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ANALYSIS OF MUNICIPAL BUDGETS OF REPUBLIC IMPORTANCE CITIES AND TOWNS FOR EVALUATION OF ECONOMIC DEVELOPMENT OPPORTUNITIES – CASE STUDY OF LATVIA

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Annotation

The article presents information about the budget revenues and expenditures of the cities and towns of republican significance – Rīga, Daugavpils, Jelgava, Jēkabpils, Jūrmala, Liepāja, Rēzekne, Valmiera, and Ventspils in 2009, 2010 and 2011. These cities are important nationwide, as they are home to more than half of Latvian residents, as well as they are the main centres of economic activity. Consequently, the municipal financial and economic situation is most significant, as well as the decisions that can both facilitate the economic development and also impact it negatively. And vice versa - the economic activity and welfare of the population closely affect the actions and perspectives of the local government. This is also highlighted in the research papers by other authors - the economic development must be balanced, and its existence and pace depend both on the business activities, as well as on the decisions taken by the state and local government institutions.

Research includes information about the municipal budget revenues of the republican cities and towns, the total amount of income and the amount of income per capita, which is a more objective indicator, which takes into account the differences in the population size. Since the main municipal budget revenue source is the tax revenues, the amount of this item per capita has been individually viewed.

The analysis of the total budget expenditures of the cities and towns and the expenditures per capita are presented. Taking into consideration the primary objective of the local government performance, namely, to act in favour of people's interests, separate analysis on the most significant items of municipal expenditures is presented, and the expenditures per capita on education, social protection and maintenance costs have also been calculated.

Municipal effectiveness cannot be assessed only by analyzing the budget revenue and expenditure items. To ensure complete situational awareness, the assessment and comparison of the needs of the current situation is required. Such indicators, characterizing the activities of the local government, as population size, the dependency ratio, the unemployment rate and the number of individual merchants and commercial companies per 1000 inhabitants are used.

KEY WORDS: municipality, budget, income, expenditure, economic development.

Introduction

The municipality is a governing body whose main task is to run their own local inhabitants interest. This authority can be implemented effectively and efficiently through its budget - the expenditure management. However, there cannot be expenditures in the absence of revenues. The local governments need to assess their revenue collection sources and to improve the budgetary situation without harming the administrative area development.

The aim of the paper is to describe the local economic development factors and assess the situation in the main republican cities and towns of Latvia. To conduct the study, such assessment methods as analysis of dynamics, comparison, strength of relationship and ranking have been used.

According to the data of the Latvian Central Statistical Bureau, at the beginning of 2012, the population in 9 main republican cities and towns (Rīga, Daugavpils, Jelgava, Rīga, Jūrmala, Liepāja, Rēzekne, Valmiera, and Ventspils) constituted 1,030,676 people, or 50.93% of the total population of the country. That proves the significance of municipal decisions because they affect more than half of the population's quality of life and to a large extent their well-being.

The object of the research is the economic development of the local governments of the republican cities and towns in Latvia.

The subject of the research is the impact of budget revenue and expenditure of the Latvian republican cities and towns on the level of their economic development.

The purpose of the research is to assess the impact of the budget revenue and expenditure management of the republican cities and towns on the economic growth: the level achieved and the future options.

The research used the data from the reports by the State Regional Development Agency "Regional Development in Latvia" (State Regional Development Agency – http://www.vraa.gov.lv/lv/petnieciba/petijumi/) about the basic indicators of the socio-economic development of the republican cities and towns (hereinafter - the cities and towns), as well as the budgetary revenue and expenditure for the period from 2009 - 2011.

The research highlights that business operations and growth prospects are largely dependent on the specific environment, favourable for the region - the infrastructure available in volume and quality, the demographic situation and other factors, such as Porter's Diamond model for the Competitive Advantage of Nations (Balkyte, Tvaronaviciene 2010), see Fig.1.

