

**TALLINN UNIVERSITY OF TECHNOLOGY**  
**FACULTY OF SOCIAL SCIENCES**  
Chair of Local Self-Government and Regional Policy

**OBSERVING THE PRECEPT OF *CLRAE* BY  
THE GOVERNMENT OF THE REPUBLIC  
IN THE PERIOD OF  
26 OCTOBER 2010 TO 1 SEPTEMBER 2011**

Overview on the order of a foundation  
Tallinn Development and Training Centre

Professor Sulev Mäeltsemees

Tallinn, 30 September 2011

## Introduction

In May 2009, the delegation of the Association of Estonian Cities and the Association of Municipalities of Estonia (headed by Ms Saima Kalev, member of Jõgeva Council of Rural Municipality) turned to the European Congress of Local and Regional Authorities (CLRAE) in Strasbourg. They protested against the cuts made in the supplementary budget made in February of the same year concerning the rural municipalities and cities, and submitted a request to carry out a surveillance visit to Estonia to find out whether the activities of the Estonian central government were in compliance with the provisions of the European Charter of Local Self-Government and get the position of the Council of Europe.

Extract of the appeal:

*“... Due to the decrease in receipt of taxes caused by the economic depression, the state budget of 2009 and the negative supplementary budget further cut the income base of local municipalities, as well as the allocations made to the local budgets from the state budget in time when the needs of the power level closest to people for the provision of public services have sharply increased.*

*During the proceeding and adoption of the state supplementary budget, several legal regulations were amended resulting in a decrease in the share of individual income tax allocated to local governments (from 11,93 per cent to 11.4 per cent – S.M.) thereby increasing the revenue of state budget on the account of the income base of local governments, the means provided for alignment of the revenue of local governments were decreased, decreased allocations to local governments in the fields of road management, education, cultural life, and other fields. The situation is further complicated by establishing extreme restrictions to local governments in taking debt obligations unlike other parts of the public sector.*

*Such a decrease in budget revenue of local governments and state allocations jeopardises the coping with obligations imposed by law and the elementary operation of local governments.*

*In the conditions of economic crisis, the need for ensuring the financial autonomy of local governments has been highlighted more sharply. During the budgetary process, the local governments were not sufficiently consulted with and their suggestions and prior agreements were not considered. Although, in the conditions of an economic crisis everyone must be prepared to consider that the continuation of the current situation is not possible, it still could be considered right that the state increased the state budgetary revenue on the account of local governments, whereas the cuts in local budgets in comparison with the cuts made in the public sector as a whole are disproportionate.*

*The importance of following the European Charter of Local Self-Government also during the economic crisis has also been emphasised in the opinion approved by the plenary session of the European Union Committee for Regional Affairs (CoR) on 22 April “Economic Recovery Plan in Regions and Cities”, as well as in the final declaration and resolution on the economic crisis adopted on 24 April by the general assembly of the Council of European Municipalities and Regions (CEMR).*

*Considering the fact that it has been 9 years since the preparation of the Congress Recommendations No. 81 (2000) “Situation of Local Democracy in Estonia” and considering the recent developments in the financial situation of municipalities, the Estonian Delegation turns to the Congress with a request of initiating surveillance proceedings to assess the compliance with the principles of the financial autonomy of municipalities provided for in the European Charter of Local Self-Government in Estonia.”*

After the submission of the Appeal, on 18 June 2009, the *Riigikogu* (Parliament of Estonia) adopted another negative supplementary budget that further tightened the situation of local budgets. Among other things, the VAT charge was increased from 18 per cent to 20 per cent, etc.

In September of the same year, CLRAE asked for a brief analysis of the Appeal from the representative of Estonia in the Group of Independent Experts of the European Charter of Local Self-Government (Prof. Sulev Mäeltsemees, TUT). In the letter of 30 October 2009, Siim-Valmar Kiisler, Minister for Regional Affairs, submitted the explanation of the central level of the state. All the above-mentioned texts are available at the website of the Association of Municipalities of Estonia ([www.emovl.ee](http://www.emovl.ee)).

On 26-27 April 2010, a delegation of CLRAE paid a visit to Estonia (Jos Wielen, representative of CLRAE Institutional Committee and Prof. Zoltan Szente, member of the Group of Independent Experts of the European Charter of Local Self-Government). A month prior the visit of CLRAE, on 16 March 2010, the Supreme Court had adopted a very important judgement 3-4-1-8-09, which among other things obliged to clearly distinguish in the law the money provided to local governments for deciding and organising the issues of local life from the money provided for the performance of the duties of the state, and provide for financing the duties of the state as imposed by law from the state budget.

Extract from the Supreme Court judgement 3-4-1-8-09, 16 March 2010:

*“To declare unconstitutional the failure to issue such legislation of general application that would:*

- 1. provide for what kind of obligations imposed to local governments by law are the duties of local governments and what are the duties of the state;*
- 2. distinguish between the money allocated to local governments for deciding and organising the issues of local life and the money meant for performing the duties of the state, and would provide for financing the duties of the state imposed to local governments by law from the state budget.”*

CLRAE delegation met our governmental authorities, the *Riigikogu*, the Supreme Court, the representatives of national associations of local governments and the cities of Tallinn and Haapsalu.

It was the second monitoring of CLRAE in Estonia, as in 2000 CLRAE itself had prepared a Recommendation 81 (2000) “Situation of Local Democracy in Estonia”.

On 26-28 October 2010, the session of CLRAE Chamber of Local Authorities approved the Recommendation 294 (2010) “Local Democracy in Estonia”, which was also approved by the Committee of Ministers of the Council of Europe in November the same year.

In May 2011, the foundation Tallinn Development and Training Centre turned to Sulev Mäeltsemees, Professor of the Tallinn University of Technology (TUT) to prepare an overview “Observing the Precept of CLRAE by the Government of the Republic in the Period of 26 October 2010 to 1 September 2011” by 30 September

2011, whereas the work should be based on the recommendations of CLRAE to the Government of the Republic.

## **Sources for the preparation of the overview**

Extracts from the Summary of CLRAE Recommendation 294 (2010):

*“...This report considers the situation of local democracy in Estonia. It follows a monitoring visit conducted in 2000 and aims at assessing the action undertaken following the adoption of Recommendation 81(2000). It concludes that local democracy in Estonia has improved since the last monitoring report. The current recommendation points out to the Estonian authorities that there are certain issues that should, according to the delegation that carried out this visit, be subject to reform. These issues include granting special status to the city of Tallinn, revising national legislation in order to allocate to local authorities financial resources commensurate with the increasing responsibilities assigned to them, allowing local governments to raise local taxes to increase revenues and adapting the procedure of consultation of local and national associations, so as to conform to Article 4, paragraph 6 of the European Charter on Local Self-Government.*

*.... The Congress of Local and Regional Authorities of the Council of Europe ...*

*4. Welcomes the progress made on certain issues by the Estonian national authorities in accordance with Recommendation 81 (2000), such as the extension of the mandate of local government councils from three to four years, and the mergers of small local authorities on a voluntary basis;*

*5. However, the Congress stresses that some important parts of Recommendation 81 (2000) have to be reiterated.*

*6. Therefore, the Congress recommends that the Committee of Ministers invite the Estonian authorities to:*

*a. grant the city of Tallinn a special status, on the basis of Congress Recommendation 219 (2007), establishing different legal arrangements to take account of the particular situation of the capital compared with other municipalities;*

*b. clarify their legislation concerning the mandatory tasks and functions of local government;*

*c. change the domestic legislation urgently to allocate a greater proportion of financial resources for local authorities in order to make them commensurate with the responsibilities provided for by the Estonian Constitution and national law, and allow local authorities to raise revenues from local taxes. This change of the legislation was already urged in Recommendation 81 (2000);*

*d. take measures to ensure that local authorities receive adequate revenues from shared taxes, and that these are allocated in a transparent way;*

*e. set up a support fund for local authorities particularly affected by the economic crisis so that they are able to continue delivering certain social services;*

*f. start wide-ranging consultations with local authorities on the planned financial reform;*

*g. clarify the procedure of consultation with local authorities and national associations of local authorities in order to make consultations and discussion possible prior to the final*

*decision making, as stated in Article 4, paragraph 6 of the Charter. This procedure should take place in due time and be organised in a proper manner before the discussion, in particular when a planned reform concerns local authorities or implies financial consequences for them;*

*h. encourage the Estonian authorities to ratify the Additional Protocol to the European Charter on Local Self-Government on the right to participate in the affairs of a local authority (CETS No. 207) as soon as possible;*

*i. wants the Estonian authorities to notify the Congress of the follow-up activities implemented on the basis of the recommendations of this report.”*

The overview is largely based on the following sources:

1. European Charter on Local Self-Government and its Explanatory Letter.
2. Other relevant regulations of the Council of Europe (e.g., Recommendation 219 (2007) “Status of capital cities”).
3. Supreme Court Judgement 3-4-1-8-09, 16 March 2010.
4. The analysis on the efficiency of the Estonian government sector “Towards single governance” compiled by OECD and published in spring 2011.
5. Acts adopted in the period provided for in the contract (autumn 2010 - autumn 2011) (above all the amendment of the Land Tax Act and the Local Taxes Act)
6. Interpellations submitted in the *Riigikogu* in the period provided for in the contract (autumn 2010 - autumn 2011) on the issues of CLRAE Recommendation 294 (2010) (above all the financing of local municipalities and their financial autonomy) and the responses of the Prime Minister Andrus Ansip, Minister of Finance Jürgen Ligi, Minister for Regional Affairs Siim-Valmar Kiisler, and Auditor General Mihkel Oviir to these interpellations, also the speech of the President of the Republic Toomas Hendrik Ilves at the opening of the autumn session of 2011 at the *Riigikogu* on 12 September 2011.
7. Presentation of Väino Tõemets, head of department of the Ministry of the Interior at the days of the cities and municipalities on 17 February 2011 “Recommendations of CLRAE and OECD for regulation of local governments, activities of the state in fulfilling them. Continuation of the execution of the Supreme Court judgement in 2011.”
8. Programme of the government association of the parties Pro Patria and Res Publica Union and the Estonian Reform Party (at the parliamentary elections of 2011) and the Estonian Government Action Plan for 2011-2015.<sup>1</sup>
9. Protocols of the negotiations of the Government Committee and a delegation of the Local Government Associations Co-operation Assembly, incl. the recommendations

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<sup>1</sup> In the opinion of the author of this article, the programme of the government association of the parties Pro Patria and Res Publica Union and the Estonian Reform Party in the government association programme of 2011 includes magnificent values in comprehension of the substance of the local authority and public administration (hence, also assumptions for the execution of the CLRAE Recommendation 294 (2010): “*Local authority is not an arm extension of the state but an independent local government of free citizens. With the Constitution of the Republic of Estonia, Local Government Organisation Act, ratification of the European Charter on Local Self-Government, Estonia has chosen and attached an autonomous, community-based local authority. Solid local identity, broad-based democratic organisation of the state, maintaining the balance of the central power, these are huge values that the Estonian independence is based on.*”

of the Local Government Associations Co-operation Assembly submitted in April 2011 to the budgetary negotiations of the Government Committee and the Local Government Associations Cooperation Assembly in the issues of drafting the state budget for 2012 and other matters, and the final protocol of the negotiations signed on 21 September 2011.

10. Relevant publications from the acknowledged experts providing an assessment of the so far solution of the suggestions made in CLRAE Recommendation 294 (2010) and/or indicate the trends of further development.

As the appeal of the Estonian Delegation to CLRAE was primarily induced by the opinion of the Delegation that in the past few years the principles of the European Charter on Local Self-Government have been violated here, above all by cutting the budgets of local municipalities with the supplementary budget of 2009, the overview also analyses the situation in compliance with the principles of the Charter.

Below, the CLRAE recommendations to the Government of the Republic will be handled in the sequence as presented in the Recommendation 294 (2010).

## **1. Give a special legal status to the City of Tallinn**

The European Charter on Local Self-Government does not deal with capital cities in a direct sense (in a comprehensive manner). However, a very big attention is being paid to the capital cities in the Council of Europe and primarily, of course, in CLRAE. The feasibility of the special status of the capital city of Estonia was already mentioned in CLRAE Recommendation 81 (2000) on “The situation of local democracy in Estonia”.

As one of the most important CLRAE regulations in this field we should mention:

1) Recommendation 219 (2007) “Status of capital cities”.  
2) CLRAE Resolution 158 (2003) on management of capital cities according to which „... *The Congress recognises the additional responsibilities of capital cities, as in addition to providing facilities of national importance they also have to fulfil tasks of international importance and maintain national institutions, transport infrastructure, etc. ... There are difficulties that occur between capital cities and other levels of administration due to:*

- 1) different political parties holding power at different levels;*
- 2) conflict of interests between different levels;*
- 3) ambiguity about the responsibilities of each level;*
- 4) lack of well-established and mandatory procedures for financing the work of capital city authorities in organising national events ...”*

The issue of special legal status of Tallinn as a capital city has been under recurrent discussions at the Government of the Republic, as well as in the *Riigikogu* as of 1994, whereas also several so-called Capital City Act drafts have been prepared (at least on five occasions)<sup>2</sup>. At the days of the cities and municipalities in February 2011, V. Tõemets stated in his presentation:

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<sup>2</sup> See the presentation of the author of this overview at the 5<sup>th</sup> special forum of municipalities on 8 December 2010 in Tallinn ([www.omavalitsusfoorum.ee](http://www.omavalitsusfoorum.ee))

*“\* Execution of the Recommendation 294 (2010) is complicated and time-consuming, there are several alternative solutions, whereas there are a lot of differences of opinion concerning its substance and the discussion over possible solutions has lasted for a long time.*

*\* Examples of different solutions – whether the Capital City Act for compensation of the expenses of the capital city, or special organisation of the capital city region to ensure better availability of services as a widespread tradition in the Nordic countries.”*

CLRAE’s suggestion of giving Tallinn a special legal status would not have needed a longer treatment here, unless the President of the Republic had not handled the problems and possible developments related to the capital at the opening session of the *Riigikogu* in the fall of 2011. The President of the Republic asked: “...to what extent is a city of a hundred or even four hundred thousand inhabitants a sub-central government entity. Do the transparency requirements required by law from a rural municipality with 900 inhabitants function in a city with the number of inhabitants reaching up to a third of the country’s population and where it is impossible to claim that decisions reflect the interests of the home? Or do we need new solutions where the term “local community” would refer to city districts or even settlements? The decisions relating to the possible special regulation of the capital city could only be based on perception of the actual nature of the local government....”

Why do we need a so-called Capital City Act? The objectives of the so-called Capital City Act could be treated from two completely different angles:

- 1) does it aim at achieving a position of the capital city, above all strengthening the international competitiveness, or
- 2) does it aim at achieving a decrease of distinctions between the economic and administrative capacities of our local government units? Even in media it has been suggested from time to time to split Tallinn in independent municipal units, as now Tallinn is by 4,000 times bigger than Ruhnu or Piiressaare rural municipalities by its population and four times as big as Tartu. But if, for example, Panama were an independent municipal unit, its population would be quite close to that of Tartu, etc. Here we have an option of 8 (or any other figure?) “new cities” formed in the territory of Tallinn making up a county (i.e., the 16<sup>th</sup> county).

What speaks against the last option is the development of the Finnish regional administration, for instance, where on the contrary – as of 2010, the feuds as levels (units) of national regional management were abolished.

The example of London illustrates how decentralisation (as an author of this overview I would call it imaginary decentralisation) could instead lead to centralisation of local administration and nationalisation of municipal functions. Until the early 1980s, London had a so-called Greater London Council and 32 city districts with its councils. With the Local Government Act of 1985, the Parliament of the United Kingdom decided to have independent city districts in the capital city of London. Confrontation between the state’s central level and the capital led to the liquidation of the London City Council. In the course of decentralisation (actually as already said – imaginary decentralisation!), ministries took over some of the citywide tasks (road network, public transport). To fulfil some of the tasks beyond city districts, joint committees were formed, such as a fire department and rescue service (London Fire and Civil Defence Authority), planning (London Planning Advisory Committee), etc., which operated as an association of local government units. In 1990, the Association of

London Authorities was established, but solving many citywide strategic problems got stuck. In the meantime, they wanted to establish a Ministry of London, then after the replacement of the Prime Minister the Government Office for London was established in 1994. In 1997, the change of the government did not change that field, just that the Minister for London became responsible. In 1997, Tony Blair's government prepared a White Paper "London's political governance" and after the period of 14 years a single city management was restored at the turn of the century in the capital of UK with the London City Council being elected. It is not insignificant to note here that London city districts have a significant role also in the new (in a way old) management structure.

In the relations of the central level of the state and the capital city, the central issue is financing national events inevitably taking place in the capital. In this respect, we could follow the example of Berlin with its contract for financing the tasks of the capital city (above all in the fields of culture and public transport), which follows the principle applied in the Federal Republic of Germany already at times when the capital was situated in Bonn. In the suggestions made by the Local Government Associations Cooperation Assembly for the negotiations with the Government Committee in the process of drafting the state budget for 2012 it was considered important *"to add a row of levelling fund – to cover the expenses required for the performance of the function of the capital city (traditional events of the Independence Day, extraordinary expenditure due to the receipt of high level foreign guests, costs related to the maintenance of objects of national significance). To provide for at least 255,647 euros (4,000,000 kroons) for that purpose."* (point 2.13 of the final protocol). Unfortunately, no agreement was reached.

From the point of view of the author of the overview, the distinctions of Tallinn in the legal system of our local governments in comparison with other municipalities and cities are revealed in the form of so-called three vectors that should also be reflected in act(s) as special regulations:

- 1) capital city in relation with the central level of the state (this is the field where the city's performance of relevant national tasks must be further financed from the state budget, comparison with Berlin);
- 2) horizontal connections of Tallinn as a large regional attraction centre with hinterland rural municipalities and cities, incl. cooperation in provision of public services, which so far has been voluntary, but probably in some fields (public transport, waste management, planning, etc.) requires legal regulation (comparison with Helsinki);
- 3) decentralisation of internal management of Tallinn as a city with a clearly distinguished size in the country.

