces permit municipalities to apply a single general tax rate to all classes of property; others permit the application of different rates to different property classes with lower rates assigned to residential and farm properties and higher rates to commercial and industrial properties. In one province (Prince Edward Island), property tax rates are lower for residents of the province than for non-residents of the province.

In summary, municipal governments are free to set their general tax rate. Their tax base and rate structure (across property types), however, are frequently controlled or restricted by provincial legislation, rules and regulations.

**United States:** In some states in the U.S., there is considerable variation in a municipality's access to local taxation. For example, in some states, municipalities are permitted to use an income tax, a sales tax, and a property tax. In other states, municipalities may be restricted to the property tax only; in still others, they have access to the property tax and a municipal sales tax. Regardless of the tax or taxes permitted, state approval or permission has either been legislated or granted.

The United States experience with a municipal income tax may be of relevance because of the variation in the way in which it is applied. Table 3 records 1999 personal income tax rates in cities over 125,000 people. Taxes are generally imposed as a flat rate ranging from a low of one percent to a high of almost five percent on residents. In some cities, a lower rate is applied to commuters. In some states, the tax is divided between the jurisdiction where the person resides and where the person works. In total, approximately 3,800 local governments currently levy local income taxes in the United States. Although, local governments in Pennsylvania (one state out of 50 states) account for 2,800 of the total, localities in fifteen other states also rely on this tax<sup>133</sup>. Further,

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<sup>133</sup> James D. Rodgers and Judy A. Temple (1996), "Sales Taxes, Income Taxes, and Other Nonproperty Tax Revenues", in J. Richard Aronson and Eli Schwartz, eds., *Management*

local income taxation is primarily a municipal tax, but in some states (Indiana and Maryland, for example), it is a county tax. As well school districts rely on income tax revenues in Pennsylvania, Ohio and Iowa<sup>134</sup>. In terms of revenue importance for municipalities, income tax revenues generate well over 20 percent of local tax revenue in Ohio and Pennsylvania and about 30 percent in Maryland. In some cities, this revenue source is so important that it accounts for more than 50% of city own source revenues<sup>135</sup>.

Table 10.3

**United States City (over 125,000 population) Personal Income Tax Rates for 1999 – (percent)**

Akron	2.0	Louisville - residents	2.2
Baltimore	2.5	non-residents	1.45
Birmingham	1.0	Newark	1.0
Cincinnati	2.1	New York**	2.675 to 3.3575
Cleveland	2.0	Philadelphia – residents	4.79
Columbus	2.0	non-residents	4.2082
Dayton	2.25	Pittsburgh (city)	1.0
Detroit* – residents	3.0	Pittsburgh (school district)	1.875
non-residents	1.5	Portland, OR	1.45
Flint – residents	1.0	St. Louis	1.0
non-residents	0.5	San Francisco	1.0 to 1.5
Grand Rapids – residents.	1.3	Toledo	2.25
non-residents	0.65	Yonkers- residents	10% surtax
Kansas city, MO	1.0	non-residents	0.5
Lansing – residents	1.0	Youngstown	1.0
non-residents.	0.5		

\* For each tax year following July 1, 1999, the rate on residents is reduced by 0.1% until it reaches a rate of 2% after June 30, 2008.

\*\* For tax years after 1999, tax rates ranged from 2.65% to 3.315%; for tax years after 2000, tax rates ranged from 2.55% to 3.2%; after 2001, 1.29% to 1.61%; after 2002, 1.18% to 1.48%. Non-residents – 0.25% of wages; 0.375% of net earnings from self-employment. Unincorporated business, 4%.

Source: *State Tax Guide* (Toronto: CCH Canadian Limited, 2000).

*Policies in Local Government Finance*, Fourth Edition (Washington, D.C.: International City Management Association), 229–258, at 242–243.

<sup>134</sup> For a discussion of local income tax structures and issues in the United States, see Robert L. Bland (1989), *A Revenue Guide for Local Government* (Washington, D.C.: International City Management Association), at 89–101.

<sup>135</sup> Rodgers and Temple, 1996, at 242–245.

Also, in the U.S., local governments in thirty-one states and the District of Columbia levy general sales taxes. Across these states, a relatively low rate of 0.25 percent is imposed in a number of transit districts to subsidize public transportation. In other states, the rates may be as high as five percent with revenues not earmarked for specific expenditures<sup>136</sup>. In some states, such as Virginia and California, the local sales tax is universal. In others, it is used by some municipalities and not others. Regardless of the locality there are two common features. First, virtually, all general sales taxes are ad valorem (fixed percent of selling price) rather than per unit taxes; and second, the tax is levied on retail purchasers<sup>137</sup>.

All municipalities impose a property tax, with two minor exceptions. These are in Oklahoma where cities use the property tax to secure bonds and not to fund services and the City of Springfield, Ohio where a local income tax is used instead of the property tax. Issues around setting local property tax rates, determining the tax base, and state restrictions on local taxation authority are similar to those described for Canada.

All local taxes in the United States are permissive taxes. As noted, the property tax is used almost everywhere. Nearly all cities impose a sales tax if given the authority, but this is not true for the income tax. For example, all cities in Georgia and Michigan have the option to use an income tax, but only about 20 cities in Michigan have adopted it. Georgia is a different case. The state law says that a city can impose an income tax only if a majority of the registered voters (not the actual voters) approve it. With voter turnout generally less than 50 percent, approval is unlikely to be forthcoming.

Property taxes are administered and collected at either the county level (most common) or by cities. Local governments are free to set their tax rates but the tax base is essentially controlled by state policy (legislation) and practice (similar to Canada). Most sales taxes are piggybacked onto the state tax with the state collecting the revenue and remitting it to the originating municipality. Income taxes are collected by the municipality in Pennsylvania, Ohio, Kentucky, and Michigan. Yonkers and New York City's income tax is piggybacked onto the state

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<sup>136</sup> *Ibid*, at 232–234.

<sup>137</sup> *Bland*, 1989, at 51–67.

income tax. For income and sales taxes, the state frequently regulates the tax rate or range of tax rates that can be used.

**Nordic countries:** The best known examples of local income taxes are in these countries (Sweden, Norway, Finland, Denmark) where it is the only local tax of any significance (*Table 10.1*). Local income taxes are basically levied at a flat, locally established rate on the same tax base as the national income tax and collected by the central government. The progressive part of the rate structure is the central income tax. After the local income tax is collected by the central government, these revenues are then remitted to each local jurisdiction.

**Belgium:** Local governments in Belgium rely almost entirely on local income taxes. Here, the local tax is not a surcharge on the central tax base (as in the Nordic countries); rather, it is a surcharge levied as a percentage of the national tax liability.

**Switzerland:** In most cantons (middle level of government), local governments are permitted to levy surcharges at locally established rates on cantonal income taxes, not on the income tax of the central government. Local taxes are levied on both income and assets (a tax on personal wealth and a tax on corporate net worth – net wealth tax).

**Japan:** Local governments rely on all three taxes but the local income tax system is rather unique. Municipal governments may tax corporations. Each year, the rate is set locally and it applies largely to national corporate taxes paid in the previous year with the tax base in each jurisdiction determined by the proportion of employees working in that jurisdiction. Corporations are also subject to a progressive municipal enterprise tax based directly on income – here, the rate varies with the category of business activity (France also has a local tax of this type).

Individuals also pay a local income tax at progressive rates on the same base as the national tax. Non-residents working in a municipality are subject to a poll tax levied at a nationally determined per capita rate that varies with the size of the municipality. Finally, all taxes are assessed and collected locally<sup>138</sup>.

**Germany:** Local government revenues in Germany come from a variety of sources. The business tax (primarily a tax on corporate profits whose base is determined by the central government with the local rate set by individual municipal governments) accounts for about 40% of

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<sup>138</sup> Bird, 2001, at 18–19.

local tax revenue after sharing. Personal income taxes are next in order of importance. They represent the local share of the national income and wage tax that is determined by the state and federal governments. Overall, local governments receive 15 percent of these revenues (this is stipulated in the Constitution) but the share for each municipality may vary. Revenues are distributed by state governments to local governments in originating municipalities (that is, where the taxpayer resides) up to a limit approximating 15 percent of national GDP per capita. This limits the amounts distributed to high-income communities and introduces an equalizing effect. Local property taxes also exist but are considerably less important than the business tax. In many municipalities, the property tax raises about 1/6 of the revenue generated by the business tax. Fees and charges are another important source of local funds, generally accounting for considerably more revenue than the property tax<sup>139</sup>.

## **10.2. Financing Model for Local Government**

A major observation from the international experience cited above is that there is no consistent or uniform approach to local government taxation. Some countries have only one tax at the local level; others have two taxes, and still others have three taxes. What is known from this experience, however, is that the more revenues that local governments are required to raise on their own (from taxes, user fees, charges, and so on), the more responsible, efficient and accountable they will be in managing their operations.

Such variation in the use of local government taxes raises the question of whether or not there is a theory of local government finance that can be used to answer two important questions. First, what is the appropriate role for local taxes vis-à-vis other own source revenues including user fees, permits and special charges in funding local services? Second, of all taxes that are available, is there one that is more desirable or appropriate than others in funding local services or should there be a mix of taxes?

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<sup>139</sup> Harry Kitchen, (2002), "Municipalities: Status and Responsibilities, Budgeting and Accounting", a paper prepared for CEPRA I Project, at 15–16.

### 10.2.1. What is the role for local taxes?

To answer the first question, let us turn to the constitutional place of local governments in most countries, especially in federal jurisdictions<sup>140</sup>. Local governments are generally 'creatures of the state'. Because of this, it is appropriate to examine their fiscal roles and responsibilities within the principal-agent model<sup>141</sup> of state-local fiscal arrangements. In this model, local governments are the agents while the state is the principal. The latter has the power to alter jurisdictional boundaries, to change revenue and expenditure responsibilities of the agent, and to change intergovernmental fiscal arrangements to overcome differing objectives between the principal and the agent. Within this context, the role of the agent is to provide and fund services that benefit local constituents; hence, financing of each service is best addressed on the basis of benefits received from local services.

#### **In principle**

The underlying principle of the benefits received model of local finance is straight-forward: those who benefit from local public services should pay for them. *Economic (allocative) efficiency*<sup>142</sup> is achieved when the user fee or tax per unit of output equals the extra cost of the last unit consumed. This is the well-known marginal cost pricing principle. The price or fee, by definition, indicates what consumers are willing to pay for this good and marginal cost, by definition, measures the cost of resources used up in producing that unit. Perhaps this could be illus-

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<sup>140</sup> Harry Kitchen (2001), "Models of Decision-Making and Collaboration (for Local Government) in Federal Systems", Mimeograph.

<sup>141</sup> For a discussion in the provincial-municipal context, see Richard M. Bird and Duan-jie Chen (1998), "Federal Finance and Fiscal Federalism: The Two Worlds of Canadian Public Finance", *Canadian Public Administration*, 1 (Spring): 50–74.

<sup>142</sup> Economic efficiency is more than technical efficiency- the latter is a necessary but not sufficient condition for economic efficiency. Technical efficiency exists when a producing unit (firm, government, commission) operates in a way such that it is not possible to secure any additional output given the available inputs (labour, material and capital) and level of technology. In other words, technical efficiency is achieved when the output per unit of input is maximized or the cost per unit of output is minimized. This, it should be noted, is not concerned with whether one good or service generates more or fewer net benefits than another good or service. It simply concentrates on the efficient employment of inputs in the production of a specific good or service. Finally, as the level of technology advances, a technically efficient production process leads to increased output with the same inputs.



trated by reference to a simple example. Suppose the extra (marginal) cost of producing the last litre of water is 10 cents and customers are willing to pay 15 cents for it. This is not an efficient level of output because the value that customers place on this litre is greater than the cost of producing it. In other words society is the beneficiary of a net gain of 5 cents for this unit. Collectively, society would be better off if water consumption increased as long as the price paid for each additional unit exceeded the cost of producing that unit; that is, for each of these units, marginal benefit would exceed marginal cost – a net gain. If, on the other hand, the marginal cost of producing the last litre is 10 cents and customers are only willing to pay 5 cents for it, this is not an efficient level of output either. The benefit that customers get from this unit is less than the cost of the resources used up in producing it and society is worse off – worse off by 5 cents for this unit. As long as the extra cost of producing the unit is less than its price, society is devoting too many resources to its production. It follows, then, that resource efficiency is achieved where marginal cost equals price because this is the point where society secures the greatest net gain from the consumption of this service.

The preceding paragraph makes it clear that the main economic reason for imposing correctly designed fees or taxes on recipients (individuals or businesses) of local government services is to provide local government with incentives for using its resources in the most efficient manner possible. The goal of maximizing efficiency in a local government's provision of services is not an objective dreamed up by some economist. It is simply common sense. Surely any society should allocate its scarce resources to those services that will provide its people with as large a bundle as possible of services that they want. That is all that is meant by efficient resource use<sup>143</sup>.

In short, correctly set user fees and tax rates promote efficiency in two ways. First, "by providing information to public sector suppliers about how much clients are actually willing to pay for particular

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<sup>143</sup> For a more detailed discussion of this, see Richard M. Bird (2001), "User Charges in Local Government Finance", in *The Challenge of Urban Government: Policies and Practices*, edited by Mila Freire and Richard Stren (Washington, D.C.: The World Bank), 171–182; and Richard M. Bird and Thomas Tsiopoulos, (1997) "User Charges for Public Services: Potential and Problems" *Canadian Tax Journal*, Vol. 45, Number 1, p. 35–37.

services”. Second, they do this “by ensuring that citizens value what the public sector supplies at least at its (marginal) cost”<sup>144</sup>.

*Accountability* is enhanced when the design of a tax, user fee or expenditure is clear to taxpayers. Furthermore, the closer the link between the beneficiaries of a government service and payment for that service, the greater is the degree of accountability. When taxes and user fees are directly matched to beneficiaries, the latter can determine whether the benefit from the last unit consumed is worth the price or tax paid for its consumption. They are then in a position to apply pressure on politicians to improve the efficiency with which services are provided.

*Transparency* is an extension of the accountability argument. Transparency is enhanced when citizens/taxpayers have access to information and decision-making forums so that the general public is familiar with the way in which local tax bases are determined and local tax rates set. Emphasis on transparency is intended to mitigate the risk of corruption by making information available<sup>145</sup>.

*Fairness* within the benefits model is achieved because those who consume public services pay for them, just as someone who benefits from a private good pays for it. Concerns about the tax burden on low-income individuals should be addressed through income transfers from state or central governments and social assistance programs targeted to individuals in need. It is far more equitable and efficient to handle income distribution issues through income transfers or targeting<sup>146</sup> than to tamper with charging or taxing mechanisms to accommodate these concerns.

Finally, the *easiest local tax system to administer* is one that is not confusing for taxpayers to understand and does not require an unnecessary amount of time, effort and money in administering it.

### **In practice**

Application of the benefits based model to the municipal sector steers us in certain directions. At the outset, it should be noted that lo-

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<sup>144</sup> *Bird and Tsiopoulos, 1997.*

<sup>145</sup> This corresponds to the “Code of Good Practices on Fiscal Transparency” (March 23, 2001), (Washington, D.C.: International Monetary Fund).

<sup>146</sup> For a discussion of these programs, see Robin Boadway and Harry Kitchen (1999), *Canadian Tax Policy*, third edition (Toronto: Canadian Tax Foundation), chapters 8 and 9.

cal governments in developed countries supply a range of services – from those that exhibit mainly private goods characteristics (water, sewers, solid waste collection and disposal, public transit, public recreation and so) to those that exhibit mainly public goods characteristics<sup>147</sup> (local streets and roads, street lighting, fire and police protection, neighbourhood parks, etc.).

For services with mainly private good characteristics, individual beneficiaries can be identified, income redistribution is not a goal, spillovers are unlikely to exist, and operating and capital costs can be measured and recorded. Here, a user fee would be relatively easy to administer and would be the best financing instrument for satisfying the principles of efficiency, accountability, transparency, and fairness.

For services providing mainly collective or ‘public goods’ benefits (specific beneficiaries cannot be identified), user fees are inappropriate. Instead, these should be funded from a local tax imposed on residents (or exported to the same extent services are) with necessary adjustments through the use of grants to account for spillovers; that is, benefits from these services that spill over into neighbouring communities should be funded from something other than a local tax<sup>148</sup>.

Local governments should not have to fund programs specifically directed toward the redistribution of income among individuals (social services and social housing, for example) nor should they be responsible for funding services that are national or state-wide in their impact and scope (education and health, to name two). These functions are more appropriately the responsibility of central and state governments and should be funded by them.

Grants from senior levels of government also have a role in funding local services. Specifically, conditional grants should be used for partial or full funding of services generating spillovers and for services in which

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<sup>147</sup> For a discussion of ‘public’ versus ‘private’ goods, see Harvey S. Rosen, Paul Boothe, Bev Dahlby and Roger S. Smith (1999), *Public Finance in Canada*, (McGraw-Hill Ryerson), chapter 7.

<sup>148</sup> Under this view, user fees or charges are retained for funding those services whose costs and benefits can be assigned to specific properties or individuals (water and sewers, and a portion of transit and recreation, for example). For an excellent discussion of the benefit model of local finance, see Richard M. Bird, “Threading the Fiscal Labyrinth: Some Issues in Fiscal Decentralization” (1993), vol. XLVI, no. 2, *National Tax Journal*, 207–227.

the state has an interest (to ensure uniform or minimum standards, for example). Unconditional grants play a role in filling the fiscal gap (mismatch in local own source revenues and expenditure responsibilities) and in supporting municipalities in their attempts to provide comparable levels of service for comparable tax rates (equalization)<sup>149</sup>.

In summary, within this benefits based model of local finance, there is a very clear role for local taxes, just as there is a role for user fees and grants from senior levels of government.

### 10.2.2. Which local tax or taxes?

The role for local taxes is to fund those services whose collective benefits are enjoyed by the residents of the local community. The question, then, is 'which tax' or 'which taxes'?

The strongest economic and fiscal arguments for assigning a tax or taxes to local governments come from the literature on fiscal federalism where there is wide spread agreement on general principles that should be followed. In short, this theory prescribes a limited tax base for local governments<sup>150</sup>. The best taxes are those that are based on an immobile tax base and therefore, borne primarily by local residents (not exported); that do not create problems with harmonization or harmful competition between local governments or local governments and more senior levels of government; and are easy to administer locally<sup>151</sup>.

Here, there is a strong defense for using property taxes<sup>152</sup>. First, the

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<sup>149</sup> Robin W. Boadway and Paul A.R. Hobson (1993), *Intergovernmental Fiscal Relations in Canada* (Toronto: Canadian Tax Foundation), chapter 3.

<sup>150</sup> Charles, E. McClure Jr. (2001), "The Tax Assignment Problem: Ruminations on How Theory and Practice Depend on History." *National Tax Journal*, Vol. LIV, No. 2, 339–363.

<sup>151</sup> Bird (2001), supra footnote 2; Richard Bird (1999), "Rethinking Tax Assignment: The Need for Better Subnational Taxes", draft paper, Fiscal Affairs Department, (Washington: International Monetary Fund); Wallace E. Oates (1998), "Federalism and Government Finance", in Wallace E. Oates (ed.), *The Economics of Fiscal Federalism and Local Finance* (Cheltenham, UK: An Elgar Reference Collection).