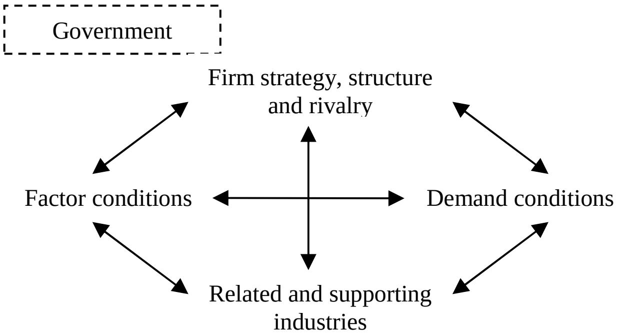

Fig. 1. Porter's Diamond model for the Competitive Advantage of Nations

Although, in this case, the model analyzes the factors affecting the country's competitiveness and its improvement, this approach is also applicable to the analysis of certain regions of the country, and the cities and towns, where the results of the economic development significantly alter the situation in the country as a whole.

Odenhal, Sedlaik, Michalek (2012) consider the following factors to be the three most significant indicators characterising the competitiveness of the region:

1. infrastructure and its availability;
2. human resources;
3. economic environmental factors.

An important role in the economic development and promotion is given to innovation activities, which significantly increases the opportunities for any company to improve their competitiveness and consequently, also refers to the level of competitiveness in the region. „Innovation, together with technological progress, is one of the main sources of economic growth. Differences in economic growth and satisfaction of society can be partly explained by differences in the success of countries in the field of innovation. Categories having a large impact on the development of innovation include capital and technological currents (cooperation between the industry and the research sphere)." (Rodnika, 2012)

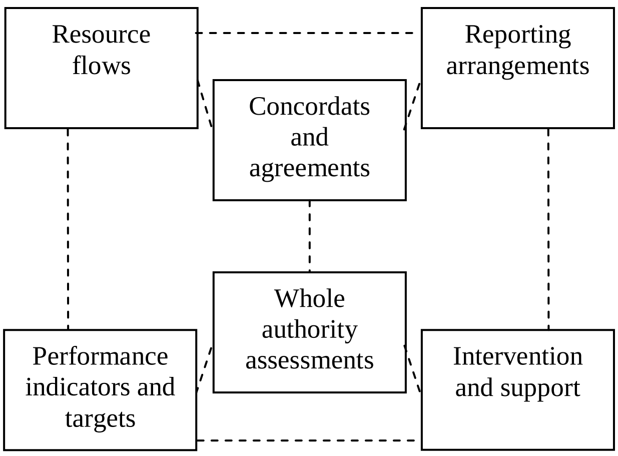

Fig. 2. Local government performance frameworks

Similar approach was used in describing the model assessing the performance of the local government (Down, Grace Martin, and Nutley 2010), see Fig.2.

Analysis of the competitiveness of the region has also been presented in a number of papers by other researchers, and it appears that a range of factors affecting the competitiveness are listed as significant, namely, the indicators characterizing the economic activity and business, and/or innovation activity. This means that not only local government decisions depend on the current situation (economic, social, political, etc.), but it should be noted that local government decisions affect (or will affect) the local economic development opportunities and performance.

Municipal basic budget revenues and their dynamics

In Latvia local government budget revenues consist of:

1. deductions from national taxes and duties;
2. municipal charges;
3. state budget subsidies and earmarked grants;
4. grants from the local government finance
5. equalization fund;
6. payments by local governments;
7. charges for services;
8. deductions from capital companies profits;
9. revenue from local government property leasing (rental) property sales;
10. other statutory revenue (Law on Local Government Budgets 2010).

The amount of revenues in the city and town basic budgets of Latvia is presented in Fig.3.

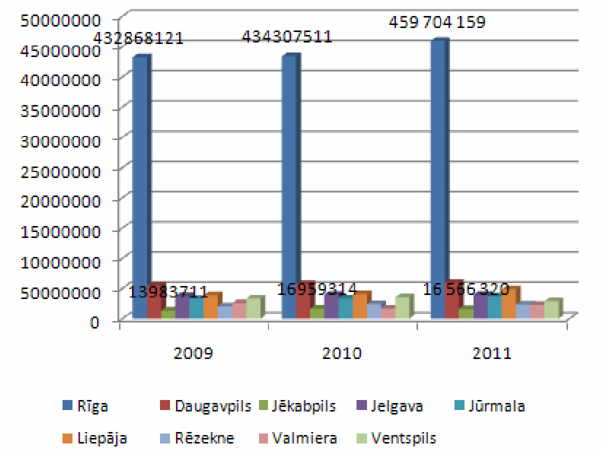

Fig. 3. Basic budget revenues of cities and towns, from 2009 to 2011, in LVL (compiled by the author of the paper, based on the data available from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