Concerning the second point of the list, we could follow the example of the management in the region of Helsinki and the changes occurred here in the past few years. As of 2010, there is a Capital City Region Waste Economy and Public Transport Cooperation Act in Finland (*Laki pääkaupunkiseudun kuntien jätehuolto ja joukkoliikennettä koskevasta yhteistoiminnasta*). The act provides for waste economy and public transport as compulsory fields of cooperation in the capital city region. Pursuant to § 5 of the act, also other communes or cities may belong to the association of capital city region's local government units (in addition to the former members of Helsinki, Espoo, Vantaa, Kauniainen). A report on a study performed by

the Tallinn University of Technology delivered to the Union of Harju County Municipalities in January 2010 provides a more detailed overview of these problems<sup>3</sup>.

In the opinion of the author of the overview, in order to regulate the distinctions of the capital city, relevant amendments (additions) should be implemented primarily to the Local Government Organisation Act, Local Government Financial Management Act, and very importantly – Local Government Cooperation Act (any other acts?). There is probably no need for a separate so-called Capital City Act? In addition, it must be noted that the capital city is required above all for public authorities. From the point of view of the legal system of local governments, all local government units have equal rights, obligations and responsibilities. As a comparison, on the basis of the District Act of 1937, up to 8 local taxes could be imposed, and on the basis of the City Act of 1938, up to 26 local taxes and the cities were categorised back then.

Among other things, the suggestion for categorisation of local government units is included in the OECD report (pp. 53-54): *“Maybe it would be practical for the state to reassess the way the needs of local authorities and citizens are perceived. For example, it could be that Tallinn and its immediate surroundings could manage better in providing services if Tallinn was categorised as a capital or metropolis area instead of aligning it in the same category with municipalities of much smaller population... Estonia should consider the system of dividing its municipalities in categories that would solve both the problems of the size and the capability.”*

The author of the overview is still of the opinion that as of the mid-20<sup>th</sup> century the municipalities have been treated equal in the European democratic countries. Even as a single term like *kunta* in Finland or *kommun* in Sweden, Denmark, Norway, etc. signifies both the city and rural municipality. At the same time, it is unrealistic if all municipalities (e.g., Tallinn and Piiressaare) had to fulfil exactly the same compulsory tasks in the same volume.

## **2. Specify the legislation providing for mandatory tasks and functions of the local government**

According to Article 3 of the European Charter on Local Self-Government:

*“1. The basic powers and responsibilities of local authorities shall be prescribed by the constitution or by statute. However, this provision shall not prevent the attribution to local authorities of powers and responsibilities for specific purposes in accordance with the law.*

Pursuant to the explanatory letter to the Charter – as the nature of the tasks of the local authority is an assumption for the actual operation of the local authority, it is both in the interest of clarity and legal certainty that the main tasks would not be assigned *ad hoc*, but these should be included in legislation. In general, the tasks should have been provided for in the constitution or parliamentary act.

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<sup>3</sup> The report “Development of legal and management solutions of cooperation models of the capital city region” of the regional development project “Increasing the Cooperation and Administrative Capacity of Municipalities of the Capital City Region” ordered by the Union of Harju County Municipalities and financed by the Norwegian and European Economic Area Financial Mechanisms. Faculty of Social Sciences, Tallinn University of Technology, Tallinn 2011

2. *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.*

3. *Public responsibilities shall generally be exercised, in preference, by those authorities, which are closest to the citizen. Allocation of responsibility to another authority should weigh up the extent and nature of the task and requirements of efficiency and economy.*

Pursuant to the explanatory letter of the Charter, the section expresses the general principle that the performance of public obligations had to be decentralised.

At the days of the cities and rural municipalities of 2011, V. Tõemets noted:

*“\* Such a convergence of the tasks of the state and local authorities is not unusual in the member states of the Council of Europe.*

*\* The first steps ensued from the Supreme Court judgement No. 3-4-1-8-09 of 16 March 2010 (identification of the national tasks performed by local authorities and clear distinction of the financing made in the state budget of 2011), the following steps are under preparation this year (further analysis of the volume of the tasks and the costs of performance of the tasks, etc.).*

*\* Complete distinction of the functions of the state and local authorities is impossible, rather the cooperation should be aimed.*

*\* It is also important to determine the financing of local authorities in case of providing services to the citizens of the other municipalities (covering capital expenses).”*

According to V. Tõemets, in 2010 the ministries analysed the national tasks carried out by local authorities in the legislation of their area of government. The performance of state functions by local governments was preliminarily ascertained by the Ministry of the Interior, Ministry of Culture, Ministry of Agriculture, and the Ministry of Defence. Amendments were made to acts by the Ministry of the Interior concerning the registration of births and deaths, and the Ministry of Culture is planning big amendments in legislation of its area of government in the course of which also the tasks imposed on local governments would be reviewed. The procedures for financing the ascertained tasks were established and they were also distinguished in the state budget of 2011.

Tim Kolk, Advisor to the Constitutional Review Chamber of the Supreme Court, characterises the analysis made by the Minister of the Interior in his article “What kind of a local government financial system is required by the constitution?” (“*Riigikogu Toimetised*”, 23, 2011, pp. 71-80), which found only a few single (NB! – a few single! – S.M.) tasks in the jurisdiction of just four (NB! – just four – S.M.) ministries in the summer of 2010, which could be considered state functions performed by local authorities. These functions include, for example, retention obligation of animals taken away from the owner of an animal by a surveillance officer, provision of the service of a county library, state-funded child care service, registration of births and deaths, transportation of the diseased without close relatives, maintenance of the unsupervised property of the persons arrested for criminal procedures, of suspects, or accused. Issues relating to the surveillance obligations and misdemeanour procedures of local authorities, maintenance of national registers, subsistence benefits remained in abeyance. The Conclusion of the Ministry of the Interior of 13 July 2010 on the state functions performed by local authorities as imposed by legislation recognised that these conclusions might not be exhaustive, there might occur other state functions in the future that could be reacted to on a case by case basis.

When characterising the execution of the Supreme Court judgement 3-4-1-8-09 of 16 March 2009, the Prime Minister said on 30 May 2011 when answering a question in the *Riigikogu*: *“The Cabinet discussed the conclusion of the assessment of state functions performed by local authorities prepared by the Minister of Regional Affairs on 15 July 2010. When preparing the state budget for 2011, the performed analyses were taken into consideration and the Riigikogu defined the financing of the duties of the state and of the local authorities imposed to local authorities in the State Budget Act of 2011. It will be done also in the future.”*

The Auditor General acknowledged when answering the questions in the *Riigikogu* on 16 May 2011: *“The National Audit Office is of the opinion that the result (distinction in financing of the duties of the state and of the local authorities imposed to local authorities in the State Budget Act – S.M.) was incomplete, it rather highlighted some of the state functions performed by local authorities. First, there was insufficient time for a thorough analysis. Second, the Guide of the Ministry of the Interior<sup>4</sup> did not expect it either. Besides, the state functions were determined with very different details. The National Audit Office assumes that the ascertaining of the additional state functions performed by local authorities would continue.”*

The Minister of Finance said when answering the questions in the *Riigikogu* on 7 February 2011: *“The Supreme Court judgement was extremely contradictory. It is unlikely it would be possible to execute it word for word, as the state is such a whole and entangled entity, but of course we try consider these interpretations in legislation as much as possible and also while preparing the budget. It is not so that we have a strict limit in front of us. There are many overlapping functions and local authorities also have different softer and stricter obligations as well.”*

Also the President of the Republic called attention to the Supreme Court judgement 3-4-1-8-09 of 16 March 2010 at the opening session of the *Riigikogu* in the fall of 2011: *“... It is a fact that the revenues of the towns and rural municipalities have been persistently decreased at the suggestion of the Government and at the approval of the Parliament. The Supreme Court, however, has demanded in his judgement to determine the functions of the state and the local authorities, and calculate the costs required for the performance thereof, and allocate appropriate funds for that purpose. I repeat it is a Supreme Court judgement. And we live in rules of law state. Dear members of the Parliament: have you asked yourselves — can the Parliament adopt the state budget for 2012 in a few months in a way it would also execute the Supreme Court judgement?”*

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<sup>4</sup> In order to classify the functions in the jurisdiction of the ministries, the Ministry of the Interior prepared a guide with a title of “Guide to the determination of the mandatory tasks of local authorities and duties of the state performed by local authorities”. The guide gives a list of possible arguments that should be considered while making the classification decisions. Besides, the guide explains borderline cases where due to their relation to the policy also a political decision or compromise would be added as an option for classification explaining what kind of a task it is. Considering the arguments provided for in the guide should give a good basis for making classification decisions. From the point of view of T. Kolk, the guide could be blamed for the suggestion to consider analysing only those legal acts that could include state functions, not the analysis of all obligations. Neither did the guide explain how detailed should the classification be in case of a more general obligation.

At the days of the cities and rural municipalities of 2011, V. Tõemets stated:  
“In 2011, we can carry on with an analysis of the volume of the functions and the cost of the performance of the functions and specification of legislation emerging as a result of it. For example, the Supreme Court judgement obliges among other things to assess the sufficiency of the means required for the performance of the functions of local authorities: a) the issue of methodology; b) practice of budgetary negotiations; c) balance between standardisation and calculation of costs and self-determination.”

