Revenue Raising and Accountability of Local Governments in Lithuania

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1. Introduction

Lithuania is a highly centralised state with local authorities caught in a "fiscal straightjacket" [World Bank (2002]. Hence there are no truly autonomous local taxes in Lithuania. All taxation is either controlled or at least heavily regulated by the national government. This study thus investigates the potential for increasing the accountability of Lithuanian local government by introducing a true local tax.

There are only two levels of democratically elected government in Lithuania, national and local. The national government contains only one elected chamber of parliament, but also has a directly elected president. There are 60 local authorities whose councils are elected by party list proportional representation. There was a major reform of local authority finance starting with the 2002 budget.

Giving local authorities (LAs) more control over their revenue potentially could increase local fiscal accountability. LAs should be given the right to increase their revenue through taxation, even though this conflicts with efficiency of location of persons and businesses. Entangled with this issue is also the question of the appropriate tax base for local government. That in turn depends on the services provided by local government. At present the main role of Lithuanian municipalities is to administer schooling, but funding of this function is centralised. It is hence necessary to consider the decentralisation of schooling in order to address decentralisation of revenue raising. By giving LAs control of their revenue we would effectively give them control over important decisions of resource allocation for public services. However, if we are reluctant to decentralise this control due to considerations of efficient location or equity then local revenue control will be less attractive. A subjective counter argument to the location efficiency critique of decentralisation is that the community of persons in a geographical area is just as valid a part of its environment as other "natural" features. Hence to preclude the interplay of the communities preferences on resource allocation would constrain these preferences unnecessarily leading to an important efficiency loss.

Turning more to methodological individualism, there is a trade-off between the efficiency loss from the political externality of a centralised resource allocation decision and that from the distortion of location decisions from differing local tax rates. The only way to avoid the latter while decentralising taxation is to tax the fixed factor, land, at a

unit rate. This may, in the short run lead to an increase in the supply of land for rent if poor land owners are forced to rent out some of their land to cover the tax. That would cause a further rise in allocative efficiency, a benefit possibly outweighed by the distributional consequences. In the absence of specific land taxes there will be a distortion of location decisions. Land is an insufficient tax base to finance modern local government, however. This is clearly observable since the total rent obtainable from all Lithuanian land is lower than the expenditure of Lithuanian municipalities.

The primary justification for local taxation must be a local public good that is to be financed. Local expenditures are dominated by provision of schooling but it is questionable whether this is a true public good. Many argue that education is a private good since it is excludable and rival (or non-joint) in consumption. Few, however, would deny that there are positive externalities associated with education and hence it could rationally be subsidised. Moreover, there may be certain features of the education of children, e.g. group learning, that do exhibit at a minimum the features of club goods, i.e. excludable but locally non-congestible. Public goods are often associated with defence, from violence or disease, and hence there may also be a public good in the defence from ignorance. The establishment of a society where illiteracy is reduced to a minimum would appear to be a commonly desired public good of this type. Hence a minimum of education is a fairly global public good. Certain communities may desire to provide higher levels of education to the attendees of schools in their district. They may be unsatisfied with the level agreed by national parliaments or may simply prefer to concentrate more resources on educating children in their immediate vicinity than on those outside.

However, the true good may not be the provision of education itself but the aspects of the environment actually consumed by individuals. Individuals consume an environment that contains traces of ignorance or knowledge, in addition to information about the conditions of others. To the extent that the former dominates an individual's preferences they might be expected to prefer higher levels of education of those in their immediate surroundings. The more mobile the individual the less this consideration will lead to focus on a local area and the more they will support education over a wider geographical area.

The foregoing argument implies that local taxation may be a mechanism for concentrating the resources that one is pooling for community projects on expenditures in the local vicinity rather than over the whole nation. This may be problematic for equity since it implies that less is invested in the human capital of children in some districts. It may, on this view, be preferable to force concerned parents to raise the general level of expenditures than to allow them to focus on their own community, probably leading to a lower level of expenditure in the nation in the political equilibrium. However, this view implicitly assumes that the raising of such expenditure is the correct policy, superior to alternative paths.