<sup>152</sup> A discussion in support of property tax funding for local public services that provide benefits of a collective nature to the local community is found in John Bossons, Harry Kitchen, and Enid Slack (1993), "Local Government Finance: Principles and Issues", an unpublished paper for the Ontario Fair Tax Commission, Toronto; Almos Tassonyi (1993), "The Benefits Rationale and the Services Provided by Local Governments", an unpublished paper for the Ontario Fair Tax Commission, Toronto; Paul A.R. Hobson (1997), "Efficiency, Equity and Accountability Issues in Local Taxation" in *Urban Governance and Finance: A Question of Who does What*, edited by Paul A.R. Hobson and France St-Hilaire

tax base is largely immobile and therefore, relatively efficient because distortions in economic behaviour are minimized<sup>153</sup>. Second, it is effective in funding, partially at least, those services whose collective benefits accrue to the local community; hence, it satisfies the benefits received criteria. Third, given that no single tax or two taxes are deemed to be entirely fair and distortion free, there is considerable merit in a state or national tax system that employs a mix of taxes including a local property tax.

The property tax that is most frequently defended, because it is used in this way in most developed countries, is one that is based on market values. But this need not be the case. It is just as defensible to support a local property tax that is based on unit-value or area assessment. Here, the tax base consists of a combination of building area and lot area. For each property, assessed value is the sum of lot area times an assessment rate per square metre plus the building area times an assessment rate per square metre of building area<sup>154</sup>.

Unit value has been used in Israel and in Rotterdam. It is also used in some economies in transition<sup>155</sup> (Poland and Ukraine, for example) where the absence of developed property or real estate markets makes it difficult to determine market value<sup>156</sup>. Similarly, it may make sense to use it in isolated hamlets or communities where there is no clearly functional market for property values because the government owns most of the housing and rents it to occupants<sup>157</sup>.

Other taxes have also been defended at the local level, even though they are generally less effective at satisfying the criteria for a good local

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(Montreal: The Institute for Research on Public Policy), 113–131 at 117–118; and see Harry M. Kitchen (2002), *Municipal Revenue and Expenditure Issues in Canada* (Toronto: Canadian Tax Foundation), chapters 3 to 5.

<sup>153</sup> McClure, 2001.

<sup>154</sup> Harry Kitchen (August 1989), "Alternative Methods of Taxation and Assessment", a report prepared for the Task Force on Reassessment in Metropolitan Toronto (mimeograph, Toronto), part VII.

<sup>155</sup> Jane Malme and Joan Youngman (2001), *The Development of Property Taxation in Economies in Transition*, (Lincoln Institute of Land Policy).

<sup>156</sup> Estonia, Poland, Czech Republic, Slovakia, Russia, and Armenia, for example. See Joan Youngman and Jane Malme (2000), *An International Survey of Taxes on Land and Buildings* (Netherlands: Kluwer Law and Taxation Publishers), p. 18.

<sup>157</sup> Harry Kitchen and Enid Slack (Dec. 18, 2001), "Providing Public Services in Remote Areas", a paper prepared for the World Bank Institute, Washington, D.C., p. 9.

tax. These include an income tax on individuals, some type of consumption based tax that could include a general sales tax, a hotel and motel occupancy tax, an automobile fuel tax, and a local automobile registration tax. The only local tax currently used, by itself, in place of the property tax is a local income tax. Support for it is generally based on the following arguments.

First, it is more progressive than the property tax in its distributional impact on local taxpayers. Second, its use would permit local governments to cast a wider net in capturing revenues from those who benefit from municipal services – residents, commuters and visitors. As noted above, a key tenet of the benefits model of local government finance is that those who enjoy the benefits of local services should pay for them. Recent U.S. evidence suggests that the cost of inner city services used by people who live in the suburbs and commute to work (in the city centre) exceeds, sometimes substantially, the taxes they pay for inner city services<sup>158</sup>. For these services, an income tax and even a sales taxes could be more effective at linking the costs and benefits of services than the property tax. Third, it is more revenue elastic than the property tax – a useful feature for local governments faced with increasing cost of local services. Fourth, it may be administratively easier for local governments in some countries to piggyback onto the state income tax than it would be to set up a new locally administered property tax system.

Many local governments in the countries summarized in this paper (*Tables 10.1 and 10.2*) currently rely on more than one local tax. In addition to the comments in the preceding paragraph, there are solid arguments for a mix of local taxes<sup>159</sup>. First, any single tax like the property tax is almost certain to create local distortions, some of which could be offset by other taxes. For example, the property tax may discourage investment in housing. A personal income tax, on the other hand, may encourage investment in owner-occupied housing because the imputed income of owner-occupied housing is not taxed. By relying on a

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<sup>158</sup> Howard Chernick and Olesya Tkacheva (August 5, 2002), “The Commuter Tax and the Fiscal Cost of Commuters in New York City” *State Tax Notes*, Vol. 25, No. 6, August 5, 2002, at 451–456; and Howard Chernick, “The Effect of Commuters on the Fiscal Costs of the District of Columbia” (December 2002), mimeograph, 36 pages.

<sup>159</sup> *Rodgers and Temple, 1996, at 229.*

number of different tax sources, there is the possibility that the distortions in one tax could be counteracted by the distortions in other taxes.

Second, additional tax sources would make the overall local tax structure more flexible, thus permitting local governments to choose taxes that fit local conditions and circumstances. For example, sales taxes might be chosen in situations where the benefits of services are enjoyed by commuters and visitors. Property taxes might be chosen where there is a need for a stable revenue source.

Third, additional tax sources could increase the revenue elasticity of the local tax base and allow it to adapt more easily to rising costs and service demands. The property tax is not an elastic source of revenue because it does not increase very quickly in times of economic growth (or decrease very quickly in time of economic slowdown). Other tax sources (such as sales and income taxes) are more elastic sources of revenue and would allow municipalities to benefit from economic success and to share in economic failure.

Fourth, access to other tax sources may permit local governments to avoid large property tax increases. Politically, this can be attractive given the extent to which increases in property taxes are highly visible and often unpopular with local taxpayers.

In general, arguments for more than one tax at the local level are particularly strong for large cities and city-regions, particularly when tax rates are set locally. Large cities and city-regions would be able to collect considerable revenues from these sources.

### *10.2.3. Are there other theories of local taxation?*

As noted in this section, the benefits based model of local taxation is an appropriate model for addressing local tax issues. Are there other theories of local taxation that might be appropriate? In general, the answer is no.

Discussion of taxation based on ability to pay criteria – an alternative to benefits received taxation – is commonly used for evaluating national, state, region, or provincial tax policy where these more senior levels of government have access to a wide range of tax instruments and where they are responsible for funding services that are more income redistributive in nature. Ability to pay as a base for local taxation is not thought to be appropriate for at least two reasons. First, the con-

stitutional role of local government in every developed country makes them creatures of the province, state, canton, or laender with their flexibility and choice of tax instruments severely restricted and controlled<sup>160</sup>. Second, services provided by municipal governments or that ought to be provided by municipal governments are those that are most efficiently and equitably funded from benefits based taxes (see section below) at the local level.

### **10.3. Issues in Local Taxation**

Recent trends, in most countries over the past decade, have displayed the following pattern. Senior levels of government, almost everywhere, have devolved additional spending responsibilities onto local governments while simultaneously reducing grant funding for these governments<sup>161</sup>. To offset this, municipalities have increased their reliance on own source revenues – user fees, permits, charges and whatever local taxation powers they have. At the same time, the growing importance of globalization has increased the importance of international cities. Cities are the major incubators of economic prosperity and the quality of urban life has become a prime determinant of location decisions made by firms and investors. International cities do not speak through their state or central governments; rather they speak for themselves. In this context, there has been increasing pressure, in some countries, to give cities access to additional taxes and greater autonomy in making their own fiscal decisions.

These trends or patterns raise a number of fiscal issues that are important for local governments in any country. These will be discussed within the benefits based taxation model and will draw upon practices in a number of countries. Some of the discussion may repeat what has been mentioned above but only where the repetition is intended to help in emphasizing a point or points.

#### *10.3.1. What public services should local taxes fund?*

Within the benefits based model of financing public services, local taxes should fund those services that benefit local residents/taxpayers.

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<sup>160</sup> Kitchen, 2001.

<sup>161</sup> *Ibid.*



In general, this means that local governments should fund a service unless it generates ‘spillovers’ or involves a redistribution of government.

**Spillovers:** This occurs when the provision of a specific service in a municipality affects residents of other municipalities. Spillovers (externalities) may consist of two types. Positive spillovers occur if residents of neighbouring municipalities receive a given service free of charge or for a user fee or tax that is less than the service’s cost. Negative spillovers occur when residents of neighbouring municipalities incur costs for services from which they derive no benefit or over which they have no control.

If the benefits of a particular service accrue almost exclusively to local residents, then the local government should be responsible for setting policy, acting as service manager and financing the service. If spillovers arise, there is a role for transferring responsibility for the service to a higher level of government to ensure the provision of the appropriate quantity and quality of service. If the spillovers are province-wide or state-wide, then the responsibility should be at the provincial or state level. If the spillovers are not province-wide but affect an area larger than the municipality, there may be a case for establishing a district, regional or metropolitan governing structure in order to internalise these externalities.

**Redistribution of Income:** In general, the central or state level of government should pay for programs whose primary purpose is the redistribution of income<sup>162</sup>. The reasons for this are twofold: first, the more senior levels of government have access to a broader mix of taxes, some of which are more closely related to ability to pay: the income tax, for example. Second, specific income redistribution programs are more effective if administered across larger geographical areas, where there is a greater opportunity to redistribute income from rich to poor. This does not, however, suggest that these services need to be delivered by federal or provincial governments. Their delivery might be more appropriate if handled locally where administrators are familiar with local circumstances and in a better position to accommodate specific circum-

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<sup>162</sup> While some elements of income distribution are inherent in most public services, income distribution services here include welfare payments, children’s aid, social housing and income transfer, to name the most obvious.

stances. Also, local delivery might be preferred if it generates cost savings although a potential downside of this may be a loss in accountability that often surfaces when one level of government spends the money that is raised by another level of government.

**Local Preferences:** For those services where spillovers are not prevalent and income redistribution is not an objective, a strong case exists for local responsibility (sometimes, referred to as satisfying the subsidiarity principle). A major advantage of this is that local preferences can be reflected in service levels and quality – an important consideration in securing efficient and accountable local government. In addition, if each municipality is responsible for a given service, a competitive environment will arise, in the sense that neighbouring municipalities will be able to benchmark the cost of providing the service with each other; the result will be stronger incentives for efficient and effective service provision. The same argument may be made for permitting neighbourhoods within municipalities to have different service levels; that is why some large cities have a number of separate tax areas where different levels of taxation fund different levels of service<sup>163</sup>.

**Other considerations:** In addition to spillovers and redistribution, some observers cite the supposed advantages of uniform state-wide or country-wide standards and economies of scale as reasons for assigning the responsibility for particular services to senior governments rather than local governments. Senior government responsibility is required, the argument goes, to achieve a minimum uniform standard across the state or country. State or central government responsibility is also appropriate if state-wide or country-wide service delivery results in economies of scale.

Neither of these arguments for assigning expenditure responsibility and hence, funding these services from locally generated revenues is accepted here. State or provincial governments in most countries already set standards for many locally provided and locally funded services including safety standards for building codes, police and fire protection; planning and zoning regulations; environmental controls and requirements for water supply, sewage treatment and solid waste; quality standards for roads; and so on. If uniformity in service standards

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<sup>163</sup> The City of Halifax in Nova Scotia, Canada has over 60 sub areas where tax differentials fund similar services of differing levels – see the *Annual Budget* of the City of Halifax.

were a criterion, the preponderance of state standards or regulations suggest that it should be responsible for almost all services currently provided by local government. As long as there is a local government, this should not happen.

Economies of scale is likewise dismissed as a criterion, primarily because it is generally associated with service production and delivery and not decision-making and funding responsibility. Distinguishing between decision-making and funding from actual production and delivery is important. The latter may be handled in a number of ways – by the governing unit itself, by contracting out to the private sector, or by buying from another governing unit. Decision-making and funding responsibility is different. It must be left with the local government which, in turn, must have the appropriate funding tools for financing local decisions.

Although these principles are easily described, the actual task of assigning policy setting responsibility and funding to either the state or municipality on the basis of these criteria is not as clear-cut as it may appear. Some individuals might perceive significant spillovers in certain services while others do not. Some might view some services as being entirely driven by local preferences while others might not. The allocation of service responsibility to a particular level of government, then, partially reflects the views of the individual(s) determining the allocation. In spite of the difficulties in assigning unequivocal responsibility for services such as land ambulance, police, public transit, to name three, there are many on which most analysts, policy makers, municipal officials and local citizens could likely agree. In particular, these include state or provincial responsibility for all income redistributive services such as social services, care for the aged and day nurseries, and social housing. As well, there is general agreement that the local sector should be responsible for local streets and roads, water, sewer and solid waste, public parks and recreation, sidewalks and street lighting, fire protection and so on. In general, application of these principles in assigning service responsibility generally results in a provincial/municipal allocation of major services that is similar to that in Table 4. Given that local governments ought to be responsible for services that benefit local residents either directly or collectively, it follows that they ought to have access to revenue sources permitting them to cover costs. Some of these revenue issues are discussed next.

Table 10.4

**State versus Local Government Responsibility for Policy Setting  
and Funding of Major Public Services**

<b>Major Service</b>	<b>Municipal</b>	<b>State</b>
Municipal government administration	XX	–
Protection:		
Police	XX	–
Fire	XX	–
Emergency planning	XX	–
Roads:		
Provincial highways	–	XX
Local roads	XX	–
Sidewalks	XX	–
Street lights	XX	–
Parking	XX	–
Public Transit	XX	–
Health:		
Hospital care	–	XX
Preventive care or public health	XX	XX
Ambulance service	–	XX
Social Services:		
Welfare assistance	–	XX
Day care services	–	XX
Children's assistance	–	XX
Homes for the aged	–	XX
Social housing	–	XX
Education:		
Elementary and secondary	–	XX
Post secondary education	–	XX
Environment:		
Water supply and distribution	XX	–
Sewage collection and treatment	XX	–
Solid waste management	XX	–
Recreation and Culture		
Community parks and recreation programs	XX	–
Local libraries	XX	–
Community centres, theatres and auditoriums	XX	–
Convention facilities	XX	–
Planning and Development:		
Local planning, zoning, severances and approvals	XX	–
Local economic development	XX	–

*Note:* Allocation of responsibilities as generally supported by reference to a set of principles discussed in this paper.

### 10.3.2. *Is one tax preferred over other taxes?*

The information in *Table 10.1* illustrated the different taxes on which local governments rely to finance local government services in a number of countries. Clearly, as discussed above, there is no obvious tax that stands out as the best or ideal tax in every instance. The property tax has often been defended as the best local tax because its base is immobile; the residential portion cannot be exported; it permits local governments to tax those residents who benefit collectively from local services<sup>164</sup>; and its high visibility helps to ensure that local governments work in an accountable, transparent, and efficient manner. Critics of the property tax have argued that it is difficult to administer<sup>165</sup>, especially if the tax base is property value and a proper functioning real estate market does not exist<sup>166</sup>. As well, it is a poor tax when it comes to taxing commuters and visitors, and it is not revenue elastic. In some countries where property taxes have been the backbone of local finance, there is increasing concern as to whether or not it can continue as the only major tax available to local governments if the latter are to be fiscally sustainable.

Local income and sales taxes are also used in a number of countries. While neither of these adhere to the benefits based model of local taxation as closely as the property tax, they may be designed to capture benefits in a more round about way and both can be useful components of a local tax system – either alone or as a supplement to the property tax. If sales or income taxes fall on local residents, their incidence may be more progressive than the property tax (injecting some elements of ability to pay into the local tax system). In addition, their use would permit local governments to collect revenue from commuters and visitors. They are more revenue elastic than the property tax and will almost certainly be easier to administer if they are piggybacked onto the state tax with tax rates set locally. A major problem with these taxes is that they may be exported which has the potential to reduce local accountability and lead to inefficiencies in the allocation of local resources.

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<sup>164</sup> User charges should be used for those services that benefit to specific individuals.

<sup>165</sup> See the property tax paper by Harry kitchen in this series of papers.

<sup>166</sup> One way around this would be to ignore market value and to tax the square metre of land and buildings. One could even have a different tax per metre for buildings and for land.

In summary, there is no single local tax that is unequivocally preferred over other taxes. Where the local public sector is well developed and plays an important role in financing a number of expenditure responsibilities, there are solid arguments for giving local government access to a range of taxes. Where the local public sector is less well developed and expenditure responsibilities minimal, access to one local tax may be sufficient. In deciding which tax or taxes are appropriate for local governments, a number of factors come into play, not the least of which is the local government's ability or capacity to administer local taxes, the kinds of public services funded by local taxes, and the tax culture of a country (are taxpayers inclined to support taxes on the basis of benefits received or are they more inclined to support taxes based on ability to pay).

### *10.3.3. Who should set local tax rates?*

International experience tells us that local governments are more responsible, efficient and accountable if they are required to fund their expenditures from locally generated revenues. This includes setting local tax rates. Additional autonomy could also be achieved if local governments were free to establish and determine their local tax base, however, high administrative costs of doing so generally argue against it. For income and consumption based taxes, it is far less expensive to piggyback onto an existing state tax with local governments setting the local tax rate. For property taxation where a senior level of government is not involved, local administration will be necessary.

For single tier local governments, local tax rates should be set by the governing council of the jurisdiction responsible for spending the money. For two-tier local governments where the lower tier is responsible for a range of services and the upper tier (that encompasses a number of lower tiers) is responsible for services that spill over the lower tier boundaries<sup>167</sup>, the lower tier should set its own tax rates and the upper tier should set its tax rates. This practice follows the principle that those who spend the money should be responsible for raising it.

The practice of having each tier of local government in a two-tier structure set its own property tax rate on the same property tax base is

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<sup>167</sup> See Enid Slack's paper in this series of papers.

common in Canada. In some U.S. states, the application of a local sales tax or income tax to the same tax base as used by the state is common practice. These examples suggest that it is not uncommon for different levels of government to impose different tax rates on the same tax base. Nor does it follow that the level of government that sets the tax rate need collect the tax revenue. Returning to the Canadian experience, let us consider the province of Ontario. Here, all regional and county governments (upper tier) set their own taxes independently of the tax rates set by the local municipalities (lower tier). The local municipalities then send out combined tax bills and collect both upper and lower tier taxes. This practice has been around for years and has been fiercely defended in the presence of a number of proposals to migrate billing and collection to the upper tier where cost savings could be achieved because of distinct economies of scale that are present in this operation<sup>168</sup>. Billing and collection is an administrative function and has nothing to do with policy setting or decision-making; hence, there is no reason why billing and collection needs to rest with the taxing jurisdiction that sets the tax rate.

#### *10.3.4. Should local tax rates be uniform or differentiated across a municipality?*

Given that local governments should be responsible for setting their own tax rates, there is the question of whether or not these rates should be uniform throughout the entire jurisdiction or whether they should be differentiated across property types and geographical areas within the jurisdiction. Whether a tax should be differentiated or not may also depend on the type of tax or the way it is administered.

Under benefits based taxation, individuals and businesses that benefit from local public services should pay for them. Where these benefits vary by individual, by property type, or by area of the municipality, a case exists for charging differential taxes to the extent that it is possible.