Evaluating the municipalities of cities and towns together, in 2010 and 2011, the municipal basic budget revenues have increased - in 2010, by 1.3% and, in 2011, by approximately 5.1%. However, from the analysis of the local government performance of each city and town alone, it becomes evident that the dynamics was different. During both years, basic budget revenue growth was experienced in Rīga, Daugavpils, Jūrmala and Liepāja, but the growth rates were different - from 0.33% growth in Riga, in 2010, to 18.8% increase in Liepāja, in 2011. While the rest of the municipal budget revenues, in 2010, have increased, in 2011, it declined (except for Valmiera with opposite directions of change). The largest reduction, as well as the largest increase was in Valmiera municipality - about 33% and 32%, respectively, in 2010 and 2011.

The highest and lowest levels of the local government basic budget revenues in Rīga and Jēkabpils, respectively, are presented in Fig. 3. However, one should note that these cities are different in terms of indicators such as the area, population, etc. Therefore, a more objective comparison rate is the basic budget revenue per capita, see Fig. 4.

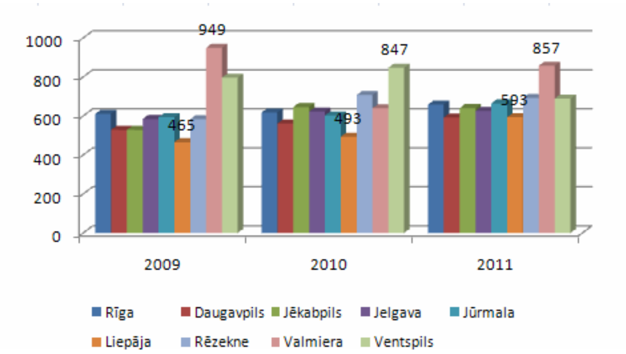

Fig. 4. Basic budget revenues per capita of cities and towns, in 2009 - 2011, in LVL (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

From Fig. 4, it becomes evident that larger local government budget revenue does not necessarily mean greater amount per number of population. Valmiera has experienced the largest average budget revenue per capita, during the period under consideration, although the total amount of revenue for this municipality was the third lowest. In turn, Riga ranked third as to the revenues per capita in 2009, whereas, in 2010 and 2011, it occupied the 5th place.

During the period under consideration, most municipalities experienced the increase of basic budget revenue per capita. The exception were Jēkabpils, Rēzekne and Ventspils municipalities in which the income per capita, in 2011, decreased by 0.8%, 2.2% and 18.7%, and Valmiera, where income per capita decreased, in 2010, by 32.7%. The largest income growth per capita was also experienced in Valmiera - 34.2%, in 2011.

Most part of the municipal revenue is made up of tax revenues – on average, in all the municipalities, they comprised 61%, in 2009, 63%, in 2010 and 2011. Data on municipal tax revenues are shown in Fig.5.

Local government tax revenues constitute personal income tax revenues and property tax revenues. During the period, most of the revenue was collected from the personal income tax - on average, 85% of all tax revenues. This confirms the importance of the changes in the number of population and in composition in the local governments. When the number of people of working age is decreasing, it significantly reduces the local authority's ability to generate revenue through taxes.

