CHALLENGES FOR LOCAL AUTHORITIES: THE POLITICS AND PRACTICE OF FINANCIAL MANAGEMENT IN THE WAY FOR SUBSTAINABLE DEVELOPMENT

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ABSTRACT

This article deals with the challenges faced by local authorities in the way for Sustainable Development nowadays. The results show that the main challenges faced by most local authorities are: the mobilization of financial resources, the inadequacy of own income, unreliability of central government transfers and weakness of financial management, economic uncertainty, the difficulty of balancing the reality of the local budget with reduced revenues, the widening gap between the availability of financial resources and municipal expenditure needs. Responsibility and financial resource management are the basis for the good governance of local governments, key drivers for public institutions on the improvement path and ensure sustainable development. To successfully implement sustainable development, for ensuring the financial resilience of local authorities it becomes crucial to develop a strategic financial management plan. Financial management can be a tool for improving the performance of local government.

Only with effective local government, with financial resilience and sound public financial management, with the active engagement of local government and citizens, it will be possible to achieve the success of sustainable development including ending poverty in all its forms, ensuring healthy lives and promoting well-being for all, ensuring availability and sustainable management of water and sanitation for all, ensuring access to affordable, reliable, sustainable and modern energy for all, promoting sustained, inclusive and sustainable economic growth, promoting peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels are the mission of local government.

Keywords: Local Government, Local Authorities, Local Budget, Financial Resilience, Fiscal Decentralization, Financial Management

INTRODUCTION

Local governments around the world today play a key role in facilitating development and improving living standards. One of the goals of the United Nations Sustainable Development Goals to 2030 is goal 11 to "Make cities and human settlements inclusive, safe, resilient and sustainable" (United Nations, 2015). However, the role of local authorities in the achievement of the Agenda goes far beyond Goal 11. All of the SDGs have targets that are directly or indirectly related to the daily work of local governments.

To achieve the success of sustainable development local government must have enough financial resources. The Covid-19 pandemic presents many challenges for local governments to ensure the financial resources and appear an opportunity for a profound, systemic shift to a more sustainable economy that works for both people and the state.

Nowadays one of the most common challenges for local government associations around the world is to have enough financial resources to fulfil their core functions The various reductions in income, costs that increase as a result of economic slowdown and rising unemployment, the need for social security requires a fundamental rethinking of how to ensure the financial sustainability of local governments.

RESULTS

The Role of Local Authorities and their Financial Autonomy

They are currently no state that is considered complete and democratic if it does not have a system of local government. Namely, local governments play a key role in the promotion and protection of human rights, which is an essential link in the relationship between the government and the citizenry.

Local authorities have different forms and functions depending on the constitutional and legal systems of the State concerned, but all of them are created to provide public services that address local needs and priorities in defined geographical areas, primarily because of the inability of the central government to attend to all the detailed requirements of the society that have to be satisfied by government institutions. They engage with their communities and encourage community participation in decision-making while considering the needs of people currently living in communities and those who will live there in the future.

To best understand the importance of how to run an effective local government, it's important to trace back to under the original intents and purposes of local government. The purpose of local government is to provide an organized system where councils exercise their power and responsibilities to work together for peace, order and good governance of their municipal districts, to enable democratic local decision-making and action by, and on behalf of, communities; to promote the social, economic, environmental, and cultural well-being of communities in the present and for the future, to lead and represent their communities.

Every country in the world wants its local government to perform well. The successful functioning of any local authorities depends to a large extent not so much on the extent of the powers vested in the local authorities as on their financial provision, their possession and the free disposal of material, human, financial and other resources, needed to effectively perform of its functions. Local governments represent on average about 23% of general government expenditure, 41% of general government public investments and only 10% of general government debt in the OECD (Vammalle & Bambalaite, 2021).

In that context, the European Charter of Local Self-Government contains key principles defining the importance and scope of financial autonomy of European local governments, in particular:

«The existence of local self-government authorities with real powers can ensure effective and close to citizens' governance». It is necessary to have the existence of such local authorities which «have a wide degree of autonomy with regard to their responsibilities, the ways and means of implementing of the exercise of these powers, as well the resources necessary for their exercise» (Preamble).