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<sup>168</sup> W. Douglas Armstrong and Harry Kitchen (May, 1997), *Peterborough County/City Municipal Review: Final Report*, (Peterborough: Joint Restructuring Steering committee), pp. 125–127.

For a local tax, such as the property tax, differential tax rates are justified on a number of grounds<sup>169</sup>. First, they are fair on the basis of benefits received as long as the tax rate is set to capture the cost of municipal services used up by different property types or property location. Second, they are efficient if they reflect differences in the cost (production, environmental and social) of delivering services to different property types. In other words, if some properties or property types are more expensive to service, a case can be made for differential property tax rates. Failure to correlate benefits from local government services, as they are reflected in effective property tax rates, with the extra cost of services consumed (or an approximation of it) leads to a redistribution of income that is not neutral. If the effective tax rate exceeds the extra cost of delivering the service, incentives exist for people or businesses to relocate to lower taxed areas unless they are willing to accept lower property values. Third, variable tax rates have a further advantage in that they could be used to distort decisions deliberately to achieve certain municipal land use objectives. For example, if higher tax rates slow development and lower tax rates speed up development, a deliberate policy to develop certain neighbourhoods instead of others might be achieved through different tax rates for different locations.

Variable property tax rates have recently grown in popularity in some jurisdictions; for example, municipal governments are now permitted to use variable property tax rates in three Canadian provinces – British Columbia, Alberta, and Ontario. Variable tax rates may also be achieved by applying the general property tax rate to one or more groups of properties (certain neighbourhoods or downtown business area, for example) whose assessments have been increased because these properties receive additional municipal services. Special assessments and special area financing are common in some municipalities; for example, the city of Halifax in Canada has over 60 such areas with different rates.

Differentiated local income tax rates are not common, but they do exist in a few cities in the United States. Use of two different rates can be justified on benefit grounds. Those who work and live in the same city benefit from city services and should pay for them. Those who work in one city and live in another community still benefit from some of the

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<sup>169</sup> Enid Slack (2002), "Property Tax Reform in Ontario: What Have We Learned?" *Canadian Tax Journal*, Vol. 50, No. 2, 576-585.



former city's services – local roads and streets, sidewalks, police and fire protection and so on. For this, they should also pay a tax, although at a lower rate than the tax on residents. In cities where split rates are used, the practice is to impose a lower rate of income tax on commuters (those who work in the taxing jurisdiction but live elsewhere) and a higher rate on residents. Here, it should be noted that New York City in 1999 dropped its income tax on commuters in spite of solid analytical and empirical support for continuing with it<sup>170</sup>. The administration of split rate local income taxes is fairly straight-forward. The employer withholds the tax and remits it to the government. The employer also knows the residence of all employees and could apply the rates accordingly.

For consumption-based taxes, however, differentiated tax rates are not administratively possible. A local sales, fuel or hotel and motel occupancy tax, for example, is collected by the vendor. The vendor could not be expected to charge different rates to different customers on the basis of residency or some other characteristic of the customer.

#### *10.3.5. Should local tax rates be regulated?*

Regulation of local tax rates may depend on the type of tax used and the role it plays within in a country. If local governments use taxes that are only in their domain (property tax, for instance) and if their tax rates are set to generate required revenues for funding local services, there are no solid economic or political arguments for regulating the general tax rate. In democratically elected local councils where all decision-making responsibilities rest with local councils, citizens/taxpayers have the ultimate control or power over council's tax decisions – the opportunity to vote the politicians out at the next election.

If, however, local governments share the tax base with a senior level of government, yet have the power to set their own rates (which they should, as was argued earlier), there may be a case for regulation if the rate setting action of local government creates spillover or externality problems for senior governments. For example, if state or central and local governments have access to the same income tax or sales tax system and if the senior level of government lowers tax rates to achieve important state or national goals (to foster economic growth or to

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<sup>170</sup> Chernick and Tkacheva, 2002.

enhance competitiveness, for example), they may wish to regulate what local governments do to prevent the latter from increasing its tax rates to take up the vacated tax room. While regulation here would be justified, significant funding problems may still exist for local governments that need tax revenue to meet expenditure needs.

A further externality argument for regulation arises in instances where local governments tax businesses. If the local tax on business is set to recover the cost of services used, it is efficient, fair and accountable. The practice in many countries, however, is for local taxation to overtax business, thus creating potentially serious economic problems for the entire state or country. To prevent harmful and serious consequences, there may be a case for some state regulation<sup>171</sup>. This is discussed in more detail below under the taxation of businesses.

Regulation has also been defended as a way of controlling local government service costs. Cost efficiency in service provision, however, is more effectively achieved through the introduction of competitive elements in the production and delivery of each public good and service, not through regulating tax rates.

#### *10.3.6. Should local government tax business?*

Depending on the country, local government taxation of businesses may include a property tax on commercial and industrial properties, a tax on capital, a corporate income tax and a range of other industry and commerce taxes<sup>172</sup>. The strongest economic argument for local taxation of commercial and industrial properties is to tax them in order to recover the cost of local public services that they use. Where specific beneficiaries of these services can be identified, user charges are preferred. Where user charges are not possible because specific beneficiaries cannot be identified, some type of general tax levy may be appropriate. Under the benefits based model of local taxation, this approach fits with the model of a good local tax – immobile base and limited opportunity for exporting the tax to other jurisdictions.

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<sup>171</sup> Richard M. Bird and Thomas A. Wilson, (June 2003), "A Tax Strategy for Ontario", a paper prepared for the Panel on the Role of Government in Ontario.

<sup>172</sup> Giancarlo Pola, ed. (1991), *Local Business Taxation: An International Overview* (Milano: Vita e Pensiero).

Local government taxation of non-residential property is almost never efficient or fair. For example, in countries with a fully developed property tax system, higher taxes – either through assessment differentials or differential tax rates – are almost always imposed on non-residential properties when compared with residential properties. This practice is inefficient because property taxes from non-residential properties are used to subsidize services consumed by the residential sector. Since service levels in any municipality are driven primarily by the demands of the residential sector (they vote), their subsidization means that the residential tax rate will be less than it would be in the absence of the subsidy and an oversupply of municipal services could follow. Equity is not achieved either if those benefiting from the services are not paying full costs.

This heavy taxation of the non-residential sector has been addressed in two Canadian studies that compared the property tax paid by non-residential properties with the cost of municipal services consumed by these properties. Both studies<sup>173</sup> found that the residential sector when compared with the non-residential sector is the recipient of proportionately more benefits from local government services (social services, elementary and secondary education, libraries, recreational facilities, etc.). When combined with higher effective property tax rates paid by the non-residential sector, the studies concluded that the latter is over-taxed and the residential sector under-taxed. Beginning in 1995, this prompted the local council in the City of Vancouver to shift, over the ensuing five years, some of its tax burden from the commercial and industrial sector onto the residential sector. More recently, the provincial government in Ontario announced that tax increases beyond the range of fairness<sup>174</sup> (established as a standard that is defined by taking the ratio of commercial/industrial taxes to single dwelling residential property taxes) must be imposed on the residential sector and not on the commercial/industrial sector.

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<sup>173</sup>Harry M. Kitchen and Enid Slack (1993), *Business Property Taxation*, Government and Competitiveness Project Discussion Paper no. 93-24 (Kingston, Ont.: Queen's University, School of Policy Studies, 1993); and KPMG, "Study of Consumption of Tax Supported City Services", a report for the City of Vancouver, mimeograph, 1995.

<sup>174</sup> For a discussion of this, see *Kitchen (2002)*, at 108–109.

A more recent study in the United States found similar results. Specifically, it was estimated that the 'business related' share of combined state and local expenditures in the United States is about 13 percent, although there is considerable variation from state to state<sup>175</sup>. These businesses, however, pay proportionately more of the state and local taxes.

Further concerns with this heavy of the non-residential sector arise because this tax represents a fixed charge that the firm must pay. This, by the way, is the same criticism that is directed at capital taxes. Both taxes are fixed in the sense that they are unrelated to the value of municipal services consumed or profits earned. As long as the tax rate is more than necessary to cover the cost of the last unit of municipal services consumed or if there are no economic rents for it to capture, resources will be allocated inefficiently. This over-taxation of the non-residential sector may lead to less economic activity, lower output, fewer jobs and a less competitive business environment<sup>176</sup>.

There is also an issue of whether taxes on non-residential properties play a role in location decisions. Since firms and businesses generally locate where they can maximize profits, the provision of fiscal inducements such as lower property taxes can influence a firm's location decision in the same way as the reduction in other production costs may play a role. The impact of property tax differentials depends on a number of factors including the size of the differential between competing municipalities and whether this differential is sufficient to offset differentials in other costs or market factors.

While it is uniformly accepted that the cost of doing business is an important factor in location decisions, there is less consensus on the role played by property taxes in this decision. The evidence, most of which is drawn from the U.S., suggests that property tax differentials are relatively unimportant in inter-municipal or inter-regional location decisions but do play an important role in intra-municipal or intra-

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<sup>175</sup> William H. Oakland and William A. Testa, "Community Development-Fiscal Interactions: Theory and Evidence from the Chicago Area", Working Paper Series No. 16 (Chicago, IL: Research Department: Federal Reserve Bank of Chicago.

<sup>176</sup> *Report of the Technical Committee on Business Taxation* (April 1998), (Ottawa: Department of Finance) at chapter 2.

regional location decisions<sup>177</sup>. In other words, property tax differentials are unlikely to affect a firm's decision to locate in a specific city-region, but once it has decided to go there, property taxes may play a role in where it locates within that region. To this extent, higher effective tax rates on commercial and industrial properties in one municipality within a region or area when compared with neighbouring municipalities create an incentive for firms and businesses to locate in the lower taxed municipalities. In the extreme, one might expect these property tax differentials to produce a heavy (why not all) concentration of all firms and businesses in the lower taxed jurisdictions. In other words, intramunicipal tax competition<sup>178</sup> could be potentially destructive if it led to a race to have the lowest tax rates. A recent study on municipalities in British Columbia examined this issue and concluded that while there is some evidence that municipalities react to tax increases of their neighbours, there is no widespread destructive competition for capital<sup>179</sup>. Similar studies in the U.S., however, have concluded that property tax competition among neighbouring municipalities is much more prevalent and wide spread<sup>180</sup>.

In reality, the extent to which firms and businesses respond to tax differentials depends on many factors. These include, for example, the importance of being in the core of the region or area for business reasons; the opportunity to shift the tax differential on to consumers (of the final service or product), employees and owners; and the enhanced amenities that may be offered by a "downtown location."

In a U.S. study of individual office buildings in downtown Chicago, it was found that 45 percent of property tax differentials were shifted forward onto tenants as higher gross rents per square foot and 55 percent were borne by owners<sup>181</sup>. Some firms are apparently willing to pay a

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<sup>177</sup> Kitchen and Slack (1993), *supra* footnote 45. Similar comments were made by officials of the Greater Toronto Marketing Agency in December of 2000.

<sup>178</sup> Tax competition is addressed in a paper by Francois Vaillancourt in this series of papers.

<sup>179</sup> Craig Brett and Joris Pinkse (2000), "The determinants of municipal tax rates in British Columbia", *Canadian Journal of Economics*, vol. 33, no. 3, 695–714.

<sup>180</sup> Jan K. Brueckner and Luz A. Saavedra (2001), "Do Local Governments Engage in Strategic Property-Tax Competition?" *National Tax Journal*, Vol. LIV, No. 2, 203–229.

<sup>181</sup> McDonald, John F. (1993), "Incidence of the Property Tax on Commercial Real Estate: The Case of Downtown Chicago", *National Tax Journal*, 109–120.

premium to locate in the downtown core. This suggests that those firms benefit from 'economic rents' created by that location; large financial institutions, for example, may benefit from a downtown location. Taxing these rents is efficient from an economics standpoint because it will not impact on the location decision. It is difficult to know, however, the extent to which economic rents exist. In other words, it is difficult to know at what rent (or property tax) level a firm will choose to move out of the downtown location.

There is at least one more positive effect that could arise from shifting the tax burden away from the non-residential sector<sup>182</sup>. Reducing the property tax burden on this sector would reduce the potential for exporting<sup>183</sup> the tax to non-residents, thus leading to an improved allocation of resources and an increase in local accountability. Tax exporting refers to situations in which some portion of the burden of a tax is borne by non-residents either through changes in relative commodity prices or in a change in the net return to foreign owned factors of production (inputs in the production process). For example, if higher effective tax rates on commercial and industrial properties lead to relatively higher prices charged on the sale of that community's exports (to other communities), the taxing jurisdiction will have effectively shifted part of its tax burden onto residents of other communities. If the non-residential tax in every jurisdiction is exported to some extent, those jurisdictions exporting relatively more of the non-residential property tax will be better off than those jurisdictions exporting relatively less. In particular, if the burden of this tax is shifted from residents of high income jurisdictions to those of low income jurisdictions, the distribution of income among jurisdictions is worsened. Furthermore, this may run counter to state equalization schemes that are aimed at redistributing resources (income) from relatively high income jurisdictions to relatively low income jurisdictions.

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<sup>182</sup> Sylvester Damus, Paul Hobson and Wayne Thirsk (1987), *The Welfare Effects of the Property Tax in an Open Economy*, Discussion Paper No. 320 (Ottawa: Economic Council of Canada); and Shantayanan Devarajan, Don Fullerton, and Richard A. Musgrave (April 1980), "Estimating the Distribution of Tax burdens: A Comparison of Different Approaches," 13 *Journal of Public Economics*, 155-82.

<sup>183</sup>Of course, the ability of a firm to export will depend on the elasticity of demand for the exported product.

The limited evidence on tax exportation in Canada covers a sample of the larger municipalities in the province of Ontario<sup>184</sup>. The results suggest that the degree of exportation ranged from a low of 16% of the non-residential tax burden to a high of 106%. More than this, relatively rich municipalities had relatively high exporting rates whereas relatively poor municipalities had relatively low tax exporting rates. Here, the practice of exporting the property tax results in an implicit transfer from relatively low income municipalities to relatively high income municipalities.

Furthermore, when the commercial/industrial sector exports its tax burden, municipal government accountability is weakened because the direct link between the government responsible for local services and the ultimate person/agency/body paying the tax is missing.

Concern over the kinds of distortions created by the non-residential property tax has prompted at least one innovative suggestion for reform in Canada<sup>185</sup>. Specifically, it has been argued that revenues from a portion (the amount that exceeds the funds necessary to cover the cost of local services consumed) of the non-residential property tax should be replaced with revenues from a new provincial business value tax (BVT). The BVT would be a value-added tax<sup>186</sup> and would exist alongside the federal goods and service tax (GST). It would be levied on business income; and it would fall on production and not on consumption. Thus, it would be an origin based, rather than destination based tax: it would tax exports and not imports. Municipalities would be able to set local rates that would be 'piggybacked' onto the provincial rate, although the province might impose limits on local surcharges to prevent location distortions. As a value-added tax (essentially, a base that is sales less cost of goods purchased), a BVT would eliminate a number of the distortions created by the current taxation of non-residential property in Canada. Comparable taxes are currently used in Germany and Japan. Italy has a

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<sup>184</sup>For elaboration on this, see Wayne R. Thirsk, (1982) "Political Sensitivity Versus Economic Sensibility: A Tale of Two Property Taxes," in Wayne R. Thirsk and John Whalley, eds., *Tax Policy Options in the 1980s* Canadian Tax Paper no. 66 (Toronto: Canadian Tax Foundation) 384-40.

<sup>185</sup> Richard M. Bird and Jack M. Mintz (2000), "Tax Assignment in Canada: A Modest proposal" in Harvey Lazar, editor, *Canada: the State of the Federation 1999/2000*, (Kingston: Queen's University, Institute of Intergovernmental Relations) at 261-292.

<sup>186</sup> For an evaluation of value added taxes, see *Boadway and Kitchen (1999), chapter 5.*

structurally similar tax that is used and administered by larger regions and metropolitan areas.

As for a local corporate income tax, there is no sound economic justification. Capital is highly mobile and the tax is almost certain to be exported, thus making it an unsatisfactory tax for local governments.

### *10.3.7. What are the conditions for local government fiscal sustainability?*

Recent trends around the world to decentralize additional funding requirements from central and state governments to local governments without corresponding grant support has raised the question of whether the latter can be fiscally sustainable in the future. This new fiscal environment has emerged at the same time as cities and urban centered regions have become increasingly important in the competitive global economy. As mentioned earlier, cities and large urban centres are the major incubators of economic prosperity<sup>187</sup> and the quality of urban life has become a prime determinant of location decisions. Growing and expanding businesses engaged in national and international activities locate in cities and urban centered regions where they have access to a highly qualified workforce (knowledge workers) as well as access to business services, transportation and communications networks. Local governments, in providing goods and services and in financing them, can play an important role in attracting and retaining businesses. The provision of local public goods and services affects the quality of life and influences where people live and invest and where businesses locate. The quality of the school system, cultural and recreational facilities, physical infrastructure, social services and the range of housing choices are important factors.

This growing importance of local government raises the question of whether they have adequate fiscal tools or levers to fund necessary local services and facilities. To thrive financially, local governments must have the capacity to generate sufficient revenues to meet their expenditure needs, obligations and commitments. This is affected by at least three things.

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<sup>187</sup> Michael Cohen (2001), "The Impact of the Global Economy on Cities", in *The Challenge of Urban Government: Policies and Practices*, edited by Mila Freire and Richard Stren (Washington: World Bank Institute), 5–17.



1. The cyclical sensitivity of local government funding responsibilities - do expenditure programs vary with the growth or slow down in economic activity (social services, social housing, for example)?
2. The capacity of the local revenue base and local taxes to keep pace with expenditure responsibilities – is there enough revenue elasticity in the local tax base to permit revenues to rise and fall with expenditure requirements?
3. The ability of local governments to control their own destiny – do local governments have sufficient control over their expenditure responsibilities and revenue sources to meet changing fiscal circumstances?

The extent to which local governments and cities, in particular, meet these conditions varies. In general, one can state that local governments should only be responsible for funding those services that benefit residents of their local jurisdiction. All income redistributive services, services that generate spillovers and those in which there is a state or national interest should be funded by more senior levels of government. As well, local governments should have access to revenue sources that are elastic enough to provide them with the necessary revenues, without imposing undue tax burdens, to meet their local expenditure commitments. Finally, they should have the power and freedom to meet the demands of their constituents without unnecessary tax restrictions and regulations.

#### **10.4. Summary**

There are no definitive conclusions that can be drawn about patterns of local taxation across countries nor can anything be concluded about the appropriateness of one local tax over another. Local governments in some countries rely on property taxes; in other countries, they rely on income taxes; and in still other countries, they rely on a mix of local taxes – property, sales and income. Reliance on a specific tax or taxes is dependent on a number of things including the traditional or historical pattern of taxation in that country; the local government's capacity to administer its own taxes; the types of expenditures that local government must fund; the willingness of state or central governments to assign taxes to local government; the constitutional and legislative re-

quirements within which local governments operate; and a variety of other factors.

What we do know from international experience is that local governments carrying out their expenditure responsibilities are likely to be more efficient, responsible, accountable and transparent if they are required to raise the revenue that they spend. As well, these criteria are more likely to be met if local governments have the fiscal autonomy to determine both their tax base and tax rates without limits on revenue collected, tax base and tax rate. Fiscal autonomy is least when both the tax base and tax rate are set or controlled by senior levels of government. Tax sharing arrangements between local and state government also lead to different levels of tax autonomy. Here, the degree of autonomy will depend on whether or not local government consent is required before any change can be made in the tax sharing formula.