In essence the discussion of decentralisation of taxation consists of a series of questions about use of a local tax to fund a particular service, e.g. schooling. Should schooling be funded by a local tax? – yes, if there is community preference for providing a minimum level of schooling locally that is higher than the national minimum. There may be some municipalities whose provision will lie on the threshold and not want any additional local funding. In that case local taxation will be zero and the town will revert to being purely an administrator of a nationally funded school. On this logic it appears that the appropriate step for Lithuania is to set national subsidy for schools to the minimum required standard and allow towns to raise further funds for their schools from local revenues. There is also the question of whether schooling provision, rather than finance, need be in the public sector. The community building nature of local schools should not be forgotten here as it may form a significant part of the public good nature of municipal schools.

Summarising this discussion the following considerations are key in determining the relevance of treating schooling as a local public good:

1. Is education received as a non-rival and non-excludable good?
2. Is the educational content of the environment consumed as a non-rival and non-excludable good?
3. Is there congestion in the consumption of the education environment?

Some aspects of education may be non-rival and non-excludable since knowledge itself is not depleted by sharing it with another person and people cannot be very cheaply prevented from sharing knowledge that is not quite highly specialised. However, the key

service provided by schools, teacher contact, is rival and easily excludable. This means that both private tutoring and private schools survive in the market. The educational environment consumed by individuals may be both non-rival and non-excludable. As individuals become more mobile their environment extends over a larger area and hence their preferences for a good environment includes a larger area. Congestion in the consumption of the education *environment* in contrast to the congestion that exists in receiving education services is complicated by the fact that all the individuals are part of the environment and so the consumers are part of what they are consuming. Looking purely at the aspect of the environment that includes the education of the younger generation, however, this is not congested by adding more consumers from the older generation (i.e. voter taxpayers). Once an environment of educated individuals has been created extra consumers of that environment do not deplete it or change the probability of meeting ignorance in that environment. In that sense investments in the environment by educating the next generation are global public goods and should be provided at the higher level of government. This contrasts with practice that education of children receives more attention from local governments than education of adults.

Hence, the cost and benefits of a global community may result in some education for a particular Lithuanian town, say funded by the UNDP. All the world now experiences an increase in the educational level of that Lithuanian town. However, there is another good which individuals consume; their *immediate* environment. They may have higher preferences for the quality of their immediate environment. Looking from the global perspective this good is clearly rival. Investments into the immediate environment use up resources that could otherwise be used for investment into the immediate environment of another distant individual. A teacher cannot simultaneously teach in two distant towns any more than an apple can be eaten by two people. It is also excludable, as education can be given to one town without being given to another. It is not rival or excludable among individuals within the immediate environment, however.

Moving to a more continuous formulation we can say that an individual may care less about a child's education the less likely they are to meet. This implies that the individual's marginal benefit from a child's individual declines with the distance between them.

An alternative is to accept that improving the education level of a particular town is a global public good but ask what is the way to reach the efficient level of provision. The most obvious way in democracy is to have each taxpayer pay their marginal benefit. Since the marginal benefit of those outside the town is likely to be much below the marginal benefit of those inside the town it is an efficient approximation to have the good financed only by those inside the town. If those outside the town have no tax liability they cannot participate in decision-making as their choice will not take into account costs. So local financing of improvements in the local environment may be seen as an approximation to a more efficient decision-making process for a public good.

Hence the local public good is the immediate living environment, which includes the level and distribution of education in the town. The main local public goods for which local tax autonomy is relevant are environmental: road quality, refuse collection, management of public land, socio-cultural projects and policing.

2. An Overview of Local Government

a. Local government at a glance

Lithuanian government expenditure has fluctuated between 31% and 38% of gdp in the last five years. Municipal expenditure was estimated at 7-8% of gdp between 1996 and 2000 [World Bank (2002), 3]. The budget law is passed each year with forecast allocations for each municipality based on projected revenues from each of the taxes, specific grants and the results of the equalisation formulae. The main specific grant is for schools and hence the financing of this function is largely controlled by the national government. Towns are then free to reduce their revenue by offering tax abatements to businesses and individuals. Towns must form their own budget for expenditures in accordance with a large set of regulations regarding salaries, number of employees and other aspects set by the national government. These restrictions severely restrict the room for manoeuvre of the local authorities on the expenditure side. Hence local authorities are largely reduced to the role of administrators of a budget that is preset for them by the national government.

b. *Local government finance*

There was a large reform of local government finance in 2002. The table below shows the scale of the shift by comparing the break down of revenue by source projected for 2002 with that realized in 2000. The main change is the switch from the personal income tax to specific grants as the main source of municipal revenue.

