Analysis of changes in the revenue and expenditure as well as financial situation of rural municipalities and cities in 2009

Which changes took place in the revenue and expenditure, and financial situation, of local governments in 2009?

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Summary of analysis results

The NAO analysed the changes that took place in local governments' revenue, expenditure, surplus/deficit and financial situation in 2009, on the basis of data submitted by local governments to the Ministry of Finance on the execution of rural municipality and city budgets and on account balances.

The analysis is a generalization that applies to all local governments and it does not provide an assessment on the financial situation of individual rural municipalities or cities, nor on the choices made upon planning revenue and expenditure in their budgets.

Local governments spend a significant amount of tax funds collected from local residents and other persons, which in 2009 formed ca EEK 11 billion of direct tax revenue in local government budgets. The amount allocated to local governments as state support is not small either and this is also significantly related to taxes collected by the state. In 2009, state support allocated to local governments amounted to ca EEK 5 billion. It is in the interests of tax-payers that local governments use tax revenue for the organization of local life and provision of public services in the best possible manner.

Unfortunately, the recession that began in 2007 has also influenced local governments' business environment, bringing along decrease in revenue and the need to limit expenses. From the viewpoint of the sustainable provision of public services by local governments it is important that the change in the environment be sensed at the right moment so that priorities could be adjusted according to possibilities.

The NAO is of the opinion that many local governments have reacted slowly to the changes in the economic environment. They have acknowledged and implemented with a delay the need to reduce expenditure, which is why they have significantly used funds collected over the previous years and due to this, local governments face difficult choices in 2010 when revenue continues to decrease.

- **Recession has taken one tenth of local governments' revenue.** Compared to 2008, the revenue of rural municipalities and cities decreased by nearly EEK 2.5 billion, i.e. 11%, in 2009: from EEK 22.7 billion to EEK 20.2 billion. Revenue from taxes, their main source of income, decreased in all but one local government. Decrease in tax revenue shall continue in 2010.

- **Decrease in local governments' revenue is significantly influenced by decisions related to the state and governing.** Compared to the previous year, the amount of support paid or distributed to local governments by the state decreased by EEK 1.5 billion, i.e. 20%, in 2009. The public is aware of the decision from the spring of 2009 to decrease the share of income tax in local governments' revenue base from 11.93% to 11.4%.

- **Local governments have delayed decreasing expenditure.** Although, compared to 2008, main revenue in 2009, i.e. revenue from taxes, decreased significantly (13%) already comparing the indicators of the second calendar quarter, many local governments did not start to actively cut their expenses until the end of the financial year.

- **Expenses are cut on things rather than on wages.** Of different types of expenses, management expenses decreased the most (18%) and expenditure on investments (29%) in 2009. At the same time, expenses related to local governments' personnel decreased only by 3%, compared to 2008. By areas, most funds have been saved on the maintenance of local roads, but significant amounts have also been saved on financing culture and sports, education and local government administration.

- **Many local governments have not reduced expenses equivalently to the decrease in revenue.** Most rural municipalities and cities (72%) have managed to cut their expenses when the revenue decreases, but many (37%) have failed to do so equivalently to the decrease in expenses. However, despite the decrease in revenue, some (11%) have managed to increase their expenditure.

- **The number of local governments with budgetary deficit and deficit of local government sector increased significantly.** In 2009, local government expenses exceeded revenue by nearly EEK 1.2 billion, i.e. the deficit is larger by ca EEK 0.3 billion than in the previous year. The number of local government who ended the year with budgetary deficit increased as well: while in 2008 such local governments formed 47%, then in 2009 the respective number was 62%.

- **A large amount of local government savings was spent on covering the deficit.** 84% of local governments used the funds from bank accounts and fixed-term deposits to cover the budgetary deficit of 2009. By the end of 2009, the funds of rural municipalities and cities decreased from ca EEK 1.7 billion to ca EEK 1 billion, i.e. by ca 40%. The decrease in monetary reserve has continued over the first months of 2010.

- **Solvency of local governments has deteriorated.** Decrease in funds has influenced local governments' financial situation which is characterized by the deterioration of short-term solvency. As at the end of 2009, in the light of the aggregate indicators for all local governments, current assets were not sufficient in covering short-term commitments. Analysis of local governments' management costs and outstanding debts to suppliers indicate extended deadlines for paying debts.

- **Local governments' burden of loans stopped growing.** Compared to the previous year, the percentage of loans in rural municipalities' and cities' balance sheets increased by 1% in 2009 (in 2008, the yearly increase was 4%). At the same time the number of local governments whose burden of loan has exceeded the limit prescribed by law, or is about to exceed that limit, is growing.

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