Based on the countries surveyed, most local governments have some, if not considerable, autonomy in setting local tax rates and almost no control over their tax base. Where local tax sharing arrangements are in place, the tax split between state and local governments is generally fixed in legislation or determined by the senior level of government. Only in a handful of countries does the local sector have any say in the tax split in the revenue sharing formula.

Given that there is no single, consistent or uniform tax used by local governments around the world, the question that emerges is whether there is a theory of local government taxation that can be used to answer two important questions. First, what is the appropriate role for local taxes? Second, of all taxes that are available, is there one that is more desirable or appropriate than others in funding local services or should a mix of taxes be used?

The first question is probably best addressed by reference to the principal-agent model of state-local fiscal relations. Here the state is the principal and local government the agent. Within this model, local taxes fund local services that provide collective benefits to the local community. Local taxes are not used for services that are income redistributive in nature, that generate spillovers affecting neighbouring communities, and that are designed to satisfy state or national goals or objectives.

In response to the second question, the best taxes are those that are based on an immobile tax base and therefore, borne primarily by local residents (not exported); that do not create problems with harmonization or harmful competition between local governments or local governments and more senior levels of government; and are easy to administer locally. Here, there is a strong case for using a property tax, especially one that includes variable tax rates to capture differences in the cost of providing local public services to different locations within a taxing jurisdiction, different property types and any other property trait that affects local service costs.

Other taxes have also been defended at the local level, even though they are generally less effective at satisfying the criteria for a good local tax. These include an income tax on individuals, some type of consumption based tax that could include a general sales tax, a hotel and motel occupancy tax, and an automobile fuel tax. The only one currently used alone in place of the property tax is a local income tax. Support for it is generally based on the following arguments. It is more progressive than the property tax in its distributional impact on local taxpayers. Its use permits local governments to cast a wider net in capturing revenues from those who benefit from municipal services – residents, commuters and visitors. It is more revenue elastic than the property tax.

There are also arguments in support of a mix of local taxes, especially for large cities and city-regions. Here, reliance on a single tax like the property tax is almost certain to create local distortions, some of which could be offset by other taxes. Additional tax sources would make the overall local tax structure more flexible, thus permitting local governments to choose taxes that fit local conditions and circumstances. Additional tax sources would increase the revenue elasticity of the local tax base and allow it to adapt more easily to rising costs and service demands.

Over the past decade or so, local governments, virtually everywhere, have faced a similar pattern – declining grants from senior governments, devolution of additional funding responsibilities, and a limited tax base that may not be sufficient to meet future fiscal challenges and objectives. This, in turn, has raised a number of issues around local taxes. In particular, there is ongoing debate over local tax funding of public services – what should local government be expected to fund

from their limited tax base? Is one tax preferred over another? Who should set local tax rates? Should these rates be uniform or differentiated across a taxing jurisdiction? Should local tax rates be regulated? Should local government tax businesses? Are local taxes currently sufficient to ensure local fiscal sustainability?

While answers to the above questions are long and, at times, convoluted, there is a general consensus that local taxes should only fund those services that benefit the local community; that there is no single tax that is ideal or preferred everywhere – indeed, a mix of taxes may be desirable; that the governing unit that spends tax dollars should be responsible for raising it including setting local tax rates; that differential tax rates should be used to capture differences in the cost of delivering local services; that local tax rates, in general, should not be regulated; that local governments should not overtax businesses as they do in virtually every country; and that senior governments must ensure that local governments have the funding tools to ensure fiscal sustainability.

## **Chapter 11. Tax Competition and Tax Mimicking by Sub-national entities: a Summary of the Literature**

The tax behaviour of sub-national entities (SNE) in a country, be it federal or not, is an important aspect of fiscal behaviour and an important source of irritants, along with direct subsidies to attract investments, in intra-country inter-SNE relations. We use sub-national entity as a generic name for a province, state, county or municipality within a country; such an entity normally has a government with a certain degree of autonomy in a varying number of matters including taxation. Tax behaviour will be the focus of this paper; we will leave aside subsidies, which are negative taxes and general SNE policies in fields such as education, language or welfare that may have an impact on SNE economic attractiveness and competitiveness. Tax behaviour has been the subject of both theoretical and empirical work by economists in the last fifty years or so. This paper will draw on this existing body of work address five questions:

1. What is tax competition?
2. What are the arguments against tax competition?
3. What are the arguments for tax competition?
4. What kind of behaviour is observed?
5. What are the policy issues?

### **11.1. What is tax competition?**

In the Encyclopaedia of Tax Policy, tax competition is defined as explicit or implicit. The author of the tax competition entry writes that « governments engage in explicit tax competition when they enact tax laws and regulations *expressly* designed to enhance the attractiveness of their jurisdictions to businesses, residents, employees or consumers...(and) ...in implicit tax competition when they modify their pursuit of other tax policy goals-such as equity, neutrality, simplicity, revenue adequacy, or tax exporting – in order to mitigate anti-competitive consequences» (Tannenwald, 1999). Thus tax competition is seen as something bad, which is odd given the connotation of good usually associated with competition in economics. In this case, good is associated with tax harmonisation which does away with disharmony, some-

thing a priori difficult to object to. Thus, one slips from tax competition to tax disharmony with little regard for what is meant exactly by harmonisation but with often the notion of uniformity synonymous with harmony. For example, Cnossen and Shoup when discussing tax harmonisation in Europe write that «EC policy makers appear to believe that members states should first be forced in the strait-jacket of a **uniform** tax system» (emphasis ours; *Cnossen and Shoup, 1977, 82*).

Wilson and Wildasin(2001) proceed differently from Tannenwald, going from the general to the particular. They present three definition of tax competition:

- The broad definition: tax competition is defined very broadly as any form of non- co-operative tax setting by independent governments.
- The narrower definition: this definition adds the requirement that each government’s tax policy influences the allocation of tax revenue across government treasuries.
- The narrowest definition: they define tax competition as non-cooperative tax setting by independent governments, under which each government’s policy choices influence the allocation of a mobile tax base among “regions” represented by these governments. In particular, governments may compete over the allocation of workers, firms, capital, or shoppers.

Thus there is no commonly accepted definition of tax competition and the various studies cited here will not in general use the same definitions. Tax mimicking is linked to tax competition since mimicking lessens competition while its absence may be due to competition.

## **11.2. What are the arguments against tax competition?**

The classic formulation of the argument against tax competition was put forward by Oates (1972) who writes that “*The result of tax competition may well be a tendency toward less than efficient levels of output of local services. In an attempt to keep taxes low to attract business investment, local officials may hold spending below those levels for which marginal benefits equal marginal costs, particularly for those programs that do not offer direct benefits to local business.*”

In fact, local officials will add to the conventional measures of marginal costs with costs such as reduced tax bases, lower wages and employment levels or capital losses on homes or other assets that result

from the negative impact of taxation on business investment. This will reduce public spending and taxes to levels where the marginal benefits equal the higher marginal costs. Oates' conclusion that this behaviour is inefficient results from the fact that when all governments behave this way, none gain a competitive advantage, and consequently communities are all worse off than they would have been if local officials had simply used the conventional measures of marginal costs in their decision rules" (*Wilson, 1999*). This is also the view of *Zodrow and Mieszkowski, 1986* and *Wilson, 1986*.

*Tannenwald, 1999, p. 370* also raises the issue of lower revenues as part of a list of four elements:

- State and local tax incentives reward firms for behaviour they would have exhibited anyway;
- Tax competition ultimately lowers revenues without enhancing competitive standing and thus lowers spending for needed services;
- Tax incentives confer windfall in a capricious pattern, distorting the inter-industry allocation of resources;
- Tax competition discourages progressive taxation by sub-national governments.

He also notes the fact that this may not modify firm behaviour, something that we will come back to in the fourth section of this paper.

*Boadway, 2001* associates three outcomes with fiscal competition in a federal context, summarized as follows:

- Fiscal Inefficiency: this results from the fact that some regions have larger tax capacities than others, either using residence-based taxes (income,...) or source-based taxes (natural resources,...) with the later capable of tax exportation and from the fact that some regions have larger needs (demography, topography,...) than others. In a unitary tax system, this is not apparent but emerges when there is decentralization. As a result, Net Fiscal Benefits (value of publicly provided goods, services and transfers *minus* taxes paid) vary between regions, creating an incentive to migrate and thus an inefficient allocation of resources between the regions of a given country;
- Horizontal Fiscal Externalities: this results from the fact that the tax choices of one region have an impact on another region. One dis-

tinguishes between positive and negative tax externalities. Positive externalities result from too low a tax rate in beggar thy neighbour type policies or too high a tax rate that reduces the tax base. Negative externalities result from tax exportation with a tax levied by one region being paid by the residents of another;

- Vertical Fiscal Externalities: this results from the interaction between the central level of government and SNEs. An increase in the tax rate of one level of government can have an effect on the tax revenues and /or tax rate(s) of the other level of government.

Beggar thy neighbour policies are a different way of labelling reduced tax revenues and expenditures.

Other explanations can be put forward as to why tax competition is seen as bad. One of them is that, implicitly at least, the model of federalism used in the analysis is that of fiscal federalism and not of federal finance (*Bird and Vaillancourt, 1998*). In the fiscal federalism view of the world, one is decentralising responsibilities and revenues, with the norm being the centralized solution. Hence, one minimises distortion with respect to a centralized country with uniform taxation as very few countries make any significant use of regionally differentiated central income (personal or corporate) and consumption taxation as proposed by *Buchanan, 1950*. In the federal finance view, one starts from a decentralised perspective where non uniformity is the norm and movement towards uniformity is seen as having both costs and benefits that have to be traded –off against one another. In some sense, the issue is: what is the default position for a federal country that is no longer federal; a centralized one or a set of new countries?

A second explanation draws on a combination of international economics and game theory. It defines good or bad not from a national perspective but from an international one. With such a perspective, well-conceived cooperation is usually preferable to non-co-operation. Tax competition will be seen as harmful if there are externalities associated with the tax policy choices of a national government not taken into account when the policy choices are made. This leads to a larger definition of tax competition compared to the narrow legal one used by the EU and OECD.

Finally, the most provocative one is provided by *Frey and Eichenberger, 1996*. They argue that the construct of a «social welfare maximising government implicitly assuming democracy to work so well that no po-



litical distortions arise» (p. 339) is wrong. They note that the importance given to such a view of the world reflects the small role played in the tax policy field by public choice theory. This theory argues that governments are not necessarily welfare maximizing entities; politicians and/or bureaucrats that use them to their own benefits may capture the institutions of the state. This usually leads them to seek a greater level of government spending and thus a greater level of taxation. And since «harmonisation of taxes is an effective means to raise the tax level»(p. 340), it is often a policy goal. The authors conclude by noting that:«societies face two kinds of distortions that reduce the welfare of individuals: economic distortions are induced by differential taxation and political distortions are induced by harmonized taxes while the possibilities for reducing economic distortions have been extensively discussed in the literature, reducing political distortions has received less attention” (p. 347). Thus self-interest of politicians and bureaucrats leads to the promotion of harmony/ uniformity.

*Overall, Wilson, 1986 and Zodrow and Mieszkowski, 1986* conclude that the main theme of the tax competition literature has been that it lowers government spending and taxes below their efficient levels.

### **11.3. What are the arguments for tax competition?**

This view of intergovernmental competition as wasteful is not the view of *Tiebout, 1956*, who argues that competition for mobile households is welfare enhancing. The “Tiebout Hypothesis is that the households choose amongst jurisdictions according to their preferences with respect to the taxes and public expenditures. Therefore, the competition among jurisdictions leads to an efficient local public good provision and consequently to an efficient tax competition. “In modern formulations of the theory, it is often assumed that each region’s government is controlled by its landowners, who seek to maximize the after-tax value of the region’s land by attracting individuals to reside on this land. To do so, the government offers public goods that are financed by local taxes” (*Wilson, 1999*). We can see that there is tax competition since the region wants to attract the persons or keep their residents providing the public goods at the lowest possible level of taxes. The taxes collected from each resident equal the cost of the public goods consumed by the resident. With this marginal-cost-pricing rule each resident makes effi-

cient decision in choosing the region where they will live. Although these results were developed for mobile households, some authors such as *Fischel, 1975* and *White, 1975* and *Ritcher and Wellish, 1996* have extended this to mobile firms. They assume that firms are in infinitely elastic supply to any given region. In equilibrium, the firms are taxed at a rate equal to the cost of providing them “public inputs”, the marginal cost of these inputs. Similarly, Brennan and Buchanan (1980) argue that tax competition improves welfare, because the size of government would be excessive in the absence of this competition. This is the kind of work that leads *Janeba et Schjelderup, 2002* to conclude that the political economy branch of the tax competition literature has a favourable outlook on tax competition which is seen as an instrument for curbing the rent seeking activities of government officials.

According to *Musgrave, 1997*, tax competition can be good or bad depending on what type of competition one observes. The competition will be good for a jurisdiction if competition provides the right services at low cost and helps in designing efficient and equitable tax systems. In addition, decentralization with multiple jurisdictions supports that process at the local level. Whereas, if the jurisdiction offers low tax rates to attract capital and high income residents, in the long run the public services will be at an inefficient level and the use of capital will be less efficient. We would add that from a fiscal federalism perspective, the main argument to give SNEs freedom in setting their own taxes is that at the margin, one wants to make them accountable for their spending by requiring them to fund it from their own additional funds and not from transfer revenues.

*Tannenwald, 1999, 370* present a list of four specific items that support the view of tax competition as good. They are:

- A reduction of the exploitation of taxpayers by leviathan;
- Encouragement to use the benefit principle which increases the efficiency of taxation;
- Increased efficiency resulting from using the benefit principle;
- Encouragement of progressive taxation at the federal level where it is more appropriate

The first point is similar to the one raised by the public choice literature; the most important one is that competition may encourage taxation according to the benefit principle, which is welfare enhancing.

## **11.4. What kind of behaviour is observed?**

According to *Wilson, 1999* “ Since the mid-1980’s, there has been an outpouring of academic research on tax competition, and this research continues unabated. Interest in this area has been stimulated by highly publicized instances where U.S. states and localities do seem to have engaged in tax competition, including the many cases where they have offered large subsidies to foreign and domestic automobile companies in an attempt to influence plant location decisions. In addition, researchers and policymakers have found that Oates’ (1972) description of tax competition can be applied more broadly to a host of important policy concerns, such as competition for investment through weaker environmental standards or reductions in welfare payments by states trying to avoid attracting poor households”.

Empirical studies have been done on countries (aggregates of local taxes), districts, cantons and municipalities to ascertain two possible impacts of tax competition. We examine each in turn.

### *11.4.1. Does tax competition attract investment or employment?*

A first strand of literature reviewed by Tannenwald examines the impact of tax competition on individuals and firms; this is sometimes referred to as location studies. Tannenwald notes that «hundreds of empirical studies have investigated the extent to which a jurisdiction’s tax characteristics influence its attractiveness. Most studies conclude that (1) taxes are a less powerful determinant of business location and expansion than centrality of location, wage rates, regulatory burden and the availability of appropriately skilled labour; and (2) taxes are a more effective instrument of intrametropolitan competition than of intermetropolitan or interstate competition» (1999, p. 367). While this is a correct summary of the literature, note that, location is one choice and choice of jurisdiction where income, particularly capital income and corporate profits, are reported is another. Establishing a manufacturing plant, a call center or a distribution facility is a real investment that requires assembling physical and human capital; deciding to use transfer prices or inter-corporate financial arrangements (loans, preferred shares,...) to shift reported profits from high taxed to low taxed jurisdictions is simpler and requires few real resources. Also distances in North

America and in Europe are not the same; what is a typical inter state distance in North America may well be an inter-country one in Europe. Thus, empirical result obtained in the North American context may not hold in the context of another country or continent.

We report in *table 11.1* on three recent studies (post-1999) to allow the reader to appreciate the kind of work done in this area. They tend to show a greater impact of taxation on location than the one described by Tannenwald; yet one notes the conclusion by *Feld and Kirchgassner, 2003* that, “differences in corporate income tax rates will have an even smaller impact on employment in the different EU member states. The main impact of such differences is presumably not the impact on the location decision of the actual production, i.e. on employment but on the firm’s decision where corporate income taxes are paid” (p. 153).

*11.4.2. Does tax competition lead to reactions by neighbouring governments?*

A second strand of literature examines the impact of tax diversity on the behaviour of governments (tax externalities). We summarise 10 recent (1992-) studies in *Table 11.2*.

*Table 11.1*

**Taxation and Location Decisions,  
2000–2003**

<b>Authors/year of study</b>	<b>Country/Units/Years examined</b>	<b>Number/Nature of observations</b>
1	2	3
<i>Mark, McGuire and Papke, 2000</i>	U.S./ D.C. and adjoining cities and counties/1969–1994	234 data point; 1 district and 8 cities/counties X 26 years
<i>Mintz and Smart, 2001</i>	Canada/ aggregated corporate tax returns, 1986–1999	3509 data point; 14 years X 6 regions X 7 industrial sectors X 6 tax and size groupings (minus 19 missing data points)
Feld and Kirchgassner, 2003	Switzerland/Cantons/1981, 1991 and 1985–1997	For the location of firm: 52 data point; 2 years (81,91) X 26 cantons For the employment: 338 data point; 13 years (85–97) X 26 cantons

<b>Authors/year of study</b>	<b>Methodology Used</b>	<b>Main results</b>	<b>Comments</b>
1	4	5	6
<i>Mark, McGuire and Papke, 2000</i>	Regression analysis with annual growth rate of population as DV and a dummy for each district and cities excepted for Prince William County which is the omitted county, personal income tax rate at 25,000\$, sales tax rate, residential property tax rate, In per capita AFDC expenditures, In per capita income, In total crime index, In per capita non-AFDC expenditures as IV for the first regression. For the second regression annual growth rate in employment as DV and a dummy for each district and cities excepted Prince William County, sales tax rate, commercial property tax rate, corporate income tax rate, personal property tax rate, In unemployment insurance cost, In per capita income, In total crim index as IV	They do not find an effect of the local property tax on either residential or business location choice	Like some previous work, they find that an increase in the level of non-welfare public service increases economic activity
<i>Mintz and Smart, 2001</i>	Regression analysis with In real taxable income per capita as DV and tax rate, In income prices, fixed effects and interactive province-industry variables as IV	Regressions are for three types of firms: (1) corporations that can shift taxable income easily versus those that cannot (2 and 3) results show a much higher tax elasticity for group (1) than (2) or (3)	The elasticity of 4.3 shows that a 1% point reduction in the mean tax rate (0.43) increases taxable income by 7.5%. No \$ estimate of this impact is given. There is no result on the impact on employment or investment

<b>Authors/year of study</b>	<b>Methodology Used</b>	<b>Main results</b>	<b>Comments</b>
1	4	5	6
<i>Feld and Kirchgassner, 2003</i>	Regression analysis with regional distribution of firms as DV and wage, corporate tax rate, personal tax rate, educational expenditure, public investment, share of urban population, year dummy for 1981, cantonal dummy for Uri as IV. After, they did the same regression analysis but they exclude personal tax rates. The model explains the number of small and medium sized firms per capita with no or high rates of returns. Secondly, a regression analysis with employment as DV and relative wage, corporate tax rate, personal tax rate, educational expenditure, public investment, population, share of old population, share of young population and share of urban population as IV	The results provide empirical evidence that corporate and personal income taxes have a impact on the regional distribution of small and medium sized firms with no, low, or high rates of returns of capital in 1981/82, 1991/92 and on cantonal employment from 1984–97	The corporate income tax rate negatively affects the number of highly profitable firms. The effect appears to be stronger for medium sized than for small firms. It has no statistically significant impact in all other cases. Personal income taxes have a more considerable negative impact on the regional distribution of firms and they relatively more important for small than for medium sized firms. Personal tax rates in Switzerland are more important for the location of business than corporate tax rates because they are crucial for the attraction of highly skilled employees. The main impact of such differences is presumably not the impact on the location decisions of the actual production, i.e. on employment, but on the firm's decision where corporate income taxes are paid

DV: dependent variables; IV: independent variables.