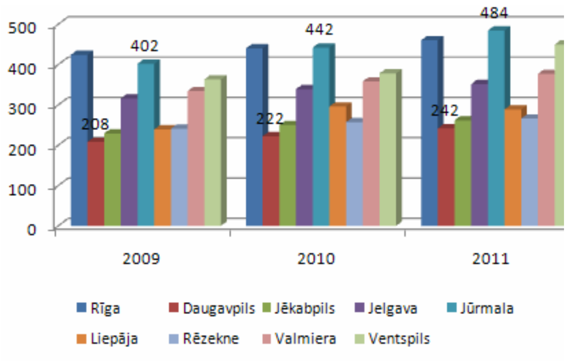

Fig. 5. Tax revenues per capita of cities and towns, in 2009 - 2011, in LVL (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

Municipal basic budget expenditures and its dynamics

The classification of budget expenses according to the economic categories is the following (LR CM Regulations No. 1031, 27.12.2005, http://likumi.lv):

1. maintenance costs;
   - 1.1. current expenses;
   - 1.2. interest expenses;
   - 1.3. subsidies, grants and social benefits;
   - 1.4. current payments to the EU budget and international cooperation;
   - 1.5. transfers of maintenance expenses;
2. capital expenditures:
   - 2.1. for capital formation;
   - 2.2. capital expenditure transfers;
3. other expenses.

The classification of budget expenses according to economic categories consists of the following items (LR CM Regulations No. 934, 13.12.2005, http://likumi.lv):

1. general government services;
2. protection;
3. public order and security;
4. economic activity;
5. environmental protection;
6. area and housing management;
7. health;
8. recreation, culture and religion;
9. education;
10. social protection.

Information about the city and town basic budget expenditures is presented in Fig.6.

In 2010 and 2011, Daugavpils and Rēzekne has experienced the increase of basic budget expenditures, compared with the previous period. In Valmiera, both years the reduction in expenditures was observed. In 2010, the rest of the municipal budget expenditures seem to have decreased, and, in 2011, it increased, the largest decrease was experienced in Jūrmala (26.85%), in 2010, the largest increase in Jēkabpils (46.94%), in 2011. The opposite dynamics has been characteristic for the Ventspils municipality - decrease in 2010 and increase in 2011.

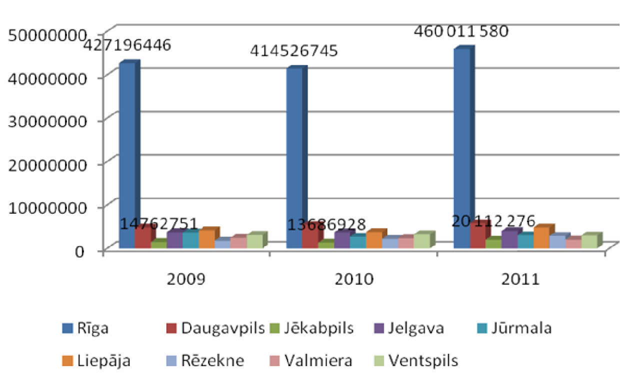

Fig. 6. Basic budget expenditures of cities and towns, in 2009 - 2011, in LVL (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi)

The highest and the lowest levels of the local government basic budget expenditures are shown in Fig. 6, which is similar to the revenues, respectively, in Rīga and Jēkabpils. However, a more objective indicator for comparison is the budget expenditures per capita, see Fig.7.

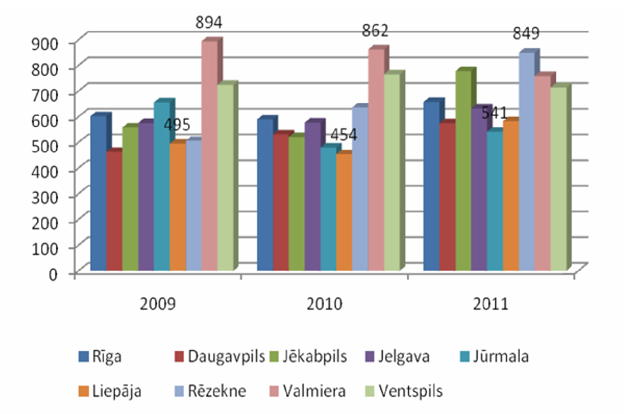

Fig. 7. Basic budget expenditures per capita of cities and towns, in 2009 - 2011, in LVL (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

In 2009 and 2010, major expenditures per capita have been experienced in Valmiera, in 2011 - in Rēzekne, while the lowest ones - for two years in Liepāja and, in 2011, in Jūrmala. It can be seen that the local governments take into account their financial capacity, because, basically, the rank by expenditures per capita coincides with the rank by revenues per capita.