Table 1. Revenues 1994-2002 (thousand litas)

	1994	1998	2000	2001	2002**	2002 in %
Total Revenue	1,927,461	3,719,954	3,274,269	3,233,895	3,527,222	100
Tax Revenue	1,301,313	2,739,550	2,829,828	2,803,503	1,494,876	42
Personal income	626,550	2,421,738	2,504,272	2,511,614	1,115,346	32
Corporate income	213,660	285	-	-	43,744	1
Property taxes	38,220	235,014	258,503	284,409	328,274	9
Land	6,876	15,046	20,849	23,065		
Land rent	31,344	50,070	46,019	47,266		
Real estate	-	169,199	189,804	211,826		
Estate, inheritance, and gift	-	699	1,831	2,252		
Other	110,130	82,513	67,053	7,480	7,512	0
Stamp duty	106,861	75,726	60,031	-	-	
Market place duty	3,269	6,787	7,022	7,480	7,512	0
Non-Tax Revenue	77,602	198,338	112,272	117,226	68,599	2
Grants, Loans and Transfers	547,928	781,775	331,920	302,932	1963747*	56
Grants from the state budget	357,392	760,816	315,405			
Loans from the state budget	15,376	-	-			
Loan from the World bank	-	-	-			
Transfers from other budgets	175,160	20,959	16,515			
Sales of fixed capital assets	618	291	249	10,234		

* - Forecast

**- Not ultimate data

Sources: *Lietuvos Respublikos valstybinio valdymo įstaigų ir finansinių įmonių finansai 1994*. V.: Lietuvos statistikos departamentas prie Lietuvos Respublikos Vyriausybės, 1995; *Valstybės ir savivaldybės institucijų finansai 1998*. V.: Lietuvos statistikos departamentas prie Lietuvos Respublikos Vyriausybės, 1999; *Lietuvos apskritys 2001*. V.: Lietuvos statistikos departamentas prie Lietuvos Respublikos Vyriausybės, 2002; www.finmin.lt.

c. *Original Revenue Sources and Local Public Borrowing*

Lithuanian municipalities have accumulated significant debts to banks for short term and long term loans. The government seeks to control this through a system of controls, but this has proved insufficient. Local authorities have run deficits, as a group making as much as 7% of revenues in 1999, the worst of the last 5 years [World Bank

(2002), 11]. There is also a growing stock of arrears, equal to 13% of revenues by October 2001. Overall the stock of arrears, short-term and long-term debt was approximately 30% of annual revenue by October 2001.

This situation led the 2002 World Bank report to recommend that the system requires both greater municipal control over their own revenues and expenditures and concurrently that the national government should harden the budget constraint faced by municipalities by refraining from ad hoc bailouts. The existence of such large stocks of arrears and debt indicate the strain already placed on local authorities. Hence it may indicate a lack of capacity to manage the additional administrative burden of a local tax, while also suggesting the need for a local tax so that local authorities can at least prevent their debt burden from growing.

3. The Political Economy of the Local Government Budgeting Process

To analyse the political element of budget allocation takes a detailed analysis of the allocations to each municipality. However, changes from year to year are more readily apparent. The reforms in 2002 gave the biggest increase in revenue to Šilute, hence we can ask whether this municipality had increased its lobbying power compared to previous years [Data provided by the Ministry of Finance, www.finmin.lt]. This contrasts with the situation for Visaginas, which although protected from actually losing revenue in 2002 by grandfathering, would otherwise have lost 36% of its revenue. A more complete table of the main winners and losers from the 2002 reform is as follows:

Table 2. Winners in the 2002 Reform

Municipality	Excess revenue (thsds litas)	Excess revenue (% of total)	Municipality type
Šilute	5,097	9	Western medium sized rural weak poor
Palanga City	4,556	18	Western small urban poor
Panevezys	1,881	4	Northern medium sized rural (weak) poor
Jonava	1,586	3	Central medium sized rural weak

Losers in the 2002 Reform

Municipality	Grandfathered revenue (thsds litas)	Grandfathered revenue (% of budget)	Municipality type
Visaginas	12,489	36	Eastern medium sized urban poor
Birstonas City	4,291	33	Southern small urban
Svencionys	2,609	8	Eastern medium sized rural weak poor
Sirvintos	2,390	10	Eastern small rural poor
Pakruojas	2,206	7	Northern medium sized rural poor

These tables show that both the winners and losers tended to be small or medium sized poor towns with weak economies. None of Lithuania's larger cities were among them. We may conjecture that this is due to the political barrier to making reforms that would affect any larger city in a dramatic way. The clearest difference between the winners and losers is geographic. The winners are concentrated in the West and North of Lithuania while the losers are in the East and South. Hence we might ask if there has been a shift of political/economic power in Lithuania, particularly away from the East.