Table 11.2

**Empirical Evidence on Tax Reaction of SNEs  
1992–2002**

Authors/year of study	Country/Units/Years examined	Number/Nature of observations
1	2	3
Ladd, 1992	USA/ 248 large counties or county/ 1978 and 1985	496 points data; 248 x 2 years
Kirchgasnner et Pommerehne, 1996	Switzerland/Cantons/1987	130 cantonal-income groups share of taxpayers (26x5)
Heydels and Vuchelen, 1998	Belgium/municipalities/1991	589 Local income tax (LIT)and local property tax (LPT)choices
Besley et Rosen, 1998	USA/48 continental states/1975–1989	720(48X15) state tax rates on tobacco and on gasoline = 1440
Brett and Pinske, 2000	Canada-Province of British Colum- bia/municipalities/1987 and 1991	Business property taxes (BPT) for 147 municipaliti- esX2 = 294
Hayashi et Boadway, 2000	Canada/Federal Ontario, Quebec and aggregate of remaining eight provinces 1961–1995	34 X4 = 136 average effec- tive tax rates (taxes paid/corporate profits)
Revelli, 2001	UK/ English non-metropolitan districts/ 1983–1990	2368 points data; 296 non- metropolitan districts x 8 years
Brueckner and Saavedra, 2001	U.S./ cities from the Boston metropoli- tan area/ 1980 and 1990	140 points data; 70 cities x 2 years
Goodspeed, 2002	13 OECD countries, 1975–1984, Ag- gregated local income tax revenues	130 country/year data points
Revelli, 2002	UK/ English non-metropolitan district/ 1990	296 points data; 296 non- metropolitan districts x 1 years

<b>Authors/year of study</b>	<b>Methodology Used</b>	<b>Main results</b>	<b>Comments</b>
1	4	5	6
Ladd, 1992	A comparison for 1978 and 1985 for the degree of clustering of tax burden among neighbouring counties within metropolitan areas to that among non-neighbouring counties within states with coefficient of variation is made. Then regressions (with instrumental variables) are estimated separately for 1978 and 1985 data. The IV is local tax burden with DV: total taxes, property taxes, residential property taxes, general sales taxes, other taxes	The local tax decisions in one jurisdiction are influenced by the tax burdens in neighbouring jurisdictions	If total taxes in a county's neighbours increase by 1\$ per 100\$ of income, the taxes in that county will increase by 0.59\$ per 100\$ in 1978 and the property tax burden by 0.45\$. While in 1985 they increased by 0.82\$ and 0.58\$ respectively. Some of these differences may be explained by the nationwide "tax revolt" of the late 1970's and early 1980's
Kirchgasnner et Pommerehne, 1996	Regression analysis with share of taxpayers in group I as DV and PIT rate per income group, % labour force in services, population, infrastructure index, and dummies for Zug and Geneva as IV	Tax rates play a significant role in determining where the highest income groups choose to locate particularly the highest. Infrastructure also plays a role	Income groups are 0-19 (omitted), 20-25, 25-50, 50-100, 100-200 and >200 CHF Regression is weighted with square root of population
Heydels and Vuchelen, 1998	3SLS estimations with either LIT or LPT as DV and IV: population, per capita income, % population <20 and also %>60, area and tax rates of neighbours	In base equation, impact of LIT increase in neighbour is 0.67% and for PIT 0.65% an increase in population increases tax rates while for income, it decreases them	Additional analysis with income treated as endogenous or different treatment of neighbours does not change results. Impact of neighbours diminishes with distance. Horizontal externalities are thus present



<b>Authors/year of study</b>	<b>Methodology Used</b>	<b>Main results</b>	<b>Comments</b>
1	4	5	6
Besley et Rosen, 1998	Regression analysis with state tax rates as DV and IV: federal tax rate, national GDP and unemployment rate, state population, income and unemployment rate, %s population aged 5–17 and 65+, state production of tobacco and gasoline as %s state income, federal grants per capita, federal income /AGI, Democrat governor, %s House and Senate democratic, Federal deficit/GDP, state effects	State tobacco tax increases by 0.028\$ for a federal tax increase of 0.1\$; for gasoline tax, the increase is 0.041\$. An increase in the size of the relevant industry in a state decreases the tax rate in that state	Taking into account general sales taxes does not change the results. Vertical externalities are thus present
Brett and Pinske, 2000	Structural form and reduced form(with IV) analysis with BPT as DV and IV: median income, own and neighbour; workforce in primary sector, own and neighbour; parks and roads per capita, distance from Vancouver, ,supra-municipal business tax rate and neighbours tax rate	There is some evidence of neighbours tax rates and supra municipal tax rates affecting the choice of tax rates but it is not consistent from one estimation to another	Adding fixed effects to the analysis reduces the number of significant coefficients
Hayashi et Boadway, 2000	Regression with each tax rate as DV; IV are the 3 other tax rates, national inflation and utilisation rate, provincial or Canadian GDP growth rate, interest rate, per capita wages, political party in power, deficit/GDP	Provincial tax rates of Quebec and 8 other provinces aggregate are diminished when the federal one is increased; an increase in the Ontario rate has a positive impact on the federal one; Ontario does not react to changes in provincial rates while Quebec reacts positively to an increase in the Ontario rate	Seemingly Unrelated Regression system is estimated by GLS. Reaction lag is assumed to be one-period (one year). The results show that vertical and horizontal externalities exist

Authors/year of study	Methodology Used	Main results	Comments
1	4	5	6
Revelli, 2001	Estimation procedure based on an instrumental variables approach (generalised method of moments) with local tax rate as DV and IV: the per capita rateable value, the Block Grant per capita, the proportion of domestic local tax rate base, the unemployment rate, a political control variable (dummy variable) that equals one if the local council is controlled by the Labour Party and equals zero otherwise	There is two different kinds of interaction. The results show the presence of large and significant horizontal interaction between UK districts, but there is no evidence of positive correlation between district and county property tax rates	A 10% increase in the local property tax rate of a district's neighbours leads to an increase of 4–5% in its own property tax rate
Brueckner and Saavedra, 2001	Regression analysis (LM) with property tax rates as DV and per capita income, per capita state aid, the African-American proportion of the population, the proportion of the adult population with at least a college education, public sector earnings per capita, annual rate of population growth, population and tax rates of neighbours as IV. In addition, a IV equal to the city's 1989 tax levy is added for the second regression (1990)	There is empirical evidence on property-tax interaction amongst local governments in both 1980 and 1990; an increase in the tax rate of a weighted sum of neighbours increases one's own tax rate by 0.16 to 0.7 of the increase depending on the weights used	The strategic interaction still occurs in the post-Proposition 2 <sup>1/2</sup> environment in the choice of business property taxes. The tax competition persisted despite the restrictions imposed by this tax limitation measure
Goodspeed, 2002	Regression analysis (Tobit) with local income tax rate as DV and national income tax rate, local spending tax base mobility, and disparity, grants and fixed effects as IV	The higher the national tax rate, the lower the local one. The higher the tax bases disparities and the higher Q1, the lower the rate	Tax rate is revenue/GDP; Disparity is Q5share/Q1share; Q1share as mobility. Results indicate that vertical and horizontal externalities appear to occur

<b>Authors/year of study</b>	<b>Methodology Used</b>	<b>Main results</b>	<b>Comments</b>
1	4	5	6
Revelli, 2002	First, a Moran spatial statistic has been computed for the assessed levels of spending per capita, the actual levels of spending per capita and the property tax rates in 1990. Second, two regression by OLS with local public spending and local property tax rates as DV with IV; grant from central government, population size, a dummy for closeness to metropolitan areas to control for the presence of externalities from the (excluded) urban areas and a political control dummy to allow for systematic ideological differences. Third, a comparison between regression analysis by LM and IV approach with DV and IV	The spatial autocorrelation is an important feature of local governments' expenditure decisions. The results support the hypothesis of spatially autocorrelated residuals in the local public expenditure determination equation and of mimicking behaviour in local property tax setting	

DV: dependent variables; IV: independent variables Q for income quartile, (1 lowest, 5 highest).

All of the studies concluded that vertical or horizontal tax externalities are present. In some cases, the authors present the elasticity, such as in the study of Ladd, in 1992, concluded that the burden of total taxes and the property tax burden increase if the neighbours' taxes increased. Indeed, in 1978 for a neighbours increase of one dollar, Ladd finds an increase of 0.59\$ for the burden of total taxes and 0.45\$ for the property tax burden in own tax rates while in 1985 the increases are 0.82\$ and 0.58\$ respectively. More recently, *Revelli, 2001* concluded that a 10% increase in the local property tax rate of a district's neighbours leads to an increase of 4-5% in its own property tax rate.

Heydels and Vuchelen (1998) find that the impact on neighbours diminishes with distance. Therefore, tax mimicking is stronger between jurisdictions that share boundaries.

### 11.5. What are the policy issues?

OECD and EU Countries over the last 20 years have seen their borders become more and more open to flows of goods, services, capital and labour. Hence they have become concerned as a group with harmful tax competition. Thus recent policy initiatives focus on the behaviour of national governments that are either members of the European Union or members of the OECD or that interact as a tax haven with such governments. One should note here that up to now, it has been common in the literature to draw lessons from federal states for the EU; yet, in some respects, the EU is a federal state, with a stronger central rules than in some federal states. Thus, it may be time to ask what lessons the EU has for federal countries. In this case, one sees the emergence of the concepts of «harmful tax competition» defined below.

Harmful Tax Competition No or Low Nominal Effective Tax Rate (generally or in special circumstances) + One or more of: <ul style="list-style-type: none"><li>• Lack of Effective Exchange of Information;</li><li>• Lack of transparency;</li><li>• Ring fencing of domestic sector or attraction of investment without substantial activities</li></ul>
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Source: Horner, 2000.

The key issue is the lack of information allowing the country of residence of the owner of an income stream the opportunity to levy the appropriate tax burden; this is embodied in predatory tax practice. Examining recent attempts (1997–2001) to harmonise taxation of income in the EU (*Cattoir and Mors, 2001*), one finds similar preoccupations.

Therefore, to cope with harmful tax competition, there are some appropriate behaviours to adopt.

To identify them, one can use the standard welfare maximising approach in examining the issue of tax choices made by or for (by the central government) SNEs. We believe that the proper question is not what

is the appropriate degree of tax competition? or what is the required degree of tax harmonisation? But rather; what are the appropriate tax choices of a given set of SNEs? This requires that criteria be set out and facts examined for each set of SNEs. In particular, this means that we recognise that «since every country both is unique and in some sense constitutes an organic unity, the significance of any particular component of its federal finance system...may be understood only in the context of the system as a whole» (*Bird and Vaillancourt, 1998, p. 34–35*).

Hence, what is proper SNE behaviour? The answer to this question will depend on each country. That said, one can note as *Cattoir and Vaillancourt, 2002* do that:

- One should distinguish between behaviour that influences real decisions, such as the location or expansion of production units (manufacturing plants, call centres,...) and financial decisions, such as where to hold saving bonds and accounts. The first have meaningful economic consequences and revenue impacts while the second only has revenue consequences if on the investment of savings side markets are efficient;
- Behaviour that influences financial decisions by individuals, such as more or less strict banking secrecy laws and non communication of relevant tax information to the tax authority of the country of residence encourages tax avoidance and tax evasion. Clearly, all countries, federal or not, can suffer from the behaviour of third parties tax havens. Comparing the EU, a quasi-federal system to federations such as Canada and the USA, one notes that intra federal tax secrecy and tax residence issues matter more within the EU than within federal states. It is appropriate to combat this type of behaviour;
- Behaviour that influences real decisions is much less reprehensible. For example, if some SNEs have less mobile populations than others, for language reasons for example, they may want to lower the taxation of job creating investments to attract complementary capital to their (relative) excess labour. The other option, out-migration to where the capital is could well result in linguistic assimilation. This means, in the absence of natural resource rents, that the residents of this SNE will have lower levels of public services or higher personal taxes, or both;

- If an SNE has an exportable tax, such as natural resource rents, why should it not use it to make its residents better off? This will lower the tax price of a given supply of public services or increase the supply of such services. This will create disparities that a higher level of government can choose or not to correct in part or in total. That said, we would argue that natural resource rents should be collected by the central government which would do away with this issue;
- The fact that the behaviour of one SNE will influence that of other SNEs in that country or that of the central government, in terms of the setting of tax rates is not a reason as such to prohibit it. The behaviour of one business unit often has impacts on that of others (prices, quantities), yet we leave it free to act.

## 11.6. Conclusion

*Janeba and Schelderup, 2002* conclude their paper by stating that early theory predicts that competition among regions over scarce capital will bid down taxes and expenditure to sub-optimal levels. Later contributions have refined the analysis of tax competition to the extent that some models predict that taxes may actually increase as competition intensifies. The political economy branch of the tax competition literature has a favourable outlook on tax competition, which is seen as an instrument for curbing the rent seeking activities of government officials. Assuming that tax competition leads to inefficiently low taxes on capital and reduces welfare, tax coordination among a group of countries may improve welfare under certain conditions.

Thus they do not come down firmly either in favour or against tax competition, arguing that the appropriateness of such competition depends on the circumstances of each case. We would like to note that, across the world, SNEs have varied degree of freedom in setting their tax rates, defining their tax bases and administering their tax collection. This freedom is highest amongst some of the richest and oldest federations of the world. While this observation should caution us against restricting it unduly, it must be coupled with the fact that in the case of Canada and the USA, physical distance may reduce the impact of such differences. Smaller distances in Europe, which do not appear to be

compensated for by linguistic heterogeneity, make the issue more salient there (*Cattoir and Vaillancourt, 2002*).

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## **Chapter 12. Property Taxation: Issues in Implementation**

Property taxation is the backbone of municipal finance in a number of developed countries. Over the years, however, it has not been without controversy on a number of implementation issues. For example, discussion has often emerged over the role that property taxes should play in financing municipal services. This is discussed in part B of this paper. Part C covers a number of implementation issues on such things as identifying taxable properties, choosing an appropriate tax base, setting up a proper assessment system and establishing property tax rates. Part D briefly summarizes the current and proposed property tax system in Russia and offers suggestions for improving it to achieve greater efficiency, accountability and fairness in the implementation of a property tax system.

### **12.1. What is the Role for A Property Tax?**

Local governments in developed countries supply a range of services – from those that exhibit mainly private goods characteristics (water, sewers, solid waste collection and disposal, public transit, public recreation and so) to those that exhibit mainly public goods characteristics<sup>188</sup> (local streets and roads, street lighting, fire and police protection, neighbourhood parks, etc.). For services with mainly private goods characteristics, individual beneficiaries can be identified, income redistribution is not a goal, spillovers are unlikely to exist, and operating and capital costs can be measured and recorded. Here, a user fee would be relatively easy to administer and would be the best financing instrument for satisfying the principles of efficiency, accountability, transparency, and fairness<sup>189</sup>.

For services providing mainly collective or ‘public goods’ benefits (specific beneficiaries cannot be identified), user fees are inappropriate. Instead, these should be funded from a local tax imposed on residents (or exported to the same extent services are) with necessary ad-

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<sup>188</sup> For a more detailed discussion, see Harry Kitchen (2003), “Local Taxation in Selected Countries: A Comparative Examination”, a paper prepared for CEPRA II, part C.

<sup>189</sup> For a discussion of these principles, see *Ibid*, pp. 17–19.

justments through the use of grants to account for spillovers; that is, benefits from these services that spill over into neighbouring communities should be funded from something other than a local tax. While there may be some debate over the criteria that should be satisfied in setting a local tax, it is generally agreed that the following criteria<sup>190</sup> should be met as closely as possible.

- The tax base should be relatively immobile, thus permitting local governments to vary their tax rate without losing much, if any, of the tax base.
- The tax yield should be stable and predictable over time.
- The tax should not be one that is easy to export to non-residents (in other words, should be borne by taxpayers in the taxing jurisdiction).
- The tax should be visible to ensure accountability and transparency.
- Taxpayers should see the tax as being reasonably fair.
- The tax should not create harmonization problems with taxes of senior levels of government nor should it create harmful competition between local governments.
- The tax should be easy to administer.

Of possible tax alternatives for local governments, the property tax meets these criteria better than any other tax. Its tax base is largely immobile. Revenue is generally predictable and stable in that it does not vary with the cyclical swings in economic activity as much as personal income and consumption based tax revenues. The part of the tax that is on residential property is unlikely to be exported. It is highly visible and fair as long as it covers the cost of providing those services that provide collective benefits to the local community. If the property tax is a local tax only (senior levels of government not involved), harmonization prob-

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<sup>190</sup> Charles, E. McClure Jr. (2001), "The Tax Assignment Problem: Ruminations on How Theory and Practice Depend on History." *National Tax Journal*, Vol. LIV, No. 2, 339–363; Richard M. Bird (2001), "Subnational Revenues: Realities and Prospects", (Washington: World Bank Institute), mimeograph; Richard M. Bird (1999), "Rethinking Tax Assignment: The Need for Better Subnational Taxes", draft paper, Fiscal Affairs Department, (Washington: International Monetary Fund); Richard M. Bird (2000), "Intergovernmental Fiscal Relations in Latin America: Policy Design and Outcomes," (Washington, D.C.: Inter-American Development Bank), pp. 16–24; and Wallace E. Oates (1998), "Federalism and Government Finance", in Wallace E. Oates (ed.), *The Economics of Fiscal Federalism and Local Finance* (Cheltenham, UK: An Elgar Reference Collection).

lems and wasteful tax competition should not be a problem. Finally, it is likely to be more expensive to administer than a local tax that is piggy-backed onto an existing federal or regional tax, but this may be a small price to pay if local governments are to have autonomy and flexibility in setting tax policy, both important ingredients of responsible, efficient and accountable local government<sup>191</sup>.

## 12.2. Implementation Issues

Recognizing that a property tax is a good local tax, there are a number of implementation issues that must be decided. These are discussed in the remainder of this paper.

### 12.2.1. Property Identification

The following steps are required in the taxation of real property<sup>192</sup>. All taxable properties must be identified and described on the assessment roll with each property assigned a roll number. This number is important for linking assessment information with tax billing and property transfer records.

The assessment roll should include the address of the property, its owner, building and lot size in square metres or hectares, the age of the building and information on renovations or improvements. This information will be used to assign an assessed value to the property, especially if the tax base is market value and the property has not recently been sold. Furthermore, this information should be reported in a consistent way and a process should be established to update assessment annually<sup>193</sup> or as frequently as administratively possible. Once assessed values have been determined, local tax rates must be set, tax bills issued, responses must be made to assessment appeals, taxes must be collected, and arrears must be addressed.

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<sup>191</sup> Bird, 2001, p. 3.