As mentioned above, the task of the local government is to act in the interests of population; therefore, the range of functions also includes the organization of access to education and social protection.

As shown, in Fig. 8 and 9, major expenditures on education per capita, every year, were experienced in Valmiera (in 2009, the same level was experienced in Rēzekne), the lowest - in Jūrmala and Liepāja. Major expenditures for social protection were experienced in Rēzekne, the lowest – in Jelgava, and, here, we observe a large unexpected expenditure increase – in 2011, the difference was almost two times.

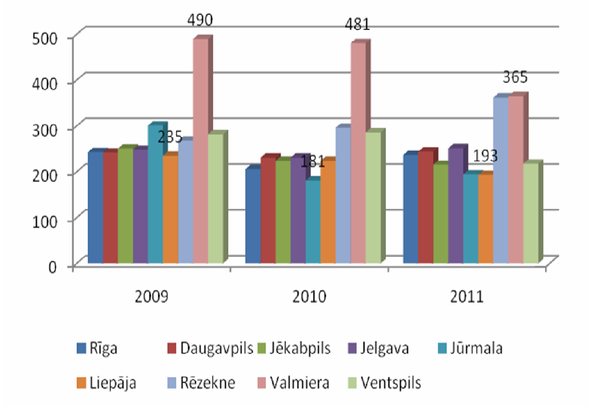

Fig. 8. Basic budget expenditures of cities and towns on education per capita, in 2009 - 2011, in LVL (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

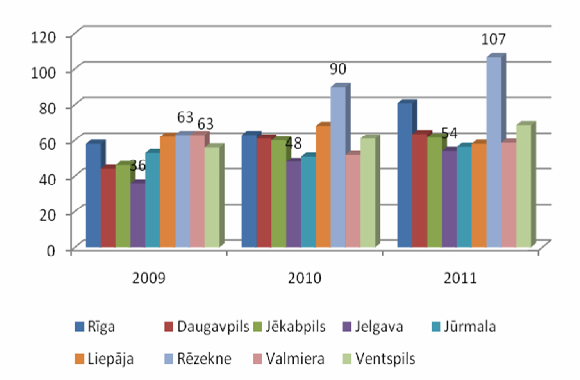

Fig. 9. Basic budget expenditures of cities and towns on social protection per capita, in 2009 - 2011, in LVL (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

During the period under consideration, the major maintenance costs incurred in Valmiera, the lowest – in Jēkabpils and Liepāja (see Fig. 10).

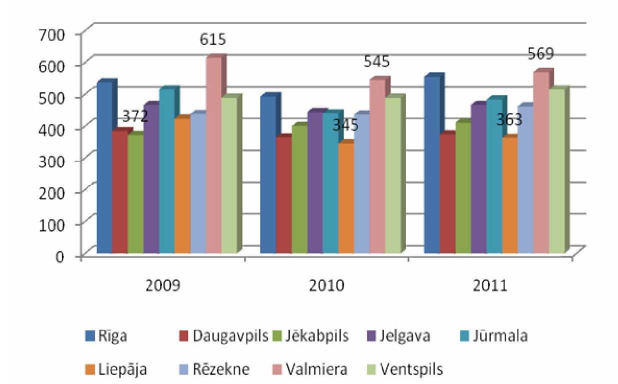

Fig.10. Municipal maintenance costs per capita, in 2009 - 2011, in LVL (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

Analysing the structure of the local government expenditures, namely, breakdown of the maintenance costs and capital expenditures, it is evident that the average maintenance costs constitute about 80% of the municipal budget, but in different local governments the breakdown is, every year, different. So, for example, in

2010, the largest share in the maintenance costs, which constituted 92%, was experienced by Jūrmala, while the lowest, in 2011, by Jēkabpils, which constituted 53% of the basic budget expenditures.