The complication of the problem is well illustrated by an article referred by T. Kolk providing a thorough analysis on the financing of local authorities (thus, the next topic of the Recommendation). It must be emphasised the position of T. Kolk that distinguishing state functions from the matters of local life is obviously the most complicated issue in the relations of the state and local authorities. T. Kolk also notes that distinguishing between the functions of the state and local authorities is not finished yet. Determining the role of the state in providing public services on the axis state–local authority means an inventory of the additional functions performed by local authorities. The Government of the Republic began with such an inventory with its decision of 8 April 2010 in the first half of 2010. The process is headed by the Ministry of the Interior. Also the negotiations between the Government Committee and a delegation of the Local Government Associations Cooperation Assembly over the state budget of 2011 (i.e., this year) were *inter alia* carried by an objective of ascertaining the functions performed by local authorities and ensuring a cost-based financing from the state budget pursuant to an agreement with local government associations.

Considering single obligations as national ones cannot remain an ultimate solution. It is not *per se* in compliance with the principle that in case of doubt it should be assumed the function belonged to the tasks of a local authority. On 4 June 2010, the Association of Estonian Cities replied the letter of the Minister for Regional Affairs on definition of state functions performed by local authorities. *Inter alia*, it was noted in the response that in a situation where the majority of functions performed by local authorities were constituted by those the state had imposed on them by acts or other legislation, such a convenient solution from the angle of the central power could not obviously last long. All it takes is a reference to the field of social security where the uncertainty of the nature of the obligation and financing thereof could have caused situations where a person in need has been left without help. Local authorities have thought it was a function of the state, the state, however, that it was the local authority that was supposed to help. Various disputes could be expected either at negotiations between a local authority and the state, local government associations and the state, or in courts. Considering the functions to be prevailingly municipal would also mean that the state must review the financing system of local authorities more thoroughly than originally planned. When the majority of the functions would remain municipal by classification, there would be a doubt of whether the current financing procedure was capable of ensuring sufficient means for those tasks. From now on, it would be wise analysing all the functions performed by local authorities and place them on the axis national–municipal considering the regional level left between them where also the (nationally directed) cooperation between local authorities could occur.

In his response to the question in the *Riigikogu* on 16 May 2011, the Auditor General said: “Execution of the solid and principle judgement of the Supreme Court is a complicated issue for the Government of the Republic, especially for the Minister of Regions and Minister

*of Finance. All levers for that, however, are in the hands of the state starting with determining the financing system of local authorities considering the economic situation of the country and the amount of money related to specific tasks to classifying the functions as national or municipal ones with the state's capability of taking decisions. ... I do not think the national functions imposed on towns and rural municipalities could be separated from municipal functions unless all the tasks imposed on municipalities by legislation were analysed. The state obligation must be determined in a precise manner, it could not be a field as a whole, whether education or social field. Financing must be organised in such a precise manner that it would be possible to check whether the state actually covered the costs related to a certain obligation from the state budget... It is more complicated to organise the financing system of the tasks of municipalities so that it would be possible for the court, for instance, to assess in case of every local authority whether there was enough money. It is important to follow a principle that the quality of the service should not be considerably poorer than the Estonian average. I do not think the steps taken by the government so far have been sufficient."*

In his article, T. Kolk emphasises that national tasks must be distinguished from the local ones. It must be determined in an act what kinds of obligations are national. This way, it would be possible to ascertain the obligations that would be reimbursed from the state budget. Among the 300-450 tasks imposed on local authorities by acts, there are surely those that by their nature could be municipal from the point of view of the state and the local authority. Mostly, (court) disputes originate from the relations between the state and local authorities. A local authority wants to solve an issue in one way, but the state's central power wants to solve it another way (the majority of disputes initiated by local authorities with the Supreme Court have had such a substance), or a local authority wants to get a certain amount of money from the state for a certain function, but the state finds it is the task of the municipality for what the local authority must find means from its own resources.

T. Kolk calls attention to the fact that the obligation of the state's central power is to determine the duties of the state first. Before that all tasks should be considered municipal. The *Riigikogu* has a right and opportunity to decide what the national issue is and, thus, determine the limit for the functions of the local authorities. The *Riigikogu*, however, does not have an unrestricted power to do so, as in this case the guarantee of local authorities (above all the right of self-management) would lose an important part of its substance. The state must decide what its role in performing public functions is. The state authority has a big liberty in classification. In case of many functions, it would be possible to provide convincing statements of both an issue being a national task, as well as a municipal one. As noted by T. Kolk, the assumption for a complete execution of the Supreme Court judgement is mapping all the tasks imposed on local authorities (whether national or municipal). To guarantee a constitutional financing, the state must assess how much the performance of certain functions cost. To determine the cost, however, the substance of the task must be described first. It means the preparation of standards-criteria for the performance of a task. Here arises the question of whether it is feasible to perform certain tasks in a local authority, or in cooperation of several local authorities, or even as a national task at a county level, for instance.

T. Kolk finished the article published in the *Riigikogu Toimetised* with the following words: "... Hopefully, the performance of that giant task would not be left on the shoulders of just a few people. When the Supreme Court would be faced with a similar situation next time

*at a moment of making a solution on a supplementary budget, it might happen that a certain term would be set for the execution of the new judgement.”*

### **3. Change the domestic legislation urgently to allocate a greater proportion of financial resources for local authorities in order to make them commensurate with the responsibilities provided for by the Estonian Constitution and national law, and allow local authorities to raise revenues from local taxes**

In practice, the legal autonomy for the performance of the tasks of local authority is fairly irrelevant if the rural municipality or town were left without financial resources for performing these tasks. And as a very important principle of municipal freedom, the rural municipalities and towns must possess a right to tax.

According to Article 9 of the European Charter on Local Self-Government:

*”1. Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.”*

The objective is to ensure that the local authorities would not be deprived of the liberty to determine the priorities of expenses.

Article 9 of the Charter includes points 2 and 3, which primarily provide for principles foreseen by the third point of the Recommendation 294 (2010) of the Government of the Republic.

*”2. Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.*

*3. Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.”*

It could be said that there are big differences of opinion concerning the application of exactly those principles of the Charter. And it is quite obvious that following the pace foreseen in Recommendation 294 (2010) *“Change national legislation fast ...”* is unrealistic. In spite of the fact at the parliamentary elections of 2011, the programme of the governmental association of the parties Pro Patria and Res Publica Union and the Estonian Reform Party denotes that concerning modernisation of local administration the governmental union considers it important to carry out reforms based also on the principle (p. 12) of increasing the independent income basis for the municipalities, regional balance, and local democracy. For that, the parties to the governmental union promise to:

*“a. take the long-term planning of the income basis of local authorities to the State Budget strategy;*

*b. review the bases for formation of the income basis of local authorities, if the budget options so allow, taking into consideration the consolidated deficit of local authorities. As a general trend, the role of local authorities in formation of its tax revenues must considerably increase instead of the current small local tax revenues, state assistance of big rate and so-called state taxes of local nature.”*

The theme of local taxes is probably one of the fields causing the most completely different opinions in the formation of the budgets of our local authorities, more widely in financial management. In the opinion of the author of this overview, the right to

establish local taxes is the substantial feature of the local authority. Yet, for example the decision of the chief auditor of the National Audit Office of 18 January 2000 notes that Estonia is too small for local taxes. Often, however, the contrary is claimed with critical opinions (among others at the discussion of a matter of significant national importance at the *Riigikogu* on 23 September 2010 "Partnership of the state and local authorities") that in Estonia the share of local taxes in the income basis of rural municipalities and towns is one of the smallest in Europe (the share in local budgets below one per cent). The last fact is correct, but it should not be over-amplified.

From the point of view of the author of this overview, the problem does not lie that much in taxes foreseen in our Local Taxes Act, although it is weird that on 23 September 2010 the *Riigikogu* abolished two more local taxes from the Local Taxes Act – sales tax and boat tax. Whereas, for example, before the war the boat tax was implicitly considered one of the possible local taxes. We had a boat tax in the City Act of 1938 (1938, 43, 404) as one of the 26 allowed local taxes, and in the District Act of 1937 (RT 1937, 32, 310) as one of the (only!) eight permitted local taxes.

In the opinion of the author of the overview, the objective should not be that much the application or non-application of a certain tax foreseen in the Local Taxes Act, which reputedly is decided by each council of rural municipality or city independently. The objective should be increasing the tax revenues returned to the local budget enabling a bigger economic autonomy for the local government. Factually, in the Scandinavian countries there is a local personal income tax the rate of which could be changed by each council in both directions.<sup>5</sup>

The final protocol of the negotiations of the Government Committee and a delegation of the Local Government Associations Cooperation Assembly in 2011 includes a suggestion made by the Cooperation Assembly (p. 2.5): *“To amend and supplement the Local Tax Act. To review and arrange the system of local taxes to increase the right, ability and responsibility of local authorities in formation of their tax revenues, including the transfer of the part of the personal income tax received in local budgets to a local tax by the year of 2013 at the latest.”*

Among others, the share of their own tax revenues in local budgets in Sweden is 69%, in Denmark 49%, in Finland 43%, but only 4% here being the third one from behind among the EU member states. We are followed by Latvia and Malta with 0% and preceded by Lithuania with 5% and Czech Republic with 6%.

When answering the questions in the *Riigikogu* on 30 May 2011, the Prime Minister said, and the same position was a bit later confirmed by the Minister of Finance, that the personal income tax could only be such the local council might decrease, not increase.