<sup>192</sup> Enid Slack (2001), "Alternative Approaches to Taxing Land and Real Property", a paper prepared for the World Bank Institute, Washington, D.C., p. 5.

<sup>193</sup> Enid Slack, John LaFaver, and Ihor Shpak (1998), "Property Tax in Ukraine: Third Attempt", in *Budget and Fiscal Review*, Second Quarter, pp. 41–2.

Property identification is often more difficult in developing countries and transitional economies<sup>194</sup>. For example, maps for property identification may not exist; property ownership data may not be provided because of disputes over who owns what; information on improvements may be missing; building permit information may not be provided to the taxing authority; tax records may be identified by taxpayer and not by property; land and building records may be maintained by different agencies and not linked; and tax records may be considered secret.

### *12.2.2. Choice of Tax Base*

There is no uniform tax base that applies everywhere. In some countries, the property tax is based on property value as determined by market value, site value, and rental value. In other countries, the tax is based on building area and property area - this is referred to as unit value. In a few countries, a mix of these approaches is employed. Each of these systems is considered below.

#### **Market Value Assessment**

Market value is the price that is determined between a willing buyer and a willing seller in an arms length deal. Market value estimates the value that the market places on individual properties. For properties that sell in any year, market value is the selling price. For properties that do not change hands in the year, market value must be estimated. There are at least three estimation methods that may be used. First, when markets are active and similar properties are being sold in the same or comparable neighbourhoods, a comparative sales approach could be used. This assigns a market value to an unsold property by looking at valid selling prices of similar or comparable properties.

Second, a depreciated cost approach is sometimes used. This is most appropriate when properties are relatively new, there are no comparable sales, and improvements are relatively unique. Here, the property is valued by assigning a value to the land as if it were vacant and adding the cost of replacing the buildings and other improvements.

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<sup>194</sup> For more detail, see William Dillinger (2002), "Urban Property Tax Reform Guidelines and Recommendations" (Washington, D.C.: The World Bank), p. 11; and Jane H. Malme and Joan M. Youngman (2000), "The Development of Property Taxation in Economies in Transition." Case Studies (Washington, D.C.: The World Bank), p. 15.

Third, a capitalized income approach may be used. This is primarily for properties that generate actual rental income. Here, the annual net rental income (gross annual rental income minus annual operating expenses) is estimated with this annual net income subsequently converted to a capitalized property value (market value) using a capitalization factor. To illustrate, if net annual rental income from a specific property is \$10,000 and if the current interest rate is 5 percent (current rate of return on a bond, for example), the capitalized value of the property would be \$200,000 (net rent divided by interest rate or  $\$10,000/0.05$ ). This is also the market value because an individual would be willing to pay \$200,000 for a property that generates an annual net rent of \$10,000 – this is a 5 percent return and is identical to the return on bonds.

Either the comparative sales or depreciated cost approach appears to be superior to net rental income (gross rental income minus expenses) in determining market value. For properties such as vacant land and those subject to rent controls, there may not be a reliable measure of net rental income at market rates. Second, rental income may be difficult, perhaps impossible, to estimate for unique commercial and industrial properties including steel mills, mining operations and so on. Third, assessors may not have access to rental income information because this information is not publicly available in the same way as are sales prices<sup>195</sup>. In spite of these problems, rental value assessment is used in France, India, and Morocco (*Table 12.1*).

Canadian and U.S. municipalities tend to rely on market value assessment (mainly comparative sales and depreciated cost approach) as do Australia, Indonesia and Japan (*Table 12.1*). Differences in the application of market value exist across these countries, however. In Canada, for example, there are no restrictions on assessment increases or local general tax rates or tax rate increases<sup>196</sup> – assessment values are intended to reflect market values and general tax rates are set to raise necessary municipal revenues. In some states in the United

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<sup>195</sup> Slack, 2001, p. 12.

<sup>196</sup> There may be restrictions on the differential that may exist between municipal tax rates applied to residential properties versus those applied to commercial and industrial properties.

States, by comparison, restrictions on assessment exist<sup>197</sup>. In California, reassessment of properties can only occur at the time of sale or resale. Between sales, assessment may only increase by 2 percent per year. In Michigan, reassessment is restricted to the lesser of 5 percent or the inflation rate. Other states have imposed limits on the property tax rate (Massachusetts at 2.5 percent) and/or the growth rate of property tax revenue (Massachusetts also at 2.5 percent and Illinois at the lesser of 5 percent or the inflation rate). Nine states now limit both the property tax rate and the growth rate of assessed property values<sup>198</sup>.

Table 12.1

**Base for property Taxes**

<b>Tax Base</b>	<b>Definition</b>	<b>Measure Used</b>	<b>Examples of countries where used</b>
Market Value	Price struck between a willing buyer and seller in arm's length transaction	Comparative sales; depreciated costs; or capitalized income	Canada, United States, Australia, Indonesia, Japan
Site Value	Price struck between a willing buyer and seller in arm's length transaction	Comparative sales; subtract improvements from total property value	Kenya, New Zealand, Jamaica, South Africa
Rental Value	Value in current use	Net rental income	France, Morocco, India
Unit Value	Size of property adjusted to reflect location, quality, or other factors	Square metres of land and building area, adjusted	Israel, Poland, Estonia, Czech Republic, Slovakia, Armenia, Russia

Source: Enid Slack (2001), "Alternative Approaches to Taxing Land and Real Property", a paper prepared for the World Bank Institute, Washington, D.C., p. 15.

Where fully functioning property and real estate markets exist, market value assessment has distinct advantages over area based assessment systems. For example, market value is able to capture the amenities of the neighbourhood, amenities that are often created by local government policies (zoning legislation, for example). Area based assessment is unlikely to capture these amenities. To illustrate, assume

<sup>197</sup> Arthur O'Sullivan, "Limits on Local Property Taxation: The United States Experience", in Wallace E. Oates (2001), *Property Taxation and Local Government Finance* (Cambridge, Mass.: Lincoln Institute of Land Policy), pp. 177–200, at 180–81.

<sup>198</sup> *Ibid.*



two properties of identical size (that is, identical in building size and land area) and age but located in different places. One is adjacent to a greenbelt while the other is next to an abattoir. Under unit assessment, both would be assessed in an identical fashion, whereas the two properties would be assessed differently under market value assessment<sup>199</sup>. It is unlikely that many would argue that unit assessment would be fair in such an instance.

In addition, benefits from local public services are more closely reflected in property values than in the size of the property. For example, properties close to parks and public transit systems benefit more from public services than do properties located some distance away. Furthermore, these benefits are reflected in higher property values for neighbouring properties. Market value assessment would capture these benefits whereas, area based assessment would not.

### **Site Value Assessment**

In its purest form, site value assessment (SVA) is a special case of market value assessment where only land is assessed. All capital improvements (buildings, for example) are excluded from the assessment base. Under a graded SVA system, capital improvements are included in the base and taxed at lower rates (sometimes significantly lower) than land, with the level of gradation varying according to the taxing jurisdiction's policies and practices. A form of site value assessment is used in New Zealand, Kenya, Jamaica, and South Africa (*Table 12.1*).

There are two potential problems with site value assessment. First, accurately separating land from improvements may be more difficult than it sounds. It is almost certain to be easier to determine market value for a piece of property than it is to estimate values for the components that constitute market value<sup>200</sup>. Second, since the base for site value taxation is smaller than the base for market value taxation, it would be necessary to impose a higher tax rate under site value taxation to raise the same amount of revenue. It may be perceived to be easier

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<sup>199</sup> Harry Kitchen (1992), *Property Taxation in Canada* (Toronto: Canadian Tax Foundation), p. 127–128.

<sup>200</sup> At least one author has suggested the opposite – the valuation of land may be easier than the valuation of property. See Dick Netzer, “The Relevance and Feasibility of Land Value Taxation in the Rich Countries” in Dick Netzer, *Land Value Taxation: Can it and will it work today?* (Cambridge, Mass.: Lincoln Institute of Land Policy, 1998), p. 123.

politically to levy a lower tax rate on market value than a higher tax rate on value of land only<sup>201</sup>.

Advocates of site value or graded assessment have argued that the practice of taxing land and buildings at the same rate (as under market assessment) discourages property improvements, since improvements lead to higher assessed values. Graded assessment would reduce this disincentive and thereby, foster growth and development – whether it be infilling vacant or under used land in the city centre or whether it be development at the city boundaries. The incentive would be all the greater because the value attached to a piece of land for tax purposes would refer not to the land’s actual use – that is, the current use that would provide the highest rate of return. Indeed, it has been demonstrated that in certain circumstances greater reliance on land taxation may result in a level of economic development that is excessive in efficiency terms<sup>202</sup>.

To be more specific, the tendency under a graded assessment system for land to be put into higher use than it would otherwise be put may not be socially desirable, especially if preservation of heritage buildings, neighbourhood parks, and/or lower density development is to be encouraged. Furthermore, any incentive to speed up development may lead to congestion or sprawl if the development proceeds more rapidly than the city or city-region can plan and coordinate its objectives<sup>203</sup>. In theory, these concerns can be addressed by zoning legislation; in practice, however, there may be considerable pressure for zoning changes, given the increased benefits (to the owner) that arise from more intensively developed land.

Evidence is scarce on the effects of a system that taxes land more intensively than it taxes buildings. A recent study has evaluated eco-

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<sup>201</sup> Roy Bahl, “Land Taxes Versus Property Taxes in Developing and Transition Countries”, in Dick Netzer, *Land Value Taxation: Can it and will it work today?* (Cambridge, Mass.: Lincoln Institute of Land Policy, 1998), p. 144.

<sup>202</sup> Brian L. Bentsick, “The Impact of Taxation and Valuation Practices on the Timing and Efficiency of Land Use” (1979), *Journal of Political Economy*, vol. 87, no. 4, 859-68; and David E. Mills, “The Non-Neutrality of Land Value Taxation” (1981), *National Tax Journal*, vol. 34, no. 1, 125-9.

<sup>203</sup> For an expression of concern over the way in which hasty, unplanned and uncoordinated development can severely limit a municipality’s policy options, see Toronto. *Final Report of the Joint Committee on Property Tax Reform* (Toronto: the committee, 1982).

conomic development in Pittsburgh after the City's decision in 1979–80 to adopt a graded system and apply a rate to land that was more than five times the rate on structures<sup>204</sup>. The study concluded that Pittsburgh did experience a dramatic increase in building activity, one far in excess of any increases in other cities in the region, but it stopped short of concluding that the change in tax policy had caused the boom. Instead, it suggested that the primary cause was a shortage of commercial space; the increase in land taxation had, however, enabled the city to avoid increases in other taxes, increases that might have impeded development. An earlier study had concluded that Pittsburgh's modified form of site value tax did not constitute a sufficient penalty to encourage owners of under-developed or undeveloped property to develop. The city's development boom was instead a response to market conditions (demand for office space or buildings for corporate headquarters) and government incentives, including tax abatements and federal income tax credits. In general, moreover, property taxes were not a factor in firms' decisions to locate in Pittsburgh<sup>205</sup>.

Some cities have claimed that a switch to graded assessment has brought them new development, but the evidence put forward to support these claims must be treated with caution. The usual practice is to claim that all new development is a consequence of the adoption of the graded tax system and to ignore factors such as changing market conditions, changes in the local labour market, the receipt of state or federal grants – factors that appear to have been important in driving the development in Pittsburgh's case. To the extent that a graded system does encourage development, much of this development tends to be at the expense of neighbouring communities that have not adopted a similar system.

Replacement of the current property tax system with either a system that taxed land alone or a graded system would generate windfall gains and losses in the short run as tax bills rise for certain properties and fall

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<sup>204</sup> Wallace E. Oates and Robert M. Schwab, "The impact of Urban Land Taxation: The Pittsburgh Experience" (1997), *The National Tax Journal*, vol. L, no. 1, 1–21.

<sup>205</sup> This study involved an analysis of real estate and assessment data in Pittsburgh from 1975 to 1985. See Michael Weir and Lillian E. Peters, "Development, Equity and the Graded Tax in the City of Pittsburgh" (June 1986), 5, *Property Tax Journal*, 71–84.

for others<sup>206</sup>. One study has suggested that the reduction in taxes on buildings that accompanies a shift to a graded system will be capitalized into higher property values and the offsetting increase in the tax on land will be capitalized into lower values<sup>207</sup>.

### **Unit-Value or Area Assessment**

Under unit-value or area assessment, the tax base is a combination of building area and lot area. For each property, assessed value is the sum of lot area times an assessment rate per square metre of lot area plus building area times an assessment rate per square metre of building area<sup>208</sup>. In its purest form, unit assessment does not take into consideration any variation in the assessment base to reflect location, market conditions, or quality of structures. In less than pure form, unit assessment may introduce variation to reflect location, zoning, use of property and other factors deemed appropriate. Achieving differentials in property type or location, however, is best handled through the use of variable tax rates rather than through the creation of differentials in the tax base (see discussion later).

Support for unit-value or area assessment (based on size of property and buildings) has emerged in a couple of instances. First, it would be superior to value based assessment systems in countries or areas of countries that do not have fully functioning and operational real estate markets. Estonia, Poland, Czech Republic, Slovakia, Russia, and Armenia use it for this reason<sup>209</sup>. Similarly, it may make sense to use it in parts of countries (Canada and Russia, for example) where there are isolated hamlets and no clearly functional market for property values because the government owns most of the housing and rents it to occupants<sup>210</sup>.

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<sup>206</sup> Richard Bird and Enid Slack, *Urban Public Finance in Canada*, 2<sup>nd</sup> edition, (Toronto: Wiley, 1993), at 82–83.

<sup>207</sup> Jan K. Brueckner, “A Modern Analysis of the Effects of Site Value Taxation” (March 1986), 29 *National Tax Journal*, 49–58.

<sup>208</sup> Harry Kitchen, “Alternative Methods of Taxation and Assessment”, a report prepared for the Task Force on Reassessment in Metropolitan Toronto (mimeograph, Toronto, August 1989), part VII.

<sup>209</sup> See Joan Youngman and Jane Malme (2000), *An International Survey of Taxes on Land and Buildings* (Netherlands: Kluwer Law and Taxation Publishers), p. 18.

<sup>210</sup> Harry Kitchen and Enid Slack (December 18, 2001), “Providing Public Services in Remote Areas”, a paper prepared for the World Bank Institute, Washington, D.C., p. 9.

Second, support has also emerged in response to perceived shortcomings of market value assessment even where fully functioning real property and estate markets exist. First, the market value for tax purposes of a property that has not been sold is a matter of the assessor's judgment and will, inevitably, vary with the competence and experience of the assessor. The result, critics argue, is a property tax system that is often arbitrary and unfair. Unit or area assessment, it is claimed, is free of the subjectivity of market value assessment.

A second argument is that market value assessment penalizes homeowners who improve their properties by imposing higher property taxes on the basis of the improvements. Assessment on the basis of unit value does not generate penalties of this kind.

Finally, market value assessment has been criticized on the ground that rapid increases in market values may increase property taxes beyond taxpayers' ability to pay them. California has addressed this problem of volatility by updating assessments to market value only when the property is sold and increasing assessment, thereafter, by 2 percent annually (noted above). In the United Kingdom, every property was assessed at its market value in April 1991 and placed into one of eight valuation bands. The higher the band, the higher was the tax rate. A property is not reassessed again once it has been placed in a higher band. Changes in value do not affect a property's assignment to a given band unless the size of the property changes. Proponents of unit assessment, however, argue that it is superior to all such modifications of market value assessment, since unlike them it entirely eliminates cyclical swings in taxes and thus creates more certainty for taxpayers.

These claims in favour of unit assessment are themselves subject to criticism. It is not entirely fair, for example, to suggest that unit assessment is more objective than market value assessment. The assignment of values to land and buildings separately would be just as much a matter of judgment as the assignment of a single value to both of them together, and the determination of the different assessment rates for land and buildings would be a matter of judgment as well. In general, it is difficult to imagine that the problem of evaluation would be any less severe under unit assessment than it is under market value assessment.

The argument that market value assessment is inferior to unit assessment because it deters owners from improving their properties

raises an empirical question that cannot be answered here. It is likely, however, that improvements invariably increase property (market) values, and hence the owner's equity, by an amount greatly in excess of the annual increase in property taxes. In other words, no increase in property tax is unlikely to be large enough to deter a property owner from attempting to increase his wealth (through higher house prices and increased owner's equity).

It is also unfair to favour unit assessment over market value assessment on the ground that in rising property markets the latter may push levels of taxation beyond taxpayers' ability to pay. Clearly, when properties are sold in rising property markets, capital gains (sometimes substantial) ensue and the seller's ability to pay increases. The fact that a given property is not sold does not change the case: the increase in value increases the taxpayer's capacity to consume and, hence, his or her ability to pay. If increases in assessed value create financial hardships for the taxpayer, tax relief schemes could be made available to alleviate them.

Quite apart from their failure to demonstrate the inferiority of market value assessment to unit-value assessment, the champions of the latter frequently overlook major shortcomings in their favoured approach. Unit assessment requires both an initial determination of value per square foot or square metre and, as circumstances change, subsequent adjustments of this value. How is this initial value to be determined and how will the adjustments be made? Is the determination to be made by a bureaucrat or is to be left to the market? If it is made by a bureaucrat, it may be arbitrary and unfair. If it is made by the market, why not simply use the market value of the property instead - as in market value assessment?

### **Summary**

Valued based assessment systems and market value, more specifically, are deemed to be superior to area based systems in countries where there are fully operational property or real estate markets. Here, market values can be determined. Where property or real estate markets do not exist or where there are a number of impediments to their operation, area based assessment is likely to be superior.

### *12.2.3. Issues in Assessment*

Regardless of the assessment base chosen, the success of any assessment system will depend on three critical parts of the assessment process – the importance of achieving uniformity in assessment; responsibility for undertaking assessment; and the frequency of reassessment.

#### **Uniformity in Assessment**

If property taxes are to be fair in their application, they must be based on assessments that are uniform within each taxing jurisdiction. Uniformity in assessment practices is especially important if the assessment base in a two-tier local government system is used to apportion the costs of upper tier services consumed by residents and businesses in the lower tier municipalities. Here, failure to assess all lower tier municipalities in a uniform manner will lead to inequities and distortions in local tax practices because the lower tier municipalities that are over assessed will very likely be taxed for public services used by those lower tier municipalities that are under assessed. As well, if a role of provincial/ state/regional grants to municipalities is to redistribute income, then the assessed value of property within the municipality is likely to be the major, if not sole, component of the grant base. If assessment practices are not uniform, the redistributive mechanism inherent in these grants will not work as intended.

Uniformity is most easily achieved when the assessment function is centralized at the regional/state/provincial level if not at the central or federal level. At the very minimum, this means that all assessors must use a standard assessment manual where all details of the assessment practice and procedures are spelled out. As well, assessors should be required to attend training courses and pass clearly defined educational standards before becoming property assessors. This is the current practice in Canada as it is in other countries that have fully developed property assessment systems.

Uniformity in assessment means that all properties must be assessed in the same way; that is, residential, commercial, industrial, farm, government, properties of charitable organizations and not-for-profit agencies, and so on. In most countries, the practice of exempting certain properties or applying differential assessment rates to others

lowers the tax base and creates potential problems. Lower assessment rates are often used to provide special treatment for farms, forests, and mines. Properties owned by charitable organizations and not-for-profit agencies including churches are generally exempt from assessment. Properties owned by senior levels of government, schools, universities, colleges and public hospitals are usually exempt. For some of these properties, however, payments-in-lieu of property taxes<sup>211</sup> may be provided. Where they exist, they are not without criticism. Local officials frequently complain about these payments because they are often deemed to be less than what the property tax would collect if it could be levied.