Let us now turn to the political economy of introducing true local taxation. Having agreed that there are local public goods in making investments into the local environment, the next question is how to achieve provision that is responsive to the will of the community about these services? In order to answer that question we should:

1. Enumerate the factors desired by the community members.
2. Find a way to evaluate the relative importance of these factors.
3. Deal with issues of timing and uncertainty.
4. Compare the effect of various systems on the overall evaluation.

This seems to be an impossible task. Hence this paper will seek only to evaluate one possible shift – adding local taxation to the current Lithuanian system.

1. What elements of service provision are desired by residents?

- overall expenditure level (quantity of provision)
- distribution of the service
- content mix in the service
- employment policy

2. Evaluating the relative importance of the above factors requires use of a social welfare function, and hence may be impossible. Lithuania's democratic institutions may provide a rough approximation of a social welfare function for Lithuania. Hence the question becomes; would local taxation make Lithuanian local government more responsive to the outcomes of decision-making by Lithuanian institutions? This question is cannibalistic, however, since local government decisions are automatically the resolution of those institutions whatever the mechanism. Hence the question would have to be reduced to comparing the actions of Lithuanian local governments to a subset of institutions such as the election results. This does not give a clear way to distinguish a result, however, since there are no polls of elected representatives other than council votes. Hence the main index of local opinion is the voting patterns of the local government council. Giving towns a local tax would enable Lithuanian councils to vote on increasing revenue. This would mean that local government actions were more accountable to local preferences.

We must conclude that there is no way to evaluate relative importance of the factors so as to correspond logically to an aggregation of individual preferences without making some simplifying assumptions. The assumptions may enable us to look at the effect on certain mechanisms of practical democracy by assuming that a positive effect on a certain mechanism will result in a positive effect on accountability. Examples of the types of mechanism we might consider are:

1. the ability of the council to affect resource allocation
2. the control of local residents over their local council.

Disadvantages of local autonomy

Another way to look at this question is to ask given a community that has a majority desire to supplement nationally provided services by taxing itself, or a majority desire to shift spending on public services to private income by reducing taxes why would you want to prevent this?

1. Reduction of equity – especially for the environment of minors and increasing uncertainty and fragmentation in the nation
2. Inefficiency of local taxation – mobility incentives
3. Reduction of minimum expenditure levels
4. Redistribution away from poorer communities – leaves them with poorer local

environments, worse schools.

This has to be set against the potential advantages of allowing richer communities greater freedom to increase their taxation, which may be partly linked through an equalisation system to aid to poorer communities. However, if your objective is maximin (based on the current minimum standards being too low) practical experience indicated that centralisation is the best policy. This conclusion, though, may be quite separate to the question of how tax autonomy impacts accountability. This centralisation removes local decision-making power and hence would need to be complemented by an increase in the power of citizens over their national government. This could be implemented through taxpayer funding for lobbying of school parent-teacher organisations to members of the national parliament and to the Education Ministry.

4. Reconsidering the "Original" Local Government Revenue Sources

Local government "own" revenue sources include the real estate tax on commercial buildings, stamp duties, land lease charges, the land tax, and market place duties. They may only partially be classified as original local sources, however, since national law places limits on the rates. Municipalities may not raise tax rates above the legal maximum but are free to abate these taxes and reduce the rates at a direct cost to the municipality's budget. The other feature that distinguishes them from the income tax is that only the local government receives revenue from these taxes. Similarly to the income tax the revenue they receive is that collected from within their jurisdiction. These taxes provided approximately a tenth of local government revenue in 2002, as shown in Table 1. The real estate tax has dominated, providing ¾ of the revenue, among this group of taxes.

General features of "original" local government revenue sources in Lithuania

Several aspects are common to all the above taxes in the Lithuanian system.