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<sup>5</sup> In 2011, the average local personal income tax rate in Finnish rural municipalities was 19,17% (0.2 per cent points higher than in 2010). The highest tax rate was 21,50% (Vihanti rural municipality) and the lowest 16,25% (Saltikivi rural municipality). In Helsinki, the tax rate was 18.5% and in Kaunianeni 16.5%. Personal income tax rate was above 20 per cent in 139 rural municipalities (incl. towns).

Let us repeat here once again that in the Scandinavian countries there is a local personal income tax that the local council might either decrease or increase. The latter is done generally for building major (sports, cultural, etc.) sites and prior consulting the inhabitants of the rural municipality/town over the necessity for such a site. Why do we want to eliminate such an option if the local community were prepared to increase the personal income tax rate in a certain period in the interests of the development of the rural municipality/town?

In the opinion of the author of the overview, local tax revenues is an issue where the *Riigikogu* and the Government of the Republic have regrettably entirely withdrawn from the CLRAE Recommendation 294 (2010), and that not just in practice (legal acts) but also as principle positions. Also the scientist of the particular field and other experts often provide a lopsided emphasis on the small share of taxes permitted in the Local Taxes Act in the revenues of local budgets.

We should start with the fact that the problem does not lie that much in the catalogue of local taxes (what kind of taxes with what kind of restrictions are allowed, etc.?). In brief – each council may impose local taxes or not impose and the share of these taxes is indeed *ca* 1% of local budgets as it is a widely known fact in Estonia. But the main problem lies in the own tax revenues of the rural municipality and town, incl. also the guaranteed taxes divided between the state and local authorities. Reputedly, the Appeal of our CLRAE Delegation was largely induced by the fact that the first supplementary budget of 2009 decreased the receipt of the personal income tax to local budgets from 11,94 per cent to 11.4 per cent.<sup>6</sup>

When answering the questions in the *Riigikogu* on 30 May 2011, the Prime Minister said: *“Such a statement is certainly not true that the income basis of local authorities has steadily decreased, however it is true that the income basis of local authorities has decreased due to the global financial crisis in Estonia, as well as in several other countries...”* At the same time, the Prime Minister noted that the Government of the Republic *“is planning an analysis, we are considering all options and it might happen that local authorities would receive more local taxes the rate of which they can change within certain limits. But I do not consider it possible giving local authorities the freedom of increasing the taxes to an unreasonable extent.”*

On 13 December 2010, the Minister for Regional Affairs answered the interpellation in the *Riigikogu* about the report prepared by a research group working at the Council of Europe *“Impact of economic depression on European local authorities”* and he said: *“The study confirmed that the economic crisis affected local authorities all over the Europe and provided a simplified overview of whether and what has been done. It stated the facts that the money of local authorities of one country were burned in the wrecking banks of another country, unemployment was increased, due to the aging of the population social*

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<sup>6</sup> At the discussion following the interpellation to the Minister of Finance in the *Riigikogu* on 7 February 2011 concerning the income basis of local authorities also the sums were mentioned that the state saved from the income basis of local authorities. In 2009, when the first cut was made and the personal income tax rate received by local authorities was decreased from 11,93% to 11.4%, the impact of six months was already 278 million kroons in favour of the state. In 2010, the impact was 410 million kroons; and in 2011, 440 million kroons.

*expenses grew. National gross production indicated a decreasing trend, hence causing the decrease in tax revenues. The study treats in detail several solutions, to what extent the Member States and local authorities themselves could improve their financial situation... I would like to praise our local authorities here, as in comparison with the budget of the preceding years the budgets of 2010 have been much more realistic. Although, the study points out in a simplified manner that in 2009 the crisis affected most local authorities in Estonia and less the state, but it does not pay attention to the fact that the state started adjusting its budgets already in 2008 and local authorities only towards the end of 2009. Also CLRAE or Congress of Local and Regional Authorities has drawn attention to it in the explanatory letter to the Recommendation addressed to the Republic of Estonia saying that local authorities did not react to the economic crisis in time, they started discussing the ways for saving costs and increasing revenues considerably later than it was done at the state's central level. The study also points out the need for more capable and larger municipalities... The state will do all from its side to decrease the impacts of the economic crisis on local authorities, and I think the application of the means of the European Union has been relevant for that purpose."*

At the days of the towns and rural municipalities of 2011, V. Tõemets stated in his presentation that the question is in sufficient administrative capacity for imposing local taxes.

*"\* Bigger freedom concerning local taxes would be feasible if the possibilities of municipalities in applying them were comparable.*

*\* We could talk about new revenues together with new functions. The majority of local authorities are small for fulfilling already the existing functions.*

*\* It is rather an issue following the administrative reform."*

The President of the Republic called attention in his speech at the opening session of the autumn of 2011 in the *Riigikogu* to the fact that the revenues of the towns and rural municipalities have been steadily decreased at the suggestion of the government and approval of the parliament. T. Kolk notes in the referred article that sufficient money must be ensured for the municipal functions.

The constitution provides for a different procedure for financing the tasks of a municipality than for the financing of national tasks. The state does not have to cover the costs related to the performance of municipal tasks straight from the state budget as allocation intended for a specific purpose. The state probably faces more serious challenges in planning a financing system for local authorities that would ensure sufficient financing for the use of the right of self-management for a specific local authority that would enable to assess also from the outside whether the money was sufficient.

It is the state's obligation to create regulations that would ensure the receipt of money for local authorities for the performance of local functions at least in a minimum level required or in the amount that would enable performing the minimum required local functions to the minimum required extent. Besides the performance of local tasks provided by law, the local authority must also have money to execute the right of self-management to decide and organise the issues of local life not provided for in an act (so-called voluntary tasks).

Auditor General said on 16 May 2011 when answering the questions in the *Riigikogu*:  
*"In order to execute an act, it is necessary for an act or other regulation to be executable, it must be reasonable."*

The state has a freedom to choose what the sources are (taxes, assistance, other) for gathering sufficient money for local authorities. Restricting the revenue determined for the performance of local functions on a so-called balance method according to which the part of the receipt of local authorities would be meant for the performance of the tasks of local authorities that exceeded the costs of performance of the duties of the state was not in compliance with the Constitution § 154(1). Financing local authorities should not become disproportionately dependent on non-recurrent appropriations of the state. In organisation of the financing, the state must consider also the fact that the local authorities have an opportunity to get money from sources over which the state does not have a significant role (such as local taxes or financing transactions).

T. Kolk writes that the most complicated task in deciding over sufficient financing is probably ascertaining the minimum volume of local tasks that needs to be performed. First, it must be understood that the volume is different in each local authority and depends on the social, demographic, economic and geographical peculiarities of the local authority. Minimum required volume is directly affected by requirements imposed on local authorities by acts or subordinate legislation concerning the substance of the task, as well as the qualification of the performers thereof. That does not mean that in case of each local authority task the state should uniquely determine what kind of requirements the performance of such a task should comply with. That would mean a clear intervention to the right of self-management. The state must find a reasonable balance here between the discretion (right of self-management) of the local authority and the desire to establish specific (quality) standards on the tasks that would enable assess easier both the performance thereof, as well as the cost of the performance (see also the OECD report<sup>7</sup>). Such standards could still be necessary in case of essential public services. Deciding over the priority of services is partially the task of the state's central power. At the same time, the Supreme Court has noted, for example, that ensuring the main social basic rights (§ 28 of the constitution) cannot have significant differences in various regions of the country in the part that is under the responsibility of the local authority depending on the differences in economic capability of local authorities. In case of essential basic rights, the level of services should not decrease much lower than the general level of such services in other local authorities in Estonia due to the lack of money.

Direct intervention to the tax revenue income basis of local authorities was abolishing the land tax from the land under dwelling that the *Riigikogu* legalised on 16 June 2011. The former Minister of Justice and the member of the *Riigikogu*, Mr Jüri Adams, has written (Necrology to the land tax, *Eesti Päevaleht*, 14 June 2011) that it is hard to call the abolishment of the land tax from the land under dwelling anything

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<sup>7</sup>“Decentralisation does not exempt the central government or local authority from ensuring the quality of public services. More quality services give better results and the citizens are more content. At the moment, there are no established quality standards for public services in Estonia. Also the quality criteria are often determined by local authorities. Local authorities, however, are worried of how they are able to provide all mandatory services and also those services required by their inhabitants but that have not been made mandatory. Due to smaller budgets, not only services are being cut, but also the quality of services would be damaged.” (OECD report, p. 53).

but populism and cutting the umbilical cord between the local authorities and people. J. Adams convincingly reasons his opinion. First, he draws attention to the principle question of *“the existence of any plot of land causes certain expenses for a municipality. And if there were no land tax, then who are the people in this case that would have a moral obligation of undertaking the expenditures of the above-mentioned plots of land or their owners? That question, however, remained in the shadow when the political support was proposed on the tax exemption ...*

*By now, it is clear that the valid Land Tax Act and the Land Valuation Act, as well as other norms related to the subject are not successful and would require to be made more reasonable. Among other things, it would also be necessary to establish a clear connection between the sum of the land tax and the services received from the local authority in return. And local authorities would not be allowed to establish excessively big tax rates on certain groups of land taxpayers.*