The policy of exempting properties or assessing them at a value that is less than other properties favours certain property types and organizations. Not only is this discriminatory and potentially unfair, it can lead to a mix of land use that may be different from the mix that would exist under equal treatment of all properties. If it is possible to make a sound case for preferential treatment of certain properties, then these properties should either be rewarded directly through a system of grants or through the application of differential tax rates (discussed below) applied to a uniform assessment base. In either case, subsidization would be more transparent and subject to review and amendment by the elected representatives according to their interpretation of the public interest.

### **Responsibility for Assessment**

Reliance on a centralized uniform assessment manual is critical but the way in which the assessment is carried out may also be important. In Canada, for example, assessors work for a variety of employers. In some provinces, they work for the province; in others, they work for an independent province-wide assessment authority; in another province, they work for a province-wide non-profit corporation; and in a couple of provinces, municipalities hire their own assessors. To emphasize what was noted above and regardless of who carries out the actual assessing, assessors in every province work from a standard province-wide assessment manual. Although the ability of these different agen-

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<sup>211</sup> For a discussion of payments-in-lieu of property taxes in the Canada, see *Kitchen, 1992, chapter 7*.



cies/governments to secure uniformity in assessment has not been studied in Canada, one U.S. study concluded that county or regional rather than local assessors leads to more uniform residential assessments<sup>212</sup>.

In addition, a centralized agency (region-wide) responsible for assessment has a further advantage. It is able to benefit from economies of scale that would otherwise not be available to each municipality if each were to carry out its own assessment<sup>213</sup>.

### **Frequency of Assessment**

If the assessment base is to be fair and productive, periodic valuations and revaluations must be undertaken to ensure that assessment bases are kept up to date. Frequent reassessments reduce the risk of sudden and dramatic changes in tax burdens that often arise when reassessments are conducted sporadically and infrequently. In Canada over the past decade, every province has moved towards more frequent and up-to-date reassessments – some provinces now complete them annually, most others every three or four years but many of them are moving towards annual reassessment<sup>214</sup>. In most countries, a three to five year cycle is the norm<sup>215</sup> and in some countries, values are indexed (by a price index) in intervening years.

### **Summary**

A uniform assessment system is necessary if one is to establish a tax base that is fair, transparent and accountable. Uniformity is more likely achieved if a few practices are followed. First, within a region, state, or province, all assessors work from a standard and uniform assessment manual that is updated frequently to reflect changing market conditions. Second, they should be required to pass specific education and training programs on assessment practices and procedures. Third, although the evidence is sketchy, assessors working for centralized as-

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<sup>212</sup> Robert P. Strauss and Sean Sullivan (December 21, 1998), "The Political Economy of the Property Tax: Assessor Authority and Assessment Uniformity", *State Tax Notes*.

<sup>213</sup> David L. Sjoquist and Mary B. Walker (1999), "Economies of Scale in Property Tax Assessment", *National Tax Journal*, Volume 52, Issue Number 2, pp. 207-220.

<sup>214</sup> Harry Kitchen (2002), *Municipal Revenue and Expenditure Issues in Canada* (Toronto: Canadian Tax Foundation), p. 67.

<sup>215</sup> Michael Bell (1999), "An Optimal Property Tax: Concepts and Practices", a paper prepared for the World Bank, Washington, D.C.

assessment agencies seem to be more successful (because they are more likely to work at arms-length) than those working for municipalities in achieving uniformity in assessment. Fourth, the more frequent the reassessment, the fairer the assessment system leading to fewer surprises for taxpayers, fewer complaints, and fewer appeals.

#### *12.2.4. Property Tax Rates*

Setting the local tax rate is the second major component of the property tax system. Here, there are a variety of issues. These are discussed below.

#### **Should municipalities use variable tax rates or uniform rates?**

The issue here is whether a local taxing jurisdiction should apply a single uniform property tax rate to all properties within its taxing jurisdiction or whether variable tax rates should be used; that is tax rates that vary with the cost of servicing different properties by type or by location within a municipality. Traditionally and historically in Canada as in most other countries with a history of property taxation based on property values, the practice has been to apply a single tax rate to all residential properties and a higher tax rate to all commercial and industrial properties. More recently in Canada, but not everywhere, this practice has changed. All municipalities in the provinces of Alberta, British Columbia, and Ontario are now permitted to use variable property tax rates. Other countries have also moved in this direction.

Variable tax rates should be designed to capture cost differences across properties, property types and municipalities or neighbourhoods within a city or city-region. For example, if some properties or property types are more expensive to service, a case can be made for using differential property tax rates. Here, higher tax rates are assigned to properties that are more expensive to service.

Variable tax rates have a number of advantages<sup>216</sup>. First, they are fair on the basis of benefits received as long as the rates are set to capture the cost of municipal services used up by different property types or property location. Second, they are efficient if designed to recover the cost of local public services consumed – no incentive would exist for a

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<sup>216</sup> Enid Slack (2002), "Property Tax Reform in Ontario: What Have We Learned?" vol. 50., No. 2 *Canadian Tax Journal*, pp. 576–85.

household or firm to alter its behaviour or location to avoid the tax as long as it matched the cost of services consumed. Third, variable tax rates have a further advantage in that they could be used to distort decisions deliberately to achieve certain municipal land use objectives. For example, if higher tax rates slow development and lower tax rates speed up development, a deliberate policy to develop certain neighbourhoods instead of others might be achieved through different tax rates for different locations.

### **Should business properties be taxed at higher rates than residential properties?**

The taxation of business properties (commercial and industrial) at higher tax rates than residential properties is generally done in one of two ways; either through the practice of assessing business properties at higher values than residential properties with the same tax rate applied to both property types; or through the simple application of higher tax rates on business properties. Higher taxation of business properties creates a number of efficiency and equity concerns. Efficiency in municipal service levels will not be achieved if revenues collected from property taxes on business properties are used to subsidize services consumed by the residential sector. Since service levels in any municipality are driven primarily by the demands of the residential sector (they vote), their subsidization means that the residential tax rate will be less than it would be in the absence of the subsidy and an oversupply of municipal services could follow. Equity is not achieved either if those benefiting from the services are not paying full costs.

This over-taxation of the non-residential sector has been addressed in two empirical studies in Canada and one in the United States. Both Canadian studies compared the property tax paid by business properties with the cost of municipal services used by them. The first study included a number of municipalities in the province of Ontario in the early nineties<sup>217</sup>. It concluded that the residential sector when compared with the business sector is the recipient of proportionately more benefits from local government services (social services in Ontario, elementary and secondary education, libraries, recreational facilities, etc.).

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<sup>217</sup> Harry M. Kitchen and Enid Slack, *Business Property Taxation*, Government and Competitiveness Project Discussion Paper No. 93-24 (Kingston, Ont.: Queen's University, School of Policy Studies, 1993).

When combined with higher effective property tax rates paid by the business sector, it concluded that the latter is over-taxed and the residential sector under-taxed.

The second study was completed in the mid-nineties on properties in the City of Vancouver (province of British Columbia). This study concluded that business properties used fewer services than residential properties but paid more in taxes<sup>218</sup>. This result prompted city council in Vancouver to shift property taxes away from business properties and onto residential properties in a series of steps in subsequent years.

A more recent study in the United States found similar results. Specifically, it was estimated that the “business related” share of combined state and local expenditures in the United States is about 13 percent, although there is considerable variation from state to state<sup>219</sup>. These businesses, however, pay proportionately more of the state and local taxes.

Further concerns with the over-taxation of the commercial/industrial sector arise because this tax represents a fixed charge that must be paid. The tax is fixed in the sense that it is unrelated to the value of municipal services used or profits earned. As long as the tax rate is more than necessary to cover the marginal cost of municipal services consumed or if there are no economic rents for it to capture, resources will be allocated inefficiently. This over-taxation of the non-residential sector can lead to less economic activity, lower output, fewer jobs and a less competitive business environment<sup>220</sup>.

Finally, there is the issue of whether this over-taxation plays a role in location decisions. Since firms and businesses generally locate where they can maximize their profits, the provision of fiscal inducements such as lower property taxes can influence a firm’s location decision in the same way as the reduction in other production costs may play a role. The impact of property tax differentials depends on a number of factors

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<sup>218</sup> KPMG, “Study of Consumption of Tax Supported City Services”, a report for the City of Vancouver, mimeograph, 1995.

<sup>219</sup> William H. Oakland and William A. Testa (1995), *Community Development-Fiscal Interactions: Theory and Evidence from the Chicago Area*, Working Paper 95–7 (Chicago: Federal Reserve Bank of Chicago).

<sup>220</sup> *Report of the Technical Committee on Business Taxation*, (Ottawa: Department of Finance, April 1998) at chapter 2.

including the size of the differential between competing municipalities and whether this differential is sufficient to offset differentials in other costs or market factors.

While it is uniformly accepted that the cost of doing business is an important factor in location decisions, there is less consensus on the role played by property taxes in this decision. The evidence, most of which is drawn from the United States, suggests that property tax differentials are relatively unimportant in inter-municipal or inter-regional location decisions but do play an important role in intra-municipal or intra-regional location decisions<sup>221</sup>. Higher effective property tax rates on commercial and industrial properties in one municipality within a region or area when compared with neighbouring municipalities create an incentive for firms and businesses to locate in the lower taxed municipalities. In the extreme, one might expect these property tax differentials to produce a heavy (why not all) concentration of all firms and businesses in the lower taxed jurisdictions. In other words, intra-municipal tax competition could be potentially destructive if it led to a race to have the lowest tax rates. A recent study on municipalities in the province of British Columbia (Canada) examined this issue and concluded that while there is some evidence that municipalities react to tax increases of their neighbours, there is no widespread destructive competition for capital<sup>222</sup>. Similar studies in the U.S., however, have concluded that property tax competition among neighbouring municipalities is much more prevalent and wide spread<sup>223</sup>.

In reality, the extent to which firms and businesses respond to property tax differentials depends on many factors. These include, for example, the importance of being in the core of the region or area for business reasons; the opportunity to shift the tax differential on to consumers (of the final service or product), employees and owners; and the enhanced amenities that may be offered by a 'downtown location.'

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<sup>221</sup> Kitchen and Slack (1993), *supra* footnote 31. Similar comments were made by officials of the Greater Toronto Marketing Agency in December 2000.

<sup>222</sup> Craig Brett and Joris Pinkse (2000), "The determinants of municipal tax rates in British Columbia", *Canadian Journal of Economics*, vol. 33, no. 3, 695–714.

<sup>223</sup> Jan K. Brueckner and Luz A. Saavedra (2001), "Do Local Governments Engage in Strategic Property-Tax Competition?" *National Tax Journal*, Vol. LIV, No. 2, 203–229.

In a U.S. study of individual office buildings in downtown Chicago, it was found that 45 percent of property tax differentials were shifted forward onto tenants as higher gross rents per square foot and 55 percent were borne by owners<sup>224</sup>. The reality that some firms are willing to pay a premium to locate in the downtown core suggests that those firms benefit from “economic rents” created by that location. For example, large financial institutions may benefit from a downtown location. Taxing these rents is efficient from an economics standpoint because it will not impact on the location decision. It is difficult to know, however, the extent of the economic rent. In other words, it is difficult to know at what rent (or property tax) a firm will choose to move out of the downtown location.

There are at least two more positive effects that would arise from shifting the relative tax burden away from the business sector<sup>225</sup>. First, a reduction in the relative property tax burden on this sector reduces the potential for exporting the property tax to non-residents (see discussion in next section). Second, since there is some evidence suggesting that capital invested in real property is, on average, taxed at higher rates than capital invested in other factors of production at least in Canada, the variation in capital tax rates is reduced if this burden is altered. On balance, the reduction in tax exporting (discussed below) and the decrease in the variance in tax rates could result in an improved allocation of resources for the Canadian economy as a whole and overall efficiency gains<sup>226</sup>.

A major defence of the over-taxation of business properties is provided by municipal officials and some taxpayers and it is as follows. Since businesses can deduct all expenses incurred in earning income (including business taxes) and since owner-occupiers of residential

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<sup>224</sup> McDonald, John F. “Incidence of the Property Tax on Commercial Real Estate: The Case of Downtown Chicago (1993),” *National Tax Journal*, 109–120.

<sup>225</sup> Sylvester Damus, Paul Hobson and Wayne Thirsk, *The Welfare Effects of the Property Tax in an Open Economy*, Discussion Paper No. 320 (Ottawa: Economic Council of Canada, 1987); and Shantayanan Devarajan, Don Fullerton, and Richard A. Musgrave, “Estimating the Distribution of Tax burdens: A Comparison of Different Approaches,” (April 1980), *13 Journal of Public Economics*, 155–82.

<sup>226</sup> Economic Council of Canada, *The Taxation of Savings and Investment*, A Research Report Prepared for the Economic Council of Canada (Ottawa the council, 1987), at 103 and 146.

dwellings are not allowed similar deductions, it has been suggested that an extra tax on business is legitimate in that it attempts to even out the disparities in taxes that would otherwise exist on these two different categories of taxable property. While it is true that owner-occupiers are not able to deduct property taxes, it is also the case that owner-occupiers are not required to include in taxable income either imputed income from their owner-occupied dwellings or in most countries, capital gains earned on the disposal of their principal residences<sup>227</sup>. Such exclusion is similar to a deduction from income for tax purposes (as in the case of the tax on businesses) in that both reduce the taxable economic income of the taxpaying unit. On this basis, it is difficult to make a case for a higher tax rate on commercial and industrial properties.

Concern over the kinds of distortions noted above with the property tax on commercial and industrial properties has prompted at least one suggestion for reform in Canada<sup>228</sup>. Specifically, it has been argued that revenues from a portion of the non-residential property tax should be replaced with revenues from a new business value tax (BVT). This BVT would be a value-added tax<sup>229</sup>. It would be levied on business income. It would be on production and not consumption. This would make it an origin, not destination based tax; hence, it would tax exports and not imports. Further, it is suggested that it be a provincial tax with municipalities having the opportunity to set local rates that are ‘piggy-backed’ onto the provincial rate. The province could even impose limits on local surcharges to prevent excessive locational distortions. Because the BVT is a value-added tax (essentially sales less cost of goods purchased), it would eliminate a number of the distortions created by the current over-taxation of business property. This type of local business is used in Germany and Japan.

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<sup>227</sup> For a discussion of capital gains and imputed rent on owner occupied dwellings, see Robin W. Boadway and Harry M. Kitchen (1999), *Canadian Tax Policy*, third edition (Toronto: Canadian Tax Foundation), chapter 3.

<sup>228</sup> Richard M. Bird and Jack M. Mintz “ Tax Assignment in Canada: A Modest proposal” in Harvey Lazar, editor, *Canada: the State of the Federation 1999/2000*, (Kingston: Queen’s University, Institute of Intergovernmental Relations, 2000) at 261–292.

<sup>229</sup> For an evaluation of value added taxes, see *Boadway and Kitchen (1999), chapter 5*.

## **Should property taxes on commercial and industrial properties be exported?**

The opportunity<sup>230</sup> for the commercial/industrial sector to export its property tax burden onto residents of other municipalities has the potential for misallocating resources and lowering municipal accountability. Tax exporting refers to situations in which some portion of the local tax burden is borne by people who live elsewhere either through changes in relative commodity prices or in a change in the net return to non-locally owned factors of production (inputs in the production process). For example, if higher effective tax rates on commercial and industrial properties lead to relatively higher prices charged on the sale of that community's exports to other communities, the taxing jurisdiction will have effectively shifted part of its tax burden onto residents of other communities. If the commercial/industrial property tax in every jurisdiction is exported to some extent, those jurisdictions exporting relatively more of the tax will be better off than those jurisdictions exporting relatively less. In particular, if the burden of this tax is shifted from residents of high income jurisdictions to those of low income jurisdictions, the distribution of income among jurisdictions is worsened. Furthermore, this runs counter to equalization schemes of senior levels of government that are aimed at redistributing resources (income) from relatively high income jurisdictions to relatively low income jurisdictions.

There is limited evidence on tax exportation. One Canadian study on a sample of large municipalities in Ontario<sup>231</sup> is somewhat dated. Nevertheless, it concluded that the degree of exportation ranged from a low of 16% of the commercial/industrial tax burden to a high of 106%. More than this, relatively rich municipalities had relatively high exporting rates whereas relatively poor municipalities had relatively low tax exporting rates. This tax exporting resulted in an implicit transfer from relatively low income municipalities to relatively high income municipalities.

Furthermore, when the commercial/industrial sector exports its tax burden, municipal government accountability is weakened because the

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<sup>230</sup> Of course, the ability of a firm to export will depend on the elasticity of demand for the exported product.

<sup>231</sup> For further elaboration on this material, see Wayne R. Thirsk (1982), "Political Sensitivity Versus Economic Sensibility: A Tale of Two Property Taxes," in Wayne R. Thirsk and John Whalley, eds., *Tax Policy Options in the 1980s* Canadian Tax Paper no. 66 (Toronto: Canadian Tax Foundation), pp. 384–40.



direct link between the municipal government responsible for local services and the ultimate person/agency/body paying the tax is missing.

### **Can property taxes lead to sprawl?**

Since the tax is levied on property, any investment that increases the value of the property (such as any improvements including an increase in density) will subject it to a higher tax. For this reason, higher property taxes are expected to discourage density. If, on the other hand, higher property taxes reflect higher levels of service, it is unlikely that there would be any impact on location or land use. To the extent that the allocation of service costs is based on property values and not on services consumed, some taxpayers pay more or less for services than the benefits they receive.

An extensive literature in Canada and the U.S. suggests that spatial factors do affect the costs of development<sup>232</sup>. In particular, the density of development and its location with respect to existing services influence the costs of providing services. For example, “hard” services such as sidewalks, roads, and water and sewer mains cost less to provide in denser neighbourhoods. With water, a pipe is laid down the centre of a street and individual service lines extend from the water main to each building. In high-density neighbourhoods, there are more dwelling units per kilometre of water main over which to spread the costs. Furthermore, increasing the distance from central infrastructure facilities such as water and sewage treatment plants will increase costs.

An efficient property tax would thus reflect the higher costs associated with providing services in less dense developments. This would generally mean that property taxes based on services received should be higher in suburban municipalities than in the core. If property taxes

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<sup>232</sup> For a review of this literature, see Marchand, Claude and Janine Charland, “The Rural Urban Fringe: A Review of Patterns and Development Costs,” Toronto: Intergovernmental Committee on Urban and Rural Research, 1992 or Transit Cooperative Research Program, *The Costs of Sprawl – Revisited*, Washington, D.C.: National Academy Press, 1998. For a theoretical discussion of how property taxation contributes to urban sprawl, see Jan K. Brueckner, “Property Taxation and Urban Sprawl”, in in *Property Taxation and Local Government Finance*, edited by Wallace E. Oates (Cambridge, Mass.: Lincoln Institute of Land Policy, 2001), 153–175.

are higher in the core and service provision less costly, the property tax creates an incentive to move to less dense developments<sup>233</sup>.

### **Who should set property tax rates?**

In developed countries, municipal governments are responsible for setting their own tax rates although limits are sometimes imposed on them by senior levels of government (discussed below). In many transitional countries, by comparison, the national government often sets the tax rate. Two exceptions are Estonia and Poland where municipalities set their own rates within limits imposed by a senior level of government<sup>234</sup>.