1. There is a maximum rate set by national law.
2. Municipalities receive the revenue collected from their jurisdiction.
3. Collection is administered by a regional tax collection agency.
4. Municipalities can abate or completely relieve the tax burden on a taxpayer or

group of taxpayers, at the cost of reducing its own revenue.

Hence these taxes are essentially imposed by the national government but the tax base may be adjusted directly and indirectly by the municipalities.

The real estate tax

The real estate tax was established by the 1994 law on "The real estate taxes of business entities and organisations". The key features of this tax, mandated by law, are:

1. It is not levied on land.
2. It is only levied on real estate owned by legal persons. Private persons' real estate is untaxed, apart from land (taxed by the separate land tax).
3. The taxable value of the property is based on the current cost of construction.
4. There is a reduction in value for depreciation since it was built.
5. The value is also adjusted for regional variation.
6. The maximum tax rate is 1%.
7. A variety of governmental, public service and agricultural entities are exempt from paying the tax.

Municipal tax abatement

This is the key area of tax autonomy currently exercised by Lithuanian local authorities. It is thus important to understand how much autonomy municipalities currently exercise over the level of abatement of these taxes. The main question that arises is are towns that currently abate taxes making a deliberate decision to sacrifice public services for increased private income or are they mainly abating taxes in order to support long run development and revenue. There are at least 3 possible explanations of municipal tax abatements.

i. Towns are trading off present collective consumption for current private consumption.
ii. Towns sacrifice present collective consumption as an investment in future business.
iii. Towns' abatements do not sacrifice any current collective consumption as the abated taxes would not have been paid even if demanded.

The first of these implies traditional tax decision-making power allowing the local community to decide how much of its private income it would like to allocate for collective use. If abatement is of only the second variety there is a particular type of tax autonomy that allows towns to act only when there is a pressing case for avoiding loss of business in the community. The last of the explanations for tax abatement implies no tax autonomy for the town, only a decision about whether to decriminalise non-payment in particular cases.

56 out of the 60 municipalities offered some tax abatement in 2000, this number dipped to 55 in 2001[1]. Total abatements were 8.75 m. LTL, approximately 1% of municipal revenue. In 2000 abated revenue was dominated by abatements of the land rent charge, land tax and real estate tax which made up 38%, 29% and 24% of total abatements, respectively.

Hence tax autonomy was not effective for at least 5 municipalities in 2001 since they engaged in no abatement. In order to assess the degree of autonomy exercised by the remainder we need to know more about the motives for abatements in those towns. A first step is to classify towns by which of the three motives above was dominant in their decision-making. I conducted a survey of municipalities in autumn 2002 in order to ascertain some answers to these questions. From the 60 municipalities surveyed answers were received from 44. Answers came from a variety of units in the municipalities including mayors' offices, departments of finance and budget, and administrators' offices. The most common reasons given for tax abatement, mentioned by over a third of respondents, were support of local employment and the difficult financial position of firms. This puts abatement into the second category, with some autonomous trade-off made between current spending and other goals. If the financial position of firms is critical, however, it may imply the third case with municipalities deciding to allow a company to continue operations despite its inability to pay its local taxes.

Another aspect of the abatement decisions is their tendency to be granted to individual cases rather than a general reduction of taxation. If a community decided to reduce collective expenditure to increase private income, exercising true control over its level of collective action, we might expect to see general abatement of a tax for all taxpayers. This would be equivalent to a reduction in the tax rate. It would also imply

that, from that point, a community had the power to increase or decrease its level of collective provision at the margin. This would be a powerful indication of tax autonomy hence it would leave the municipality effectively unconstrained by national law. In practice there have been only a few municipalities that have passed council decisions to make general reductions in abatements. This situation may change with the increase in the legally allowed maximum tax rate on land in 2002. Nevertheless, it is important to note that allowing municipalities to receive more revenue from the land tax would enable them to increase revenue from only a narrow tax base. Increasing taxation in this way could put acute financial pressure on a relatively small group of land-owners, who would bear the entire incidence of the tax. The significant and unexpected loss might cause such an action to be perceived as an unjust appropriation of property by the government. Land-owners could be expected to resist strongly.