"Local self-government denotes the right and the ability of local authorities, within the limits of the law, to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population" (article 3.1)

"Local authorities shall, within the limits of the law, have full discretion to exercise their initiative with regard to any matter which is not excluded from their competence nor assigned to any other authority" (article 4.2).

"Powers given to local authorities shall normally be full and exclusive. They may not be undermined or limited by another, central or regional, authority except as provided for by the law” (article 4.4).

“Where powers are delegated to them by a central or regional authority, local authorities shall, insofar as possible, be allowed discretion in adapting their exercise to local conditions” (article 4.5) (Council of Europe, 1985).

An analysis of the provisions of the European Charter of Local Self-Government confirm that financial autonomy represents an essential instrument for local authorities and means:

1) To have their adequate financial resources commensurate with their powers.
2) To manage these financial resources and use them on their responsibility, without State intervention.
3) The effective regulation and management of affairs of local government.
4) To receive assistance in building capacity to generate own income.
5) To receive appropriate advice on all financial matters affecting self-government on the allocation of redistributed resources.

The availability of financial autonomy and making their own decisions about taxation depends of the decentralization (OECD, 2020b). A local or regional government that is able to define its own tax bases, tax rates, and other characteristics of a tax has a high degree of tax autonomy or taxing power. Lack of financial autonomy reinforces their dependency on central government and hinders their ability to plan for the future.

Decentralization of power is a component of the development policy of any country to strengthen their regional and local governments to meet the challenges of the 21st Century (Kee, 2003), promoting changes in governance structures that are reshaping the relationship between local governments and citizens. Decentralization in any country associated with the process of devolving powers to regional and local governments, where the priority a in is to foster regional development from below by giving subnational government’s greater discretion in determining programmes that are more aspirational to the interests of the community and local and regional development objectives (Talitha, Firman & Hudalah, 2020).

Fiscal decentralization aims to distribute financial resources between different levels of government so that the regions and the government should have a strong financial base for their activities and the state makes transfers to local budgets not because they can finance their minimum needs, but only for delegated functions. Fiscal decentralization aims to increase the financial capacity of local authorities. This financial capacity of local authorities is based on the ability to attract existing and potential financial resources from this territory to finance economic, social and environmental needs, establish rational and efficient directions for their distribution and use. Fiscal decentralization balances the public services with the needs and preferences of local communities and citizens increases the responsibility of local authorities for their respective functions and the efficiency of the public sector on the whole due to the introduction of competition elements (Teremetskiy, 2021).

Fiscal decentralisation is a complex phenomenon, which comprises several dimensions. The degree of decentralisation in a country can be assessed based on fiscal indicators, in particular, the level of subnational government spending (measured as a share of GDP and as a share of public expenditure) and the level of subnational government tax revenue (measured as a share of GDP, as a share of total subnational revenue and as a share of public tax revenue) (World Bank, 2001; OECD, 2019). Also there several fiscal decentralization indicators, that are used one by one (sequentially):

1) Spending decentralisation (the ratio of sub-central to general government spending)
2) Revenue decentralisation (the ratio of sub-central own revenue to general government revenue)
3) Tax revenue decentralisation (the ratio of sub-central tax revenue to general government tax revenue)
4) Tax autonomy (the ratio of taxes over which SCGs have some base or rate-setting autonomy to general government tax revenue (Blöchliger, 2013).

Fiscal decentralisation can lead to a more efficient provision of local public goods and services and promote a better match between policies and citizens’ preferences. Tax and revenue decentralisation, measured by the share of sub-central government tax (or revenue) on total tax (or revenue), tend to reduce regional disparities; for instance, a 10 percentage point increase in revenue decentralisation reduces regional disparities by 11% (or 4 basis points of the coefficient of variation) (Bartolini, Stossberg & Blöchliger, 2016).

Challenges in Ensuring of Financial Resources of Local Government

Today, the world faces challenges in financially ensuring the functioning of policies at all levels of government.