Municipal socio-economic development indicators

The analysis of the following characteristic parameters of the economic development is presented:

1. number of inhabitants, because, in Latvia, the problem of the decreasing number of inhabitants is crucial;
2. unemployment rate is the indicator of untapped human potential for value creation, leaving an impact on the level of welfare too;
3. demographic burden is the indicator of the region's public distribution by age groups. It also characterizes the existing public burden imposed on the people of working age;
4. the number of the economically active statistical units characterizes economic activities in the region under consideration, and also provides opportunities for the current (or the potential) job creation.

During the period under consideration, all the municipalities experienced a negative trend of changes in the number of population. The number of population is shrinking, except in Jūrmala where, in 2011, compared to 2010, the number of population grew by 0.44%. The intensity of the changes has been different. For two years, the sharpest decrease in the number of population was experienced in Rēzekne and, in 2011, it reached 1.91%. In all the cities and towns (except for the above mentioned Jūrmala), in 2011, the population was declining faster than, in 2010, whereby, only in Rīga, it was less than 1%.

In Fig.11, the information about the dependency ratio of cities and towns is presented.

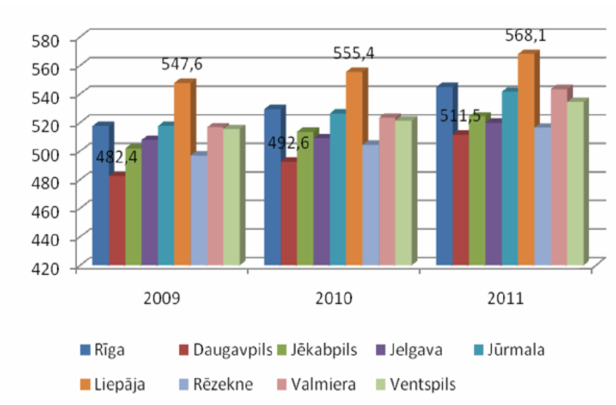

Fig. 11. Dependency ratio in cities and towns, in 2009 – 2011 (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

The dependency ratio may be differently evaluated. On the one hand, according to data presented in Fig.11, compared to the information, provided in Fig.4, it becomes evident that, the municipalities with a greater demographic burden experience lower revenues per capita (over years, the nature of relationship has not been stable, but the comparison of the information about Liepāja provides a sound basis for this conclusion). On the other hand, the indicator includes the information about the number of population before and after the working-age, so that, if the dependency ratio rises, mainly, due to a large number of people before working age, this means that, in the future, the economic and financial situation of the local governments would improve. However, we should take into account the "aging" problem of the total population, existing in Latvia, which severely reduces such development opportunities in the cities and towns.

As mentioned above, the unemployment has a negative impact on the local government socio-economic situation, and this, in turn, affects the local government budget. Comparing the information provided in Fig.9 and 12, we see that higher unemployment rates lead to shifts in spending towards social protection (assessed as moderate correlation).

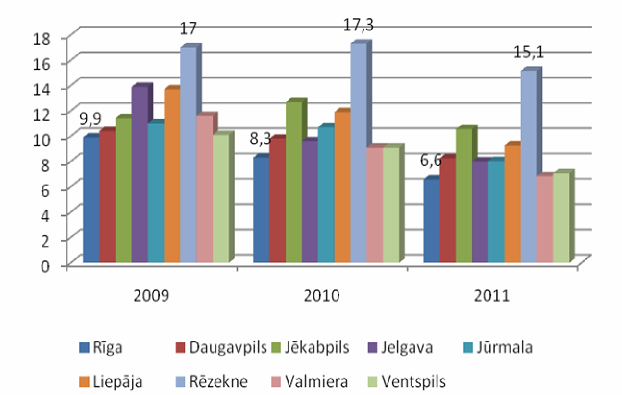

Fig. 12. The unemployment rate in urban areas, in 2009 - 2011, % (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

As shown above, in Fig. 5, the main source of revenues for local governments come from the tax revenues – primarily, the personal income tax and the real estate tax. In the local government budget the amount of the tax revenues (in particular - the personal income tax) is closely dependent on the economic activities of the local government.