*At the same time, further connections should not be neglected. Land tax, however badly the act establishing it has been written, is the only direct connection between the local authority and the people operating therein (although the technical side of gathering it belongs to the tasks of the Tax and Customs Board). Income tax appropriations are still only the “gift” of the state. Execution of the plan of the populists means that the fragile rope of independence the local authorities are hanging on to would be half cut. After that, all it remains is to ask: would it not be easier and cheaper to cut through also the remaining part of the rope, or terminate the gathering of the rest of the parts of the land tax in favour of local authorities altogether?”*

Thus – also according to an experienced politician and one of the authors of the Constitution of the Republic of Estonia, land tax is the only direct connection between the local authority and people operating therein! Also J. Ligi, Minister of Finance, shares a similar or at least a close opinion. According to point 12 of the coalition agreement, the objective of the coalition is increasing the autonomy of the income basis of local authorities. Minister of Finance said when answering the questions in the Riigikogu on 30 May 2011 that *“for me it is not decisive whether a local authority had more or less money, but the very strong association of that money with a local issue. The most local thing is land. There is no other thing that would be more local. There would be no land accruing, it would not go away unlike people and their incomes. Tax policy is a solidly logical thing if we looked into it. That is where our OECD and IMF recommendations come from. That would ensure reversely also such a stable income basis, you would always get that tax.”* We could also refer to the words said by the Prime Minister when he replied the questions in the Riigikogu on 30 May 2011 *“...land tax has by its nature a characteristics of a local tax...”*

To the question raised in the Riigikogu *“what kind of impact the decrease of land tax would have on the financial autonomy of local authorities”* the Minister of Finance replied that *“surely a weakening one, but it is not a dead end either”*.

Moreover, the Minister of Finance admitted answering the same question in the Riigikogu: *“I do not consider it wise, but that is my personal opinion that remained in the minority that it (exemption of the land under dwelling from the land tax – S.M.) will just be compensated on account of other taxpayers or from the state budget. Because from the point of view of the tax system, in my opinion it has a very important relation with the local life, the local territory. The local authority is the one that is actually responsible for the area where it operates – it is steadfast, it cannot be lifted to another place – and for the people by providing them with public services, but also by increasing the value of that land. If the property of land*

*was situated in a well governed place, its value would be higher, if the local authority has ensured an access, public order, maybe even if it were a possession of a central power by principle, the lighting and infrastructure in a wider sense, there is nothing wrong if the land owner whether he lived in the region or not paid taxes for it. And that has been my position also in the government coalition. So that I do not consider it wrong if the tax was collected differently.”*

The Minister for Regional Affairs said when answering the questions in the *Riigikogu* on 13 December 2010 that *“The autonomy of Estonian local authorities is fairly big. Let us take the example of planning where it is quite uncommon for the local authorities to have a complete, absolute power of decision over local plans. In many countries, the intervention possibilities by the state are much bigger than in Estonia.”*

In April 2011, the Local Government Associations Cooperation Assembly submitted its suggestions for negotiations with the Government of the Republic in the process of establishment of the state budget for 2012 concerning the national budgetary strategy for the period of 2012–2015, and the state budget for 2012. The objective of the negotiations was worded as follows: *“The income basis of local authorities is insufficient for performing the tasks imposed on them by law. The main objective of the negotiations of the Local Government Associations Cooperation Assembly and the Government Committee is securing a stable income basis based on the European Charter of Local Self-Government that would ensure the income basis required for the performance of functions imposed on local authorities by acts and on the basis of acts and would enable the investments required for local development and sustainable development of local authorities.”* The final protocol of the negotiations of the Government Committee and the Local Government Associations Cooperation Assembly of 2011 includes a dissenting opinion of the Cooperation Assembly that did not agree with the disregarding the suggestion of the local government associations of the restoration of the income basis and allocation of sector-specific subsidies. It draws attention to the fact that pursuant to the Supreme Court judgement the means allocated to local authorities must cover the costs required for the performance of obligations imposed on local authorities by legislation.

Prime Minister admitted in responding the questions in the *Riigikogu* on 30 May 2011 that *“in 2010, the share of state budget subsidies constituted 35% of the revenues of local authorities. In 2003, the indicator was 37%, thus in the past 7 years the share of revenues received from the local authorities’ tax revenues, goods, services and sale of assets and other revenues in the budget has increased.”*

#### **4. Take measures to ensure that local authorities receive adequate revenues from shared taxes, and that these are allocated in a transparent way**

On 30 May 2011, the Prime Minister said when answering the questions in the *Riigikogu*: *“... it has been often claimed, especially by the representatives of the opposition parties, that the income basis of local authorities has been steadily decreased illustrating it by an example that 11,93% of personal income tax revenue constitutes the share of local authorities. As a reminder it must be said that the former system according to which 56% of the received income tax went to the local authorities and the rest was received by the state was changed in 2004, the income share rate for local authorities was established to be 11.4% of the personal income revenues, which in comparison with the 56% the 11.4% was a remarkably higher increase in a year – then it was about 13%, or 12.9% - something like that. And the revenues of local authorities from the income tax have always increased. When I*

*look at the years 2002–07, the share of income tax received by local authorities has increased by 2,26 times. 2,26 times, whereas the share of income tax received by the state has increased by 38.4%. That is a huge difference! And it largely comes from the fact that the state has to bear the refund of income tax, also the decrease of the income tax rate, local authorities have received what has been entitled to them by legislation. The revenue of local authorities would have been 430 million kroons bigger a year if the share of local authority revenue had not decreased from 11,93% to 11.4%. And that 430 million kroons have always been reproached to the government and it has always been talked of how the local authorities have been bullied and humiliated and led them almost to insolvency. I would not want to accept that criticism. The accusation that the central government takes care of its own concerns first and the concerns of local authorities remain distant, unknown. That is not true! The receipt of personal income tax decreased by 7.2% for local authorities, 37.3% for the state. I do not think there is much reason for complaining. It would have been better for everyone if there had not been a global financial crisis.”*

At the days of the cities and municipalities in February 2011, V. Tõemets stated:

*”\* The issues for changing the further income basis are related with assessing the compliance of the income basis with the volume of municipal tasks, which is one of the further actions related to the Supreme Court judgement.*

*\* The place of discussion is finding a suitable balance between self-determination and standardisation.*

*\* The state budget of 2012 is prepared by a new coalition and the budgetary preferences of the new coalition are not known yet.”*

Supreme Court judgement 3-4-1-8-09 of 16 March 2010 specified better than before what should be perceived as a financial guarantee provided for local authorities by the Constitution. As § 154 of the Constitution distinguishes the matters of local life and state obligations, also the organisation of financing of local authorities is formed pursuant to the Supreme Court judgement from the financing system on one side and, on the other side, provisions regulating the financing of national obligations imposed on local authorities by law. The first system includes the following rights:

- 1) right for sufficient financial means for the performance of municipal tasks;
- 2) right to establish taxes and impose duties;
- 3) right to take debt obligations, and
- 4) right for the stability of a financing system of municipal tasks.

At the moment, a shared tax is a personal income tax, also environmental charges, but the latter ones have a marginal importance in the majority of rural municipalities and towns, and therefore there is no need to treat them here. Personal income tax, however, constitutes *ca* 40 of the revenue of Estonian local budgets.

The OECD report (p. 57) also treats the local personal income tax. *“One of the options is considering the establishment of a local income tax to provide the voters and taxpayers with a bigger autonomy in their town or rural municipalities and make the local democracy more efficient. It is possible to plan it so that the tax base (including exceptions) is decided centrally like in case of the majority of other countries, but the specific tax rates would be left for the local authorities to decide. Local income tax could also provide the taxpayers with a means for comparison of their town or rural municipalities with others and that might help increase the quality of services and, moreover, decrease costs. Such a measure has got a sense in case the size of the local authority increased.”*

Prime Minister said in responding the questions in the *Riigikogu* on 30 May 2011: *“The income base of Estonian local authorities has been repeatedly assessed by various*

*international institutions and they have reached almost the same conclusion that also the interpellators refer to that yes the share of local taxes of local authorities in their revenues is small, but the financial autonomy of local authorities is ensured by an income basis on the basis of an independent act and no one blames the state of Estonia in this respect.” As a remark we will bring a conclusion from the OECD report (p. 57) according to which: “financing of local authorities is fairly centralised in Estonia, as about 80% of the revenues of local authorities are centrally regulated (e.g., natural person’s income tax, subsidies, corrective land tax).”*

Prime Minister continued in the *Riigikogu* on 30 May 2011: *“It is more a matter of taste and beauty whether to call the land tax, for example, a local tax at some point or not, as also in case of local taxes the central government, the parliament usually, determines the limits in the scope of which that tax rate could be amended by local authorities. By its nature, the land tax has a feature of a local tax but in the Estonian circumstances it is a state tax. Also the income tax received by local governments on the basis of an act is local by nature. It is received there – at local authorities but local authorities have no possibilities for changing the tax rate. I do not exclude it that in the future, for example, the local authorities would not be given the right to lower the tax rate, but not increase it in no way. Also then the share of local taxes could increase very fast in the conditions of Estonia. But the per cent of the revenues that coming from local taxes is not the most important issue for local authorities. It is not the main question of local autonomy! The most important role of a local authority lies in balancing the central power, and the local authority must balance the central power based on a solid local identity. The right to say no to the central government is the reason why these local authorities exist in a democratic organisation of state. When looking at the European local authorities and the financing thereof in comparison with Estonia, we see that in 11 countries out of the European Union Member States the share of all public sector expenses made at local levels are bigger than in Estonia, and in 15 countries the expenses of public sector made at local level as a share of all public sector costs are smaller than in Estonia. We have nothing to be ashamed of in the context of the European Union other member states in financing our local authorities. When looking at the countries with the lowest share of public sector costs, where at the local level the share of the use of public sector costs is the lowest, then for example the percentage is the lowest in Malta. In Malta, only 1.4% of all the public sector costs are made at local authority level and I have never heard the inhabitants of Malta or as a member of the Congress of Local and Regional Authorities of the Council of Europe where I have been a member for 6 years complain that there were problems with local autonomy in Malta. It is not the size of the wallet that determines the local autonomy. Local autonomy is rather determined by a constitutional right of local authorities to confront the central power. And in Estonia such a right has been granted in such an amount that local authorities take to sue the state in court, for example, but we cannot say it is very common among the member states of the Council of Europe.”*

I can completely agree with the last statement of the Prime Minister – the Constitutional Review Proceedings Act (RT I 2002, 29, 174) adopted in 2002 indeed provides wide opportunities for rural municipalities and towns to defend their basic rights. It is a separate question, however, to what extent the local councils have used these rights.