We want to emphasize several challenges are dominate depending on the degree of decentralization; the impact of the COVID-19 crisis is asymmetric across countries depending on their degree of fiscal decentralization (OECD, 2020c). More decentralization seems to be linked to more overlapping responsibilities challenges, which could be potentially explained by the fact have more autonomy to implement policies that differ from the central government's, allowing for more flexibility but potentially increasing overlapping and centralized countries seem to be facing more difficulties in coordinating well across different levels of government (OECD, 2019).The regional and local impact of the COVID-19 crisis is highly heterogeneous, with significant implications for crisis management and policy responses (OECD, 2020c), has, in turn, placed significant pressure on local authorities' finances, which in many cases were already under strain going into the pandemic.

Despite the historical, geographical, national, political and other differences, local authorities have the same problems. The main challenges faced by most local authorities are the mobilization of financial resources, the inadequacy of own income, unreliability of central government transfers and weakness of financial management, economic uncertainty, the difficulty of balancing the reality of the local budget with reduced revenues, the widening gap between the availability of financial resources and municipal expenditure needs.

Nowadays local budgets play a significant role in financing the sustainability of local government's provision of primarily social services. Local authorities within countries vary considerably in terms of budget composition, revenue sources, dependency on certain economic activities (OECD, 2020c). Generally, there are only two types of local revenue: own-source revenues from taxes, fees, and sometimes the sale or lease of public assets; and transferred revenues from a higher level of government. So, for instance, upper- and lower-tier authorities of England have access to three main sources of finance: Council tax receipts; a proportion of business rates raised within the authority area; funding from the central government. Local authorities also take in money in the form of fees for providing services, but these offset the cost of those services rather than being used as part of their overall pool of money. Central funding is made up of several different grants, several of which are bundled together into the Local Government Finance Settlement. (Authorities also receive several other grants outside this settlement, ring-fenced for specific purposes.) The calculations used to create the settlement take into account each council's ability to raise its revenue, balance funding across authority areas and ensure that they can carry out services (Brien, 2021). The revenue part of the local budgets of Ukraine is formed mainly at the expense of national taxes and fees, the standards of distribution of which are constantly changing. Thus, local authorities are not able to plan their activities to perform functions in the field of development of their locality.

Challenges in mobilizing financial resources, subnational income decline comes from two sources: the reduction in economic activity and changes in tax policies. Local authorities have limited autonomy to increase revenues since they depend on intergovernmental transfers and have limited autonomy to change tax policies (Dougherty et al., 2019). In turn, local governments have been forced to closely examine how they spend money on programs and services to best meet constituent needs and interests.

Central governments are often reluctant to devolve revenue sources to the local level or to enable local governments to enact revenue-generating policies. Central governments are often quite willing to delegate responsibility for service provision, but all too frequently do not provide local urban leaders with the fiscal policy tools necessary to generate additional revenue.

However, the fiscal policy serves to ensure the stability and sustainability of the national economy, to achieve the maximum possible well-being of society by creating the proper conditions for the socio-economic system (Kurylo et al., 2020). Along with that, local authorities do not always know or can ensure the implementation of best practices of State tax policy to be able to mobilize financial resources for the development of the relevant territorial unit. Poor performance in the public sector is attributed not only to external circumstances but also to incompetence in preparing for and responding to changes in the environment (Andrews, Boyne & Enticott, 2006).

A higher spending and lower tax revenue may hurt local authorities fiscal capacity to take the necessary measures to tackle the outbreak. Central governments can use equalization systems to mitigate regional disparities in fiscal capacity and expenditure needs by transferring resources from the central government to local governments that face higher costs or lower revenues. These grants aim at reducing inequality on the revenue side, due to the uneven distribution of taxable activities across jurisdictions of a country, and on the expenditure side, due to inter-regional demographic or geographical differences that may require a larger expenditure on a specific function within one region (for instance, a region with an ageing population or high unemployment may need more health and social protection resources than others). But here again, fiscal equalisation systems depend on the extent of fiscal decentralization and financial autonomy. Normally, equalisation systems are redistributive rules-based mechanisms that aim to compensate for regional imbalances that may be exacerbated by decentralisation (OECD, 2020a).