5. Enhancing Local Fiscal Capacity and Democratic Accountability

In Lithuania the step toward tax autonomy under most serious discussion is the introduction of a real estate tax for natural persons, giving local authorities control over the rates. Hence pressure on the government for increasing tax autonomy is most likely to speed up introduction of this reform. It is likely to include at first some upper limit on the tax rates. If towns will choose rates below the upper limit they will still have effective tax autonomy at the margin. This would increase the statutory ability of local councils to affect resource allocation.

A framework for analysis

Whether the above change translates into practical autonomy depends to a large extent on the capacity of the local governments to use that power. The effect on residents' control of the council is equally unclear. So the two key determinants of whether tax autonomy leads to greater accountability are

(i) what is the capacity of local government to make use of tax autonomy

(ii) how much control will residents have over their local government given tax

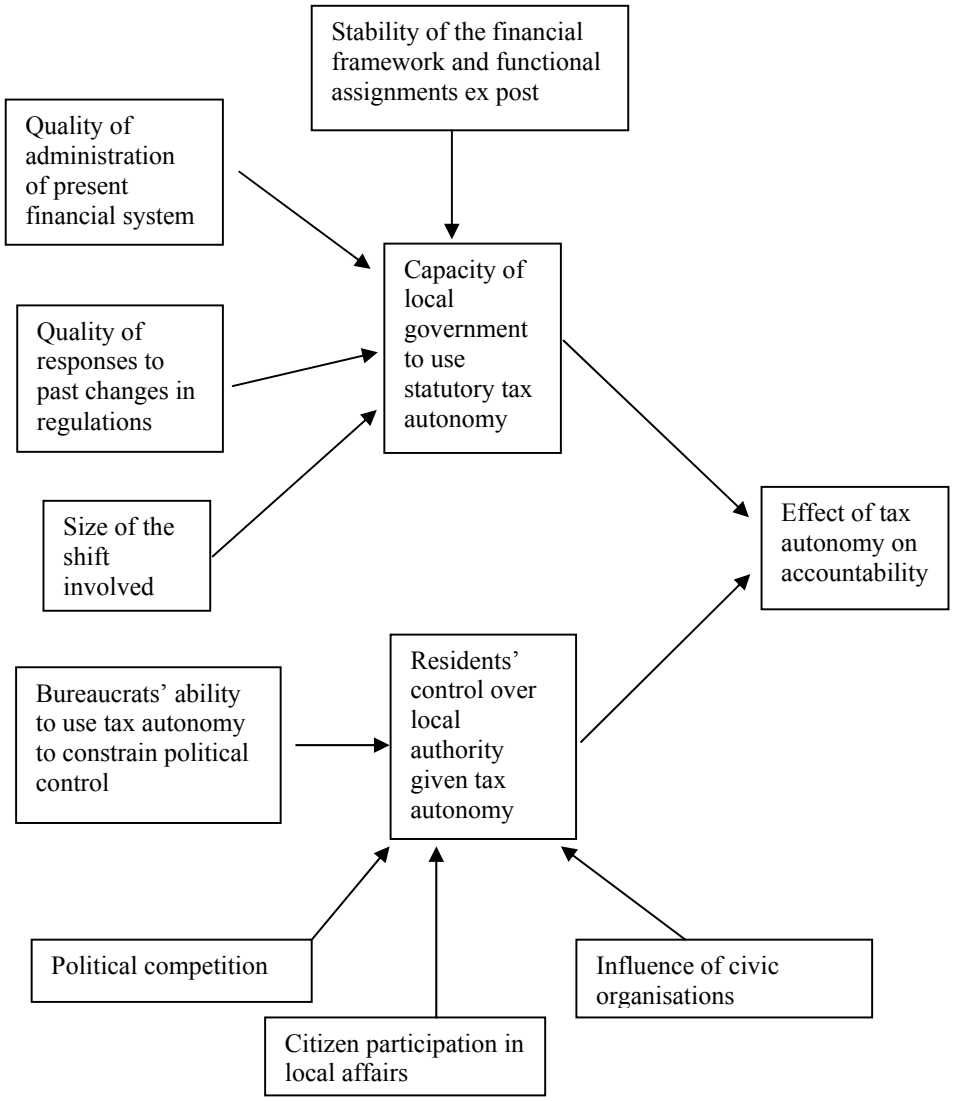
autonomy.

Thus I will comment on each of these in turn for the Lithuanian local government system.

