The role of local authorities in promoting business

Whether and how could local authorities contribute more to the development of business?

Summary of analysis results

What did we analyse?

The National Audit Office analysed the role of local authorities in the development of business. The audit focused on the definition of the role, perceptions thereof, expectations of undertakings to local authorities, activities of local authorities in promoting undertakings, and issues related to the aforementioned. It was also analysed how the role could change in the future and how could performance thereof be motivated.

Why is this important to taxpayers?

The well-being of the state is largely dependent on the success of its companies. Among others, the success of companies is often also dependent on the local authorities whose attitudes and activities may give business a boost or put brakes on it. Business is also one way to reverse processes that result in rural areas becoming increasingly empty of people. Much has been talked about the greater responsibility of local authorities in promoting business, but no steps have been taken to date.

What did we find and conclude from the results of the analysis?

Undertakings expect more from local authorities than they are able to provide. While all the expectations cannot be set as norm, it does imply overall that the interests of local authorities and undertakings are often headed in different directions. In terms of local development, this is wasted potential. The situation is largely due to the fact that the role of a local authority as a promoter of business has not been clearly defined and the financing of local authorities does not currently motivate them to undertake a greater role. Because of this, perceptions of the role are quite different. While some local authorities only wish to serve companies within the context of their current tasks, the others find it important to think about the business environment more broadly and do everything in their power to foster business activity. The contribution of local authorities to these matters, however, should not be dependent on the perception of the head of the local authority.

88% of the undertakings (159) that responded to the survey conducted by the Estonian Chamber of Commerce and Industry in cooperation with the National Audit Office found that local authorities should do more to promote business. The expectations of undertakings to local authorities are not linked to financial support. Proper infrastructure, assistance upon processing plans and permits and upon communicating with the state as well as thinking along, listening and involvement in the development of local living and business environment are important. Local authorities would already be able to offer much of this now if they changed their attitudes.

The main observations of the National Audit Office:

- **The meaning of business and opportunities to influence it are often not thought out from the point of view of the local authority.** The treatment of business in the development documents of local authorities is often superficial, objectives are general and weakly supported by activities. There is also a growing number of instances where the local authority has been hesitant about the investment planned by an undertaking, trying to meet both the undertaking as well as the local community halfway. Emotions and not rational agreements uniting the interests of the parties often tend to prevail. A clearly formulated strategic approach in matters of business (*What type of business do we want in the first place?*) and communicating thereof in the community would help to prevent such issues.

A decision also has to be made on which matters should be resolved on their own, which through cooperation of the local authorities of the region, and how to better take advantage of the potential of county development centres. *Approx. 160* specialists from across Estonia are concentrated to these development centres. Although county development centres came under the official control of local authorities following the elimination of county governments, local authorities continue to perceive these more as state organisations rather than their own. Funding is largely based on state budget, the interest of local authorities in their activities is inconsistent, and few orders associated with the development of business come from local authorities.

- **There is no effective incentive system to convince local authorities to put more effort into the business environment.** The only significant link between the funding of local authorities and effort put into the development of business comes from the higher personal income tax that accompanies new or better-paying jobs. At the same time, however, this may also not occur, because the distribution of income tax between local authorities is based on residence, not on place of employment. Other taxes affected by business (corporation tax, incl. from dividends, value added tax, excise duties, etc.) accrue into the state budget.

  Scarcity of land by regions also prevents local authorities from taking greater responsibility. This is particularly the case for the establishment of industrial sites that have so far proven to be one of the best ways to promote higher value added and business that creates jobs. There are regions where local authorities are not able to work on establishing industrial sites, because suitable land is held by the state, but no decisions have been made regarding the future thereof. It is therefore difficult to deploy it quickly for business.

What do we recommend?

In order to increase the role of local authorities, the role should be first clearly defined and a common understanding thereof should be put in place, but this does not require amendments to the laws. Rather it requires practical guidance, so that local authorities would start thinking about how to positively influence business both separately and together when planning their development. In the opinion of the National Audit Office, a written guideline (see for example appendix A) could be of help here on how to take these matters into consideration when drawing up the development plans of local authorities and the development strategies of counties. Agreeing on common interests in matters concerning the development of business in county development strategies could, among others, give a boost to taking better advantage of the potential of county development centres.

The question of motivation is more important than defining the role. In order to increase it, the principles of funding local authorities as well as of allocating state land to them need to be reviewed. Funding is ultimately a question of political choices, but, ideally, funding should be increased and a component of revenue base, the distribution of which between local authorities would be dependent on the indicators characterising the condition of business (e.g. number of jobs), should be added in order to make local authorities more active. The redistribution of the current revenue of local authorities may not have a good effect as local authorities are in a poor position in terms of competition for business due to their location as it is, and natural laggards should not be penalised by reducing their current revenues.

Based on the aforementioned, the National Audit Office drew up recommendations for the Minister of Public Administration.

It follows from the Minister’s responses that the issues raised by the National Audit Office need to be addressed and are already planned. Going forward, effort is put into supporting local authorities with guidance on how to address matters associated with business more substantively in development documents. Ways to partially distribute personal income tax between local authorities based on places of employment in the future and make the allocation of land necessary for business easier are also analysed. An analysis on compensating impacts of business on the local community is underway.