The gap between the revenue collected and the necessary expenditure to tackle the crisis is larger than usual, which, therefore, might require exceptional mechanisms to offset the additional costs and/or the fall in revenue. Subnational taxation and spending powers should be strengthened to allow governments to respond better to local needs and regional variations (Forman et al., 2020).

In several countries, there is the weakness of local government's financial management as well as their planning and administrative capacity in general lack of qualified staff needed to effectively perform the tasks important for revenue generation and management. These circumstances lead to a severe lack of public trust. Those who would be expected to pay the taxes and fees to support local initiatives do not trust that the monies they pay will be used within the community, will be used wisely, and will be spent as promised. As a result, they either resist new revenue efforts or simply do not pay their taxes.

These challenges, in summary, are immersing and we are not suggesting there are any easy solutions. However, new ways of thinking and working required to achieve financial stability.

Financial Resilience and Sound Public Financial Management

Responsibility and financial resource management are the basis for the good governance of local governments, key drivers for public institutions on the improvement path (Beauchamp & Hicks, 2004) and ensure sustainable development.

Local authorities are searching for a sustainable and equitable source of public finance, one that can fund infrastructure, education and other public goods while also addressing poverty, wealth inequality and the need for affordable housing for all. In this context, the implementation of financial management plays a significant role, the essence of which is the ability to prioritize and reconcile unlimited requirements and needs with limited financial resources. Today financial resilience and sound public financial management need to be at the core of decision making today to impart financial sustainability for the future.

The ability of local governments to provide high-quality social services, improve the living conditions of their citizens, improve infrastructure and attract the necessary resources to meet their needs is based on a rational allocation of expenditure obligations between different levels of government and a strong and reliable income.

To successfully implement sustainable development, for ensuring the financial resilience of local authorities it becomes crucial to develop the strategic plan of financial management. This plan can be developing proposals that are clearly in the community's best interests, improving the efficiency of activities, political stability and continuity of the programs implemented by previous governments, institutional credibility in the eyes of citizens a shared responsibility between citizens and the municipality for financing urban development, active citizenship that participates in the process, is vigilant in taking oversight, and fulfils its obligations.

Financial management can be a tool for improving the performance of local government. The important aspect in ensuring financial management is the development of a strategic plan to define the strategy and the resources needed for the achievement of these priorities, programs, set the organisation's long-term direction, defines the values and aspirations. When local governments develop their strategic plans, they should also consider these aspects of financial capacity and their potential influences on how governments prepare and respond to external changes (Park, Kim & Chen, 2020). The annual budget should be a detailed financial translation per year of the strategic plan, as the financial basis for management.

To achieve the implementation of the plan it is important to the introduction of monitoring and control tools. The right controls can play a major part in completing projects on time. The data gathered also lets project managers make informed decisions. They can take advantage of opportunities, make changes and avoid crisis management issues. Monitoring and control ensure the seamless execution of tasks that improves productivity and efficiency.

The control and monitoring process mainly focuses on measuring planned performance *vs* actual performance, ongoing assessment of the project's performance to identify any preventive or corrective actions needed, keeping accurate, timely information based on the project's output and associated documentation, providing information that supports status updates, forecasting and measuring progress, delivering forecasts that update current costs and project schedule, monitoring the implementation of any approved changes or schedule amendments.

A well-developed strategic plan accompanied by an adequate multi-annual budget can be a strong and persuasive communication tool for local authorities in search of financial and/or technical support.

Along with this, building a successful relationship between the central government and local government remains important. These preconditions are: the need and urge for a strong system of local government in a democratic political environment; that local government be allowed to play a vital role as a full partner in regional and national development; a fair division of financial resources between central, regional and local bodies; formal and effective checks and balances between central and local government; political and social harmony.

CONCLUSION

Only with effective local government, with financial resilience and sound public financial management, with the active engagement of local government and citizens, it will be possible to achieve the success of sustainable development including ending poverty in all its forms, ensuring healthy lives and promoting well-being for all, ensuring availability and sustainable management of water and sanitation for all, ensuring access to affordable, reliable, sustainable and modern energy for all, promoting sustained, inclusive and sustainable economic growth, promoting peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels are the mission of local government.

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