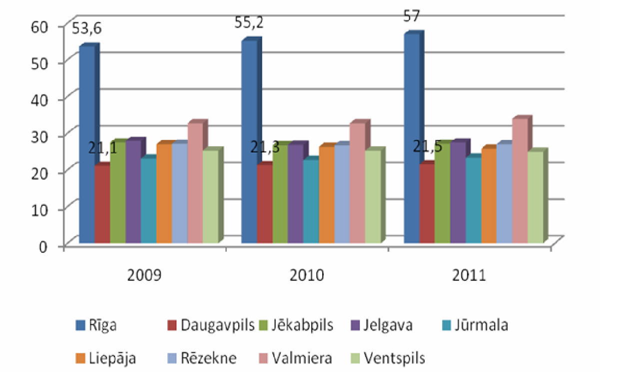

Fig. 13. Number of individual merchants and companies in cities, in 2009 - 2011, per 1,000 of population. (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

According to the data provided in Fig.5, one of the biggest amounts of tax revenues is experienced in Riga, the lowest - in Daugavpils. The same situation can be related to the number of individual merchants and commercial companies. A larger number of operators can have a positive impact on the employment (illustrated by comparing the data in Fig.12 and 13.) Of course, we must also take into account the mobility of citizens to work in one place and live in another urban or rural area, as well as the different sizes of the individual merchants and commercial companies, which influence their ability to provide jobs.

Fig.14 and 15 present summaries about the budgets of cities and towns and their socio-economic situation.

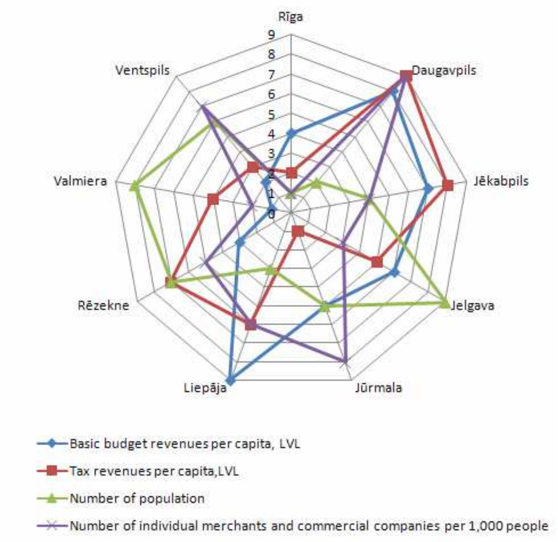

Fig.14. Ranking results of local government performance in cities and towns (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

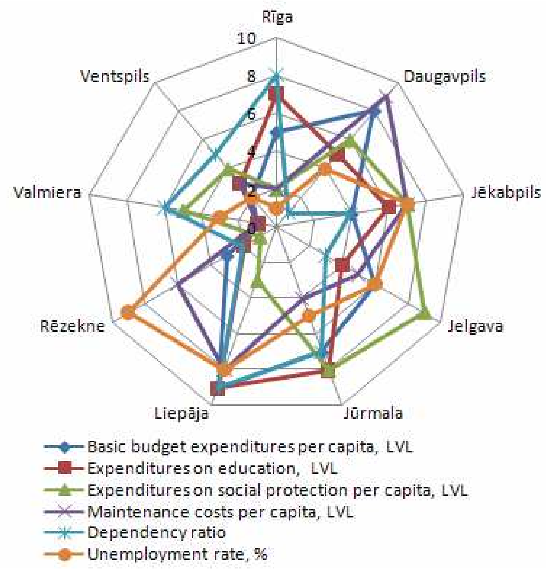

Fig.15. Ranking results of local government performance in cities and towns (compiled by the author using data from http://www.vraa.gov.lv/lv/petnieciba/petijumi/)

The summaries present the information by calculating the average ratio of the indicators, in the cities and towns. In ranking the cities and towns, 1 represents the highest and 9 – the lowest level. Provisional grouping of indicators was performed, and, in Fig. 14, those indicators are presented, the best indicator of which has the highest level. In Fig.15, the indicators with the lowest value are presented. Ranking of these indicators is provisional, because greater local government spending cannot be regarded as clearly good or bad. The amount should be assessed together with the analysis of the effectiveness of management, namely, the level of service and quality that is not carried out by this research.