(i) The capacity of local government to make use of tax autonomy

In order to determine the capacity of local government to make use of tax autonomy there are a few guides. First there is the capacity already demonstrated by

Figure: A framework for analysis of the impact of tax autonomy on accountability



Lithuanian local government in their administration of the present system. Second there are examples of Lithuanian municipalities' reactions to previous changes in their responsibilities, particularly in financing regulation. Third is the size of the shift, i.e. how great of an adjustment will it be for local authorities to implement true local taxation? Fourth is the likely impact of any further shifts in the financial structure and functional assignments. These measures are likely to reveal unequal capacity across municipalities and thus it is reasonable to expect unequal use of the power granted them by statutory tax autonomy. To make an overall evaluation it would be useful to compare with other countries, particularly those who have then moved to decentralisation of taxation. Thus a system of benchmarking and ranking could be used.

Hence one way to evaluate the capacity of Lithuanian local authorities is to evaluate their administration of the present financial system. This may be done with measures of outputs produced by the LAs, as proxies for effectiveness. A less direct alternative is to use measures of inputs such as the qualifications or turnover of staff.

Quality of administration of the present system

a) Problems:

One of the most prominent features of the Lithuanian local government finance system in recent years has been conflict between the municipalities and the national government. This is an output feature, thus it impinges directly on the capacity of Lithuanian local authorities. The Lithuanian Association of Local Authorities long contended that the national government had not followed the law in providing local authorities adequate compensation for new mandates and low tax revenue. Eventually the Association took the national government to court over the issue and won its case. The fact that cooperation between the levels of government broke down so completely as to require court action may be a sign of low institutional capacity to manage finance. Alternatively the local governments may be commended for having the capacity to stand up to the national government and strike an historical legal victory that lay down an important marker in the evolution of the rule of law in Lithuania. Perhaps most directly what these events demonstrate is the difficulty of the present intergovernmental financial system, that this may be improved by giving fiscal autonomy to local authorities. Fiscal

autonomy would reduce the municipalities' dependence on the national government and hence may reduce the scope for conflict.

Another problem, related to the first, has been the growing indebtedness of the local authorities. Some of them have taken on markedly higher loans than others putting them in a precarious financial position.

b) Successes:

Perhaps the most outstanding successes of Lithuanian local government have been its ability to work with international agencies, primarily the EU PHARE program, to facilitate investments that improve the standard of living of the population.

Quality of responses to past changes in regulations

Local government finance continues to be in transition in Lithuania, there are frequent changes to the budget system. Local authorities have shown considerable flexibility in dealing with these changes overall, despite problems in some municipalities. Instability of the financial system and functional assignments harm local authorities by providing continuous extra administrative burden in adjusting to new frameworks, preventing the accumulation of learning on the administration of a framework and necessitating disruptive reallocations of resources. In Lithuania, however, reforms such as the introduction of the "pupil basket" categorical school grant in 2002 seem to have taken place fairly smoothly.

Size of the shift involved

This factor depends on what reform of local taxation is considered. Since the current situation only gives revenue control to local authorities through tax abatement we may judge the shift to be quite large. If, however, we take option most discussed in Lithuania, the introduction of a real estate tax for natural persons with some control over the rate in the hands of local authorities, we can evaluate the size of this shift. The shift would be significant because it would be levied on an entirely new tax base. It would be likely to yield considerably more revenue than the land tax and in time could become a significant part of the municipalities' revenue. Hence the shift would be one of the largest reforms undertaken in Lithuanian local government finance in recent years, perhaps more

of a challenge for the municipalities even than the introduction of equalisation grants several years ago.

Stability of the financial framework and functional assignments ex post

There are two prominent aspects to this question. The first aspect is that the changes in the financial framework have shown no sign of slowing down in Lithuania in recent years. Hence we might anticipate continued changes for some years to come. The second aspect is that the introduction of local taxation is likely to be a catalyst for further changes in the financial framework and possibly in the assignment of functions also. Since a local tax gives municipalities more flexibility over their revenue it also introduces flexibility over expenditure. Both of these benefits are likely to be expropriated by the national government to some extent through rearrangements of the financial and functional structure. This is especially true for local taxation introduced via a new tax base such as the real estate of natural persons. The continuing shifts in the framework will hinder the abilities of Lithuanian municipalities to take advantage of their new local tax. It is likely that this will be disproportionately problematic for the smaller and economically weaker local authorities.