From the point of view of the author of this overview, the most important ones are the statements of the Prime Minister concerning the local autonomy being rather determined by the constitutional right to confront the central power and the example of Malta. Yes, the fact is correct. As in general in other Mediterranean countries the share of local authorities in public administration is modest in Malta. Thereby, the lowest in the EU on Malta – only 1.4% of the governing costs is carried by local

authorities. Followed by Cyprus with 5.1% and Greece with 6.6%. As a comparison, the index of Estonia is 25%. But the problem is a principle one – do we consider it feasible to develop the local authority model similar to the Mediterranean countries or with an emphasis like in the Scandinavian countries? The share of local government expenditure in state running costs prior used is 62% in Denmark, 44.3% in Sweden and 39.4% in Finland. Unfortunately, the constitutional right of local authorities (and their associations) in Malta and other Mediterranean countries to confront the central power is fairly modest. There is neither a remarkable necessity for that either when the meaning of the local authority in public administration is marginal (deals with street cleaning and other fairly cheap tasks). Without the local “economic power”, however, the “confrontation to the central power” (actually it should be emphasised – balancing the central power) would be quite unthinkable.

The Prime Minister was right when he claimed in the *Riigikogu* on 30 May 2011 that *“the substance of the autonomy of local authorities is not merely the establishment of taxes. The task of local authorities is making independent decisions concerning the local life and managing thereof, and providing public services”*. But if the tasks of the local authority were just snow removal, refuse collection and similar activities, would it be really the entire function of the local life? From time to time, we could hear-read about a significant decrease in the tasks of local authorities (incl. nationalisation of basic and upper secondary education, etc.). Something like that could also be deduced from the speech of the President of the Republic made in the *Riigikogu* on 12 September 2011 when he said: *“Or do we need completely new solutions where the term “local community” would refer to city districts or even settlements?”*

The promise made by the Prime Minister in the *Riigikogu* on 30 May 2011 when answering the questions was: *“I can claim you once again that very soon that income share of personal income tax allocated to local authorities would again be 11,93%, as it used to be before the crisis. And there is nothing new in it, already when we cut it, we emphasised on several occasions that it was a temporary measure.”*

## **5. Set up a support fund for local authorities particularly affected by the economic crisis so that they are able to continue delivering certain social services**

At the days of the cities and municipalities in February 2011, V. Tõemets stated in relation to the recommendation of CLRAE:

*“Stabilisation subsidy of the income basis was applied by the government during the entire period of the crisis*

*- in 2009, there was 5,11 million euros (80 million kroons) in the budget, and*

*- in 2010, 7,67 million euros (120 million kroons).*

*- Also, the means paid for subsistence benefits for local authorities were increased.”*

The OECD report recommends (p. 58): *“The system of subsidies should be reviewed. At the moment, the systems of the equalisation fund and local authorities’ support funds overlap, thus both consider the needs for services and bigger expenses. That scheme could be made clearer by distinguishing the levelling of costs from the levelling of profits. ... The idea that the local authorities participate in rectification costs (whether by levelling the costs or profits) is important, as it makes them commit to expenditures and monitor the functioning of the system. Another option is to reform the current levelling system so that the general subsidies of education and social services were added to a single levelling measure.”*

There was a provision already in the State Budget Act of 2010 (RT I 2010, 10, 51), as well as in the State Budget Act of 2011 (RT I, 14 March 2011, 49) saying that local authorities may in case of financial difficulties (long-term inability to satisfy the claims of creditors) apply for assistance for rehabilitation of the budget, although such an opportunity has been used in a minimum amount so far (Imavere rural municipality). The rural municipality or city government submits an application in a free form to the Ministry of Finance. The application would be supplemented by a plan for recovering the difficult financial situation and the projects for the financial plan prepared by the rural municipality or city government. But such a measure cannot yet be considered to be in compliance with the suggestion of the CLRAE Recommendation 294 (2010) to form a support fund for providing social services for the rural municipalities and towns in difficulties.

The Government of the Republic has also made single allocations to support rural municipalities and towns that are economically weaker. For example, also before the submission of this overview the Government of the Republic allocated on 8 September 2011 from the subsistence benefit reserve additional 4.4 million euros for 168 local authorities until the end of 2011 to cover the increased costs. 2.9 million euros were left that should be sufficient for covering possible additional needs by the end of 2011 as assessed by the government.

In the opinion of the author of this overview, the Government of the Republic has to deal with the execution of point 5 of CLRAE Recommendation 294 (2010) to form a relevant assistance fund.

## **6. Start wide-ranging consultations with local authorities on the planned financial reform**

At the days of the cities and municipalities in February 2011, V. Tõemets stated:  
”\* *If the state planned changes in the income basis, the local authorities would be included both through the government committee and the Local Government Associations Cooperation Assembly.*”

The draft state budget for 2012 received the support of the Association of Estonian Cities and the Association of Municipalities of Estonia when they signed the protocol of negotiations held between the Government Committee and the Delegation of the Local Government Associations Cooperation Assembly on 21 September 2011.

E.g., Local Government Financial Management Act (RT I 2010, 72, 543) was adopted after several discussions in the expert group of finance and tax policy at the negotiations of the Government Committee and the Delegation of the Local Government Associations Cooperation Assembly. The draft act was first submitted for approval on 30 August 2007, and for the second time on 9 April 2008 through the e-law information system.

When answering the questions in the *Riigikogu* on 30 May 2011, the Prime Minister said: “*The majority of the revenue of local authorities is secured by the income basis ensured by law and the most important part thereof is also the equalisation fund over the distribution of which we have no big debates at the moment, I think, because all local authorities, both*

*wealthier and less wealthier find the formula for apportionment to be quite fair.”* On the other hand, the suggestions of the Local Government Associations Cooperation Assembly made in April 2011 for the negotiations of preparing the state budget for 2012 with the Government Committee did not express satisfaction with the formula of the equalisation fund. They made a suggestion to prepare a thorough analysis for the formula of the equalisation fund and modernisation of allocation principles considering the changes taking place in the economy and the necessity for functional operation of the equalisation fund. Determination of values of the income and cost constituents of the formula of the equalisation fund and the volume of the equalisation fund must occur on the basis of negotiations as suggested by the Local Government Associations Cooperation Assembly.

## **7. Clarify the procedure of consultation with local authorities and national associations of local authorities in order to make consultations and discussion possible prior to the final decision making**

Pursuant to Article 4 (6) of the European Charter on Local Self-Government:

*”6. Local authorities shall be consulted, insofar as possible, in due time and in an appropriate way in the planning and decision-making processes for all matters which concern them directly.”*

According to Section 6 of the explanatory letter to the Charter, it concerns such questions that remain in the areas of activity of local authorities, as well as areas affecting thereof. The text shows that the timing and manner of the consultation should be such that the local authorities would have a realistic opportunity to affect it at the same time agreeing with the fact that exceptional circumstances might exclude the consultation requirement, especially in urgent cases. Such a consultation should take place directly with the relevant authority or authorities, or indirectly by the means of these parties, if several authorities were involved with the issue.