As seen, in the previous two figures, there are considerable cross-correlations and effects in the indicators. As a result, in the group of republican significance in Latvia, there are visible leaders and those, losing ground. When analyzing all the indicators, the best situation is in Valmiera, Rīga and Ventspils, the worst - in Daugavpils and Liepāja. These findings, as mentioned above, are based on the condition that, in ranking the major expenditures are considered to show poorer performance. However, in reality, more local government spending, if it is used in a rational and strategic way, will ensure the local government commitment and better economic situation, in the future, which may contribute to the improvement of the other indicators under consideration.

Conclusions

Major budget revenues are collected in the Rīga municipality, though, calculating by per capita, the greatest amount is collected in Valmiera and Ventspils. Rīga by this indicator ranks the third, or the fourth. During the period under consideration, total municipal budget revenues increase every year, but the dynamics is not true for all cities and towns. The rate of change of revenues is also different. The situation is similar with regard to the revenues, calculated by per capita. The main source of local government revenues is the tax revenues. During the period under consideration, the majority of municipalities have collected the basic budget revenues from the personal income tax - on average, 85% of all tax revenues. This confirms the significance of the number of total population and the changes in the composition in the local governments. The decrease in the number of people of working age will significantly reduce the local government ability to generate the revenues through taxes.

The level of spending reflects a similar situation, like with the revenues. The largest expenditures are experienced in Riga, but expenditures **by per capita** – **in** Valmiera and Ventspils. Also, the dynamics of the amount of expenditures **is** volatile, which means that, the local governments analyze the development opportunities and adapt to the existing and predictable economic situation.

Local government major expenditures **refer to maintenance** costs (**classified by** economic categories**)** - on average, 80% of the total expenditures. According to the functional categories**,** a significant proportion (even **more than 50% of the** budget expenditure) constitutes the expenditures on education**.** Comparing the municipal budget indicators, such as, revenues, tax revenues, expenditures, costs of education, social protection expenditures and maintenance expenses, estimated per capita, with the socio-economic situation of the performance indicators, such as, the number of population, the number of individual merchants and commercial companies (per 1000 people), the dependency ratio and the unemployment rate, we may confirm the great relevance and importance of the municipal budget for ensuring the well-being and higher standard of living. In the cities and towns, with lower unemployment rates there are lower costs for social protection, while in urban areas with a lower demographic burden, the budget revenues per capita are higher, etc.

Correlations exist, but they are not functional, as well as there also exist other factors - the economic situation in the world, statistical accounting problems, the shadow economy, etc. The results confirm the strong commitment and impact between the well-being of people, business environment, and government decisions. Moreover, we get a very clear perception about the ranking of the Latvian cities and towns. The analysis proves that taking into consideration all the indicators, the best situation is in Valmiera, Rīga and Ventspils, the worst - in Daugavpils and Liepāja. This means that both the existing socio-economic situation affects the local government opportunities, and the local government activities and decisions affect the potential socio-economic developments.

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S u m m a r y

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Municipal effectiveness cannot be assessed only by analyzing the budget revenue and expenditure items. To ensure complete situational awareness, the assessment and comparison of the needs of the current situation is required. Such indicators, characterizing the activities of the local government, as population size, the dependency ratio, the unemployment rate and the number of individual merchants and commercial companies per 1000 inhabitants are used.

The research also presents the summary of the indicators, characterizing the budgetary and socio-economic situation of the main cities and towns. The results suggest that the rates show considerable cross-correlation and effects, and, consequently, we may conclude that in the local government group of republican significance, there are visible leaders and those, losing ground. Analyzing all the indicators included in the research, the best situation is in Valmiera, Rīga and Ventspils, the worst - in Daugavpils and Liepāja. It shows that the existing socio-economic situation leaves an impact on the local government opportunities, and government actions and decisions affect the development of the potential socio-economic situation. These conclusions are based on the condition, that in ranking, greater expenditures lead to poor indicators. However, in reality, more government spending, if it is used in a rational and strategic approach, will ensure the local government commitment and better economic situation in the future, which may contribute to the improvement of the other parameters under consideration.

KEYWORDS: municipality, budget, income, expenditure, economic development.

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