Taking together these factors governing the capacity of Lithuanian local authorities to administer local taxation what overall assessment can we make? It would seem that Lithuanian authorities have demonstrated a strong flexibility to adjust to changes in their framework, but not without some strains on their capacity to manage operations and the introduction of a new local tax would be a larger shift than most previous changes experienced by Lithuanian local government since the mid-1990s. The reform would also be likely to lead to further aftershocks in the evolution of the system of local government that would increase the challenge for municipalities to quickly manage the new revenue source.

(ii) Resident control over the tax autonomy of local authorities

This aspect of the increase in accountability depends in large part on the degree of political accountability of the local councils. As noted by Wright (2000) not only

administrative but also political and civic development is important for decentralisation. Hence it is important to question the degree of political competition for local council control and the possibility for residents' influence over local government between elections through civic organisations. Both of these aspects are connected to the degree of the population's participation in local affairs. A fourth factor here is the power of the local bureaucracy to interfere in the political control of the population, which is a familiar type of principal-agent problem.

A positive factor for Lithuanian residents' involvement in local affairs is their low mobility compared to populations in other European countries. However, trust in local government is low in Lithuania. Lithuanian municipalities are among the largest in Europe, hence residents may also feel quite distant from their municipal government compared to countries where average municipal units have less than a tenth of the population of the average Lithuanian municipality. Residents' ability to lobby local government between elections depends on the formation on interest groups and NGOs. There has been steady development of the NGO sector but it is largely confined to the capital and the larger cities. Political competition in Lithuanian municipal elections is completely within the framework of parties, there is an absence of independent councillors. This fits with the regional trend of greater party involvement in larger municipalities. Local government election results have not exactly paralleled national elections, however, with a different mix of party strengths emerging. Hence poltical competition may be said to be active. Another measure of the political competitiveness is that in the 2000 elections only 8 of the 60 municipalities, or 13% of them, have town councils with a single party majority. Hence 87% of the councils rely on cross-party agreement to pass resolutions, making them more susceptible to residents' pressure.

Whether the municipal bureaucracies significantly reduce political control over revenue from a local tax is perhaps the most difficult aspect to predict. The bureaucracies will have a natural tendency to try to reduce competition among them by increasing regulation. For that reason they are likely opponents of the whole project of decentralisation. Once tax decentralisation is inevitable, the local bureaucracies may nevertheless seek to institute national regulation that ameliorates inter-authority differences and hence reduces the power of residents to make local choices. In order to

know how successful the bureaucracy may be in this endeavour we can ask whether the necessary institutions exist and how successful the Lithuanian municipal bureaucracies have been in past similar cases. The existence of the Association of Local Authorities of Lithuania (ALAL) for several years now, and its incorporation even into the law for the allocation of budget funds, suggests that there is an institutional basis for municipal bureaucracies to lobby for their interests. Although the ALAL operates as a political association of municipal mayors, it also has the bureaucratic structure that might enable pressure on behalf of the local bureaucracies. It is difficult to find evidence of bureaucratic behaviour in an environment where the structure is continuously changing. However, one might speculate that the tendency of Lithuanian municipalities to follow central government guidelines without deviation, although partly driven by asymmetric political preferences with respect to local reductions and increases from the guideline levels, may be reinforced by the bureaucratic desire for uniformity. Hence it would seem important that any local tax, even if introduced with an allowed range of tax rates, should not be accompanied by a guideline rate, or the local bureaucracies may be similarly successful in leveraging a uniformity that contradicts the objective of allowing local control.

6. Conclusion

The consequences for accountability of an increase in local autonomy depend on two major factors. The first is the technical capacity of the municipality to cope with the introduction of a local tax and the second is the amount of control residents have over their municipality. The introduction of a true local tax would be a major administrative challenge for Lithuanian local authorities in an environment where the continuing flow of institutional changes put significant pressure on their management capabilities. This may be combined with weak participation of residents in local affairs, particularly outside the major cities, and established channels of bureaucratic influence to ameliorate the ability of local authorities to make independent policy choices with the new revenue source. This will be especially true if the national government does not refrain from forming a guideline tax rate for the local tax.

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Notes

[1] Data provided by the Ministry of Finance