Following on the established theme that the most transparent, efficient and accountable local government is one that is responsible for raising its own revenue, it follows that local governments should be responsible for setting their own tax rates<sup>235</sup>. Failure to permit and require this means that the close link between decisions over revenue generation and expenditure decisions is lost.

Where two tier systems of local government exist, the upper tier should set its tax rate independently of the tax rate set by the lower tier. For each level of government, the tax rate should be high enough to generate sufficient revenues (beyond those generated by user fees, grants from senior levels of government, and other local revenues including permits, licences, and so on) to cover the cost of local public services that each level provides. As noted earlier in this paper, each tier should also use variable tax rates if service levels and standards vary across the municipality or jurisdictional area.

### **Should limits be imposed on property tax rates?**

The practice of imposing tax limits on municipal governments by a senior level of government is more prominent in some countries than in others. In the U.S., for example, thirty-two states impose limits on tax rates for local government. In Canada, provincial governments do not

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<sup>233</sup> For a detailed discussion, see Enid Slack, "Municipal Finance and the Pattern of Urban Growth", *Commentary* (Toronto: D.D. Howe Institute, 2002).

<sup>234</sup> *Malme and Youngman, 2000, p. 15.*

<sup>235</sup> *Bird, 2001.*

place limits on municipal tax rates, although there has been a recent call for tax and expenditure limits in Canada<sup>236</sup>.

These limits are intended to control and restrict the growth in municipal government spending and hence, property taxation. Recent research on the success of these limits has addressed three main questions. First, have property tax limits reduced property tax revenues? Based on the evidence, the answer is yes. Property tax revenues have declined in constant dollars if not in current dollars. In California, proposition 13 led to an immediate decrease of about 45 percent. In Massachusetts, the initial impact was a decrease of 18 percent<sup>237</sup>. Overall in the U.S., it has been estimated that local property taxes per capita fell by 3 percent after tax limits were imposed<sup>238</sup>.

Second, have reductions in property tax revenues been offset by increases in other local revenues? The evidence here is not as compelling but it does indicate that other local revenue sources have generally been substituted for property tax decreases. Greater reliance is now placed on local user fees, permits, licences, and so on.

Third, have property tax limits affected input choices (administrative staff versus service providers such as police officers and fire fighters) and quantities of output produced by local governments? The evidence here is mixed. Some studies found that local governments responded to tax limits by cutting proportionately more of their administrative costs while others found that local governments responded by cutting proportionately more of their service costs. Similar variation in results was noted for output. Some studies found that municipalities produced roughly the same quantity of services with less revenue while other studies noted that private sector provision had replaced public provision of local services.

Property tax limits also have another major impact. They curtail the decision-making power of municipal governments if they reduce the municipal sector's flexibility and capacity to raise its own revenue. This

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<sup>236</sup> Jason Clemens, Todd Fox, Amela Karabegovic, Sylvia LeRoy, and Niels Veldhuis, (October 2003) *Tax and Expenditure Limitations: The Next Step in Fiscal Discipline*, Critical Issues Bulletin (Vancouver: The Fraser Institute).

<sup>237</sup> *Ibid*, p. 189–190.

<sup>238</sup> Ronald J. Shadbegian (1999), "The effect of tax and expenditure limitations on the revenue structure of local government, 1962–1987", *National Tax Journal*, vol. 52, No. 2, pp. 221–238.

is particularly worrisome if it means that municipalities cannot provide sufficient revenues to provide local public services that are desired or wanted by local citizens.

Analytical arguments supporting property tax limits for local governments are generally weak. Locally elected councils should be responsible for setting local property tax rates. They are in the best position to determine what citizens want and need. Furthermore, if these councils are unresponsive to local wishes, they are likely to be voted out of office at the next municipal election. As well, the comparatively large number of municipalities in every country means that local tax rates are set in a competitive environment; that is, every municipality is aware of its neighbouring jurisdiction's tax rates and unwilling to have its rate differ from its neighbours for fear of losing businesses<sup>239</sup> and people. This type of tax competition works to control tax rates and it permits the municipality to make its own spending and taxation decisions without the restrictive controls of a senior level of government. Finally, the implementation and use of municipal performance measures would be much more effective and efficient in controlling the spending behaviour of local governments than are tax limitations<sup>240</sup>.

### **Property tax billing and collection – who should do it?**

Before property taxes may be collected, each taxing jurisdiction is generally responsible for preparing the tax role, establishing tax liability for each property (the tax bill), and ensuring that the tax bills are mailed to all property owners. In some countries, all of these functions are handled by the jurisdiction that sets the tax rate. In other countries, municipalities set their own tax rates with the remainder of the activities handled by another level of government (regional or state) or a private sector institution (banks, for example). To illustrate, the tax role is often prepared by a region/state/province wide agency (see discussion on assessment above); tax billing and collection are often done by the taxing jurisdiction but there is no reason why this need be the case. Tax

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<sup>239</sup> The literature tells us that property tax differentials play a role in intra-regional location decisions; hence, the reason why municipal governments compete with their neighbours to restrict property taxes. See discussion earlier in this paper.

<sup>240</sup> For a discussion of performance measures, see Harry Kitchen (September, 2002), "Municipalities: Status and Responsibilities, Budgeting and Accounting", a paper prepared for CEPRA I, pp. 51–56.

billing and collection benefit from economies of scale<sup>241</sup> – hence, these two functions could be handled by a private sector institution or by a larger unit of government. In the province of Ontario in Canada, for example, all regional and county governments (upper tier) set their own taxes independently of the tax rates set by the local municipalities (lower tier). The local municipalities then send out combined tax bills and collect both upper and lower tier taxes. This practice has been around for years and has been fiercely defended in the face of proposals to migrate billing and collection to the upper tier in order to take advantage of economies of scale. Furthermore, billing and collection is an administrative function and has nothing to do with policy setting or decision-making; hence, no reason why billing and collection needs to rest with the taxing jurisdiction that sets the tax rate.

### **Should property tax relief programs be implemented and if so, what program?**

Property tax relief programs are intended to reduce the property tax burden on specific individuals in specific circumstances. Reliance on one or more of these programs is motivated by a perception that the property tax is regressive (takes proportionately more income from low income individuals than from high income individuals) – an issue that has been the subject of many studies and debates for a number of years without any firm conclusion or direction<sup>242</sup>. In spite of the uncertainty over whether or not the property tax is regressive, municipal governments and their senior counterparts in countries where a property tax is used almost always assume that it is regressive. This has produced a variety of programs including those described here. While this description concentrates on the Canadian schemes or potential schemes, it is indicative of those also used in other countries.

**Property tax credits** are used in five Canadian provinces (Quebec, Ontario, Manitoba, Alberta, and British Columbia). The credit is designed so that its value varies inversely with personal income tax liabil-

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<sup>241</sup> W. Douglas Armstrong and Harry Kitchen (May, 1997), *Peterborough County/City Municipal Review: Final Report*, (Peterborough: Joint Restructuring Steering committee), pp. 125–127.

<sup>242</sup> For a discussion of these studies, see Kitchen (2002) *supra* footnote 28, ch. 5; Kitchen, (1992), *supra* footnote 12, ch. 6; and William Duncombe and John Yinger (2001), “Alternative Paths to Property Tax Relief”, in Oates (2001), *supra* footnote 10, pp. 243–194.

ity; that is, as income tax liability increases, the value of the credit, which is subtracted from personal income taxes payable, declines.

One comprehensive analysis of the Ontario refundable property tax credit program suggested that the property tax credit is progressive in its impact on taxpayers; that is, it provides relatively greater benefits to low income households vis-a-vis high income households<sup>243</sup>. A similar conclusion was noted some years later in a study completed for the Fair Tax Commission in Ontario<sup>244</sup>. While property tax credits are likely to be progressive, especially if they are refundable<sup>245</sup>, they are not problem free. For example, residents pay their property taxes during the year, yet they do not receive the tax credit until their income tax return has been filed on or before April 30 of the following year. This practice can create liquidity problems for income-poor taxpayers because of the relatively long wait between payment of property taxes and receipt of the tax credit.

Furthermore, given the uncertainty over whether or not the property tax is regressive, the property tax credit could more appropriately be analyzed as part of the general income-transfer program in province, region or state and not as a credit specifically designed to offset property tax liability. Indeed, it is unlikely that many taxpayers see any link between property taxes paid and the ensuing tax credit. After all, the credit for property taxes paid in one year is not available until the income tax return is filed in the following year.

When it is considered as a component of the provincial income-transfer system, one could question whether the property tax credit, which is designed to provide more relief to those with more wealth (higher property values), generates the desired income redistributive results. To some, it may seem strange to have an income distribution system that provides more relief for taxpayers with more wealth.

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<sup>243</sup> R.M. Bird and N.E. Slack (1978), *Residential Property Tax Relief in Ontario*, Ontario Economic Research Council Studies (Toronto: University of Toronto Press).

<sup>244</sup> Ontario (1993), *Fair Taxation in a Changing World: Report of the Ontario Fair Tax Commission* (Toronto: University of Toronto Press in cooperation with the Ontario Fair Tax Commission), p. 644.

<sup>245</sup> When a tax credit exceeds tax liability, the tax is refundable if the government reimburses the taxpayer for this difference. It is non-refundable if the government does not refund this difference.

In summary, uncertainty over regressivity of the property tax and the tendency to provide relief that varies directly with property values argues strongly in favour of eliminating property tax credits<sup>246</sup> and using other components of the state, region, or provincial government's income-transfer system to improve inequities in the overall distribution of income. Indeed, the analysis of the province of Ontario's property tax credit program referred to above concluded that it is "difficult to argue convincingly that the property tax credit system ... has been either terribly successful or terribly needed"<sup>247</sup>.

**Tax deferral** programs are not widely used, although local governments in some countries have the power to implement them for specific taxpayers. As well, they are sometimes implemented by a more senior level of government. For example, in the province of British Columbia in Canada, a province-wide tax deferral program for senior citizens and handicapped individuals operates. As well, in the province of Ontario, a deferral scheme is mandatory for low-income seniors and the disabled to alleviate any tax burden arising from increased taxes due to reassessment.

Under a tax deferral program, the owner of the property is permitted to defer some or all of his/her property taxes on an annual basis. Depending on the program, the lost revenue will be made up from revenue provided by a senior level of government or from general revenues of the municipality itself. The amount of the tax deferred becomes a lien against the property and is payable to the senior level of government or the municipality when the property is transferred. As well, there is usually, but not always, an interest charge applied to the deferred taxes.

There are a number of implications arising from the use of tax deferral schemes. First, if one's ability to pay taxes is measured by a combination of income and wealth where the property tax is viewed as a proxy for a tax on wealth, then a taxpayer who is asset rich but income poor could use this scheme to reduce his/her tax burden. In fact, tax deferral schemes can be especially useful in alleviating cash flow problems for income deficient taxpayers.

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<sup>246</sup> Tax credits inversely related to ability to pay are supported as a means of redistributing income.

<sup>247</sup> *Bird and Slack, 1978, p. 120.*

Second, and more critically, eligibility for most tax deferral programs is restricted by age (seniors) and sometimes, disability. While one may be critical of age or disability dependent eligibility requirements for any income transfer scheme, it may be administratively practical to impose restrictions of this sort. Otherwise, if this program were expanded to include everyone, there could be a significant increase in the number of applicants with the ensuing result that loans (tax deferrals plus interest charges on them) would be outstanding for a much longer period of time. According to some municipal officials, this would be administratively more complicated and costly<sup>248</sup>.

**Grants**, designed to remove some of the property tax burden, are provided to eligible homeowner's and/or renters in some countries. The value of the grant usually varies inversely with income and/or is given according to whether or not potential recipients are elderly or in receipt of welfare assistance. In the province of New Brunswick in Canada, for example, grants are the only property tax credit scheme while in other provinces (Alberta and Manitoba to name two), grants are used in conjunction with tax credits. In British Columbia and Ontario, tax credits, deferrals and grants are used for various purposes.

As a mechanism for transferring income, the grant should be evaluated in the same way as any other component of the overall provincial income-transfer scheme. By comparison with current property tax credit schemes, the disbursement of grants could be more directly linked with the payment of or reduction in property tax liability. As well, it is frequently easier to direct grants to specific individuals especially in smaller communities where hardship cases are more quickly identified, even though it may be more complex administratively to operate than the tax credit program.

**Exempting** individuals from property taxes as is done for certain taxpayers under specific circumstances in the provinces of Newfoundland and Nova Scotia in Canada effectively removes the burden of funding local services from these taxpayers and shifts the costs on to other taxpayers. This differs from grants in that the individuals do not receive actual cash payments from the province but its impact is similar to that

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<sup>248</sup> Enid Slack (1989), *An Analysis of Property Tax Relief Measures and Phase-in Mechanisms*, a Report prepared for the Task Force on Reassessment in Metropolitan Toronto (mimeograph, Toronto).



where grants, reductions, cancellations or refunds completely offset property tax payments. Exempting property differs from tax deferrals in that taxes are simply postponed under the latter scheme while they are not payable under the former.

Where the exemption is available to people over a certain age only (senior citizens, for example), these exemptions, as a tax relief measure, may be deficient because they fail to consider the ability of the recipient to pay taxes. Similar deficiencies may exist where the criteria for exempting property for owner-occupiers is based strictly on taxpayer's income and ignores property values.

**Reducing, cancelling or refunding** property taxes is generally associated with special circumstances, usually with poverty or illness. These programs last for one year and taxpayers are required to apply for them annually. The lost revenues are absorbed out of general municipal revenues. These programs are used infrequently and appear to operate more appropriately in smaller municipalities where it is easier to identify worthy recipients.

**Assessment credits** are not used as widely as the other programs but they have been suggested as a possible mechanism for relieving the property tax burden on residential properties<sup>249</sup>. This scheme involves the removal of a fixed amount (determined by the local council) of market value assessment from property taxation. It works quite simply. After all properties are assessed at market value, a fixed amount of assessment is deducted from the total assessed value<sup>250</sup>. Use of assessment credits applied to each piece of property would convert the property tax into a progressive tax rate. While this may appear to have merit on the surface, it would be a suspect device unless all properties owned by any particular individual were aggregated. Use of assessment credits would also result in a reduced assessment base overall. When compared with the system before the assessment credit is introduced, an equivalent amount of property tax dollars would be generated, then, through the imposition of higher property tax rates. For those proper-

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<sup>249</sup> For a discussion of this topic, see Metropolitan Toronto Advisory Task Force on Assessment Reform (1987), *Report of the Sub-Committee on Implementation Mechanisms* (Toronto: The Task Force).

<sup>250</sup> This is similar to allowing personal income tax exemptions in a personal income tax system.

ties with relatively low assessed values, the value of the assessment exemption would offset the higher tax rates and these taxpayers would be better off financially. For properties with relatively high values, the higher tax rates would more than offset the taxes saved from the availability of the assessment credit and these taxpayers would be worse off financially. As a relief mechanism, the assessment credit, which is the same dollar value for all residential property owners, is deficient because it is based on the assessed value of property and not on the property owner's total ability to pay<sup>251</sup>.

**Summary:** While tax relief for people who are deemed to have insufficient ability to pay is an important policy objective of governments, there is some question whether local governments ought to be using property tax relief instruments for income redistribution purposes. There are at least three objections to these instruments at the municipal level. First, the available evidence is not conclusive on whether or not the property tax is regressive. If it is not regressive, there is little basis for providing relief to reduce any alleged regressivity.

Second, if the tax is considered as a tax on one component of wealth (namely, property values), there may be limited support for granting property tax relief on the basis of the taxpayers income. In other words, if some recipients are asset rich and income poor, the real issue is whether people with significant assets should get relief from property tax payments, under any circumstances. Third, if taxpayers are not required to pay for local services they use, there is every incentive for them to demand larger quantities than is allocatively efficient.

Briefly, then, greater dependence on province-wide, region-wide, state-wide or nation-wide income-transfer schemes could more appropriately handle the income distribution issue (greater over-all equity in the tax system based on ability to pay) while greater use of tax deferral schemes could handle the liquidity problem for asset wealthy homeowners.

### **12.3. Comments on Property Tax System in Russia**

This discussion may be separated into two parts. The first part describes the existing system and proposed changes to it. The second

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<sup>251</sup>Slack, 1989, pp. 16–17.

part summarizes this paper by highlighting what could be done to improve the Russian property tax system.

### **Existing and Proposed System**

Federal legislation in Russia permits local government to use specific taxes<sup>252</sup>. This includes a tax on land with municipalities having no control over the tax base and limited control over the tax rate. The latter is set within a narrow range established by the federal and regional governments.

Local governments are also authorized to levy individual property taxes. These apply to structures (houses, apartments, dachas, garages, and other buildings) owned by people and to motorboats, aircraft, and other vehicles except automobiles, motorcycles and other self-propelled vehicles. Tax rates may vary by type of structure with the rates set by local governments but subject to (low) maximum federal limits. For vehicles, the tax is levied according to engine power.

The enterprise property tax applies to the annual average balance sheet value of assets (fixed, intangible, and inventories) of legal entities. Assets used for agricultural production are exempted from property taxation. Rates are set by regional legislatures and can vary by type of producing asset. The maximum tax rate is 2 percent with tax revenues being split between regional and local governments.

Tax reform has been on the agenda of the federal parliament in Russia since 1999. As part of this reform package, the draft *Tax Code* provides for the introduction of a western style real estate tax at the regional level with all revenues shared with local governments. Once enacted, this tax is intended to replace the three existing property taxes – land tax, individual property tax, and enterprise property tax.

### **Summary**

From the discussion in this paper, it is apparent that the most efficient, uniform, accountable and transparent municipal property tax systems around the world exist where the following conditions are met.

- All taxable properties are identified, described and recorded on the assessment roll.

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<sup>252</sup> For a more detailed discussion, see Andrey Timofeev (2002) “Land and Property Taxes in Russia”, mimeograph,

- The property tax base, whether assessed value or area value, is determined in a uniform and consistent manner across a region (as opposed to local) if not across an entire country.
- Assessment is updated as frequently as possible, ideally on an annual basis, so that the tax base is current, uniform, consistent and fair.
- Property assessment (determination of property values or property area) is the responsibility of an arms-length regional assessment authority in order to avoid local distortions created by local pressure groups.
- Each level of government using property tax revenues to fund expenditures is responsible for setting its own property tax rate(s).
- Variable tax rates are used when the cost of providing municipal services varies by property type and location.
- Variable rates, as opposed to a uniform rate, are more likely to discourage urban sprawl and to minimize the extent to which the local property tax is exported to other jurisdictions.
- Business properties (commercial and industrial) are not over taxed vis-à-vis residential properties.
- Limits (by a senior level of government) are not imposed on tax rates set by local governments unless it is to prevent local taxing authorities from imposing unnecessarily high rates on commercial and industrial properties vis-à-vis residential properties.
- The existence of a large number of municipalities in a region or country creates a competitive environment (where municipalities know what the tax rates are in neighbouring communities) that provides an incentive for all competing municipalities to set their tax rate at the lowest possible level.
- Tax billing and collection is an administrative function that benefits from economies of scale and should, therefore, be administered on a regional basis.
- Caution should be exercised in creating specific property tax relief schemes – a better approach comes from implementing a comprehensive tax relief scheme administered by the regional or central government.

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