OECD report (p. 64): *“There are several ways for improving the relations of the central government and the local level. A part of them are targeted at improving vertical coordination and increasing the capability, especially in case of local authorities. Such means might include legislation, formal contractual relations, coordinating bodies, surveillance over legality, unofficial meetings, efficiency measurement and also other mechanisms such as experiments or pilot programmes. ... In Estonia, a lot of those means are being used also in management of the relations of the central government and local level, especially acts and other legislation. Although, these make the situation clearer, they tend to evoke some rigidity in the system that might restrict their activities. That is the case for example with county local government associations that play a more and more important role in coordinating the activities of local authorities and providing services on spot. Thus, although acts and legislation are popular and useful means, more flexible means might more appropriate in managing the relations of the central government and local authorities. Contracts signed between the central government and the local level would be one of such options.”*

OECD report (pp. 64-65): *“The coordinating bodies play an important role in increasing the efficiency and spreading good practices, especially at the local level. Such bodies can operate as necessary forums to overcome problems in communication and mutual dialogue. Besides, coordinating bodies might help combine interests and time schedules, especially in implementing horizontal policies. As in many OECD countries, two national local*

*government associations were established in Estonia (Association of Municipalities of Estonia and the Association of Estonian Cities) to operate as partners to both the central government and local authorities negotiating with the central government on behalf of its members. Estonian local government associations have several problems, mainly with human and financial means, which might hinder them from operating as versatile and efficient partners of the members of the local level. They have valuable knowledge about the functions and management of local authorities that could be put in a better use in coordinating the relations of central and local levels and increasing their efficiency. Negotiations are under way about the possible merger of the two associations. Although, it is inevitably complicated, the merger of the two associations, as it has been done in Finland, would expand its scale and enable the new unity to be a stronger partner to all the government levels.”*

T. Kolk has written in the referred article: *“Now, the main cooperation form is the annual budgetary negotiations held between the government committee formed by the Government of the Republic and the Delegation of the Local Government Associations Cooperation Assembly. Such a cooperation form together with its working groups should be suitable also in this text (distinction and financing the duties of the state and local authorities – S.M.) with slight modifications in their tasks and mandates to discuss the treated topics. It should not be excluded to form a special working group for mapping, classification and financing the duties. The negotiations cannot be merely technical, it is possible they should take place also at the political level besides the level of the officials. Such a dialogue mechanism is also favoured by Article 4 (6) of the Charter, and the special provision on financing thereof in Article 9 (6). Concluding agreements might occur also in an administrative agreement signed between single local authorities and the state... It would be a good plan to include people or their associations affected by the particular task-service in determining the substance of a specific duty and the decision-making level. The activities derived from the Supreme Court judgement are still executed with an objective of ensuring the people with more or less identical availability and quality of public services for the people.”*

On 14 April 2011, at the negotiations of the Government Committee and the Delegation of the Local Government Associations Cooperation Assembly, a question was again raised about the competence of the negotiations of the Government Committee and the Cooperation Assembly. The parties acknowledge the necessity for writing a bigger competence of the negotiations in a more detailed wording in the act. It was noted that the Ministry of Finance was planning to amend the basic law of the State Budget in the fourth quarter of 2011 after which the draft State Budget Act should go to the Government of the Republic. In summer 2011, Sulev Liivik, head of the Local Governments Financial Management Department of the Ministry of Finance presented an analysis on whether it would be necessary and possible to give the suggestion (i.e., negotiations) of the Local Government Associations Cooperation Assembly a legal effect. The analysis also recalls that CLRAE Recommendation 294 (2010) contains a need for specification of the negotiations procedure to ensure the local authorities and their associations bigger confidence concerning the decisions of the state.

Local government associations have submitted an application at budgetary negotiations to provide for in the State Budget Act:

- nature, substance and volume of the income basis of the local authority;
- continuity guarantees of the volume of the income basis;
- equalisation system of the revenue and the used formula, conditions for changing thereof and relations to the regional policy objectives.

The term of local authority income basis is not defined in any legislation at the moment. It has been used in various documents consisting of the personal income tax and the equalisation fund. The share of the income tax paid to the local authority is provided for in the Income Tax Act § 5 (1) 1). The amount of the equalisation fund is determined in the annual state budget and the horizontal distribution thereof occurs pursuant to a formula for apportionment. The remaining allocations to rural municipalities and towns are determined in the annual Government of the Republic Regulation of the Equalisation Fund.

State Budget Act § 9 (3) defines that the object of the negotiations held with local authorities is the volume and principles of distribution of the equalisation fund. Pursuant to the rules of procedure of the negotiations (<http://portaal.ell.ee/10796>), the scope of negotiations is considerably wider and agreements have been concluded among other issues also concerning the amount of the share of the income tax of local authorities. The rules of procedure lack principles on how, for example, the formula for apportionment is being amended and that every single amendment would be discussed separately. There is a so-called tacit agreement between the parties that generally (except for the wishes of the politicians) nothing is changed without the approval of the local government associations. Rules of the Government of the Republic § 4 (1) establishes that the preparer of the issue that is decided by a minister or submitted to the Government of the Republic would cooperate in good time with ministries and the State Chancellery and, if necessary, with other relevant public law institutions and national local government associations. § 6 (1) of the Rules say that the draft must be approved by national local government associations if the draft concerned the rights, obligations and tasks of local authorities or the management of local life.

A government committee headed by the Minister for Regional Affairs has been formed for the negotiations (<https://www.riigiteataja.ee/akt/13324548>). Local Authority Financial Management Act § 25 provides the local authorities with a guarantee that the decisions made by the state in the midst of the budgetary year causing a decrease in the revenue or increasing the costs must be compensated to local authorities. Regional policy objectives are not provided in any legislation. Regional policy objectives are written in the regional development strategy for the years 2005-2015 ([www.siseministeerium.ee](http://www.siseministeerium.ee)).

The rules of procedure of the negotiations enable concluding agreements between the parties and, for instance, approve instructions on how to proceed with the amendment of distribution of allocations at the general assembly.

In the opinion of the author of the overview, the execution of point 6 of CLRAE Recommendation 294 (2010) must be further dealt with that also hooks the problem raised by the Local Government Associations Cooperation Assembly. The analysis of analogous experience of foreign countries would be necessary, as well.

**8. Ratify the Additional Protocol to the European Charter on Local Self-Government on the right to participate in the affairs of a local authority (CETS No. 207) as soon as possible**

*Riigikogu* executed that task on 16 February 2011 (RT II, 8 March 2011, 1). It is the first international document with an objective of ensuring internationally the citizens' right to participate as voters or candidates in the elections of members of the representative body of a local authority of his residence, it is important for Estonia to signal the international public that Estonia complies with that democratic obligation of the rule of law. Above all, the approval of the additional protocol came from the desire to acknowledge the person's right to participate in the activities of the local authority as a right derived from international law. At the reading of the draft in the *Riigikogu*, the Minister for Regional Affairs noted that with ratification of the additional protocol we would fulfil the recommendation of the Congress of Local and Regional Authorities of the Council of Europe (CLRAE) of 28 October 2010 "Local Democracy in Estonia", which advises the Estonian competent authorities to ratify the additional protocol as soon as possible.

## **9. Wants the Estonian authorities to notify the Congress of the follow-up measures implemented on the basis of the recommendations of this report**

The suggestions made by the Local Government Associations Cooperation Assembly in April 2011 for negotiations with the Government of the Republic in the process of preparing a state budget of 2012 it is considered important to plan the activities and launch a regular sector-specific monitoring in cooperation with national local government associations over the execution of the Supreme Court judgement 3-4-1-7-09 and the implementation of suggestions made in the CLRAE and OECD reports.

## **Conclusion**

As a conclusion, the following remarks could be made in the sequence of points of the CLRAE Recommendation 294 (2010).

### **1. Give a special legal status to the City of Tallinn**

Specifications of Tallinn in the judicial area of our local authorities with other rural municipalities and towns are expressed in so-called three vectors that should also be reflected in legislation as special regulations:

- 1) capital city in relations with the state's central level (it is a field where the performance of relevant duties of the state performed by the city must be additionally financed from the state budget, comparison Berlin);
- 2) horizontal connections of Tallinn as a big regional attraction centre with the rural municipalities and cities of the hinterland, incl. cooperation in providing public services that so far has been voluntary, but probably in some fields (public transport, waste management, plans, etc.) requires legal regulation (comparison Helsinki);
- 3) decentralisation of the internal management of Tallinn as a city with a size clearly distinguished from other towns in the country.

The last point is largely for the city itself to solve, as also pursuant to Article 6 (1) of the European Charter of Local Self-Governments local authorities can determine their internal management structures themselves to adapt to the local needs and ensure an efficient management. Of course, it would be good if the current fairly general regulation of the rural municipality district/city district were improved in the Local

Government Organisation Act (Chapter VIII). What needs regulation by act most (as in case of any bigger city) is cooperation with the hinterland, at least in providing certain services. The relations of the capital city and the state are primarily financial ones (performance of the tasks of the capital) and these could be solved by allocating a relevant money in the state budget that would be prior fixed in the final protocol of the negotiations of the Government Committee and the Delegation of the Local Government Associations Cooperation Assembly.

**Therefore:** No special legal status has been given to Tallinn.

## **2. Specify the legislation providing for mandatory tasks and functions of the local government**

Already before CLRAE Recommendation 294 (2010), the Supreme Court judgement 3-4-1-8-09 of 16 March 2010 obliged to clearly distinguish in legislation the money foreseen to local authorities for deciding and managing the issues of local life from the money meant for the performance of the duties of the state, and provide for the financing of national obligations imposed on local authorities by law from the state budget. In spite of the fact that the relevant Supreme Court judgement is interpreted differently, it must be admitted that the execution of the task has gone quite slowly so far. The President of the Republic (question at the opening session of the Riigikogu in the fall of 2011 – can the parliament adopt the state budget for 2012 in a few months so it would execute the Supreme Court judgement?), Auditor General, Tim Kolk - advisor to the Constitutional Review Chamber of the Supreme Court, Association of Estonian Cities and the Association of Municipalities of Estonia, etc. have been critical towards the issue.

**Therefore:** The recommendation has been fulfilled only to a small extent.

## **3. Change the domestic legislation urgently to allocate a greater proportion of financial resources for local authorities in order to make them commensurate with the responsibilities provided for by the Estonian Constitution and national law, and allow local authorities to raise revenues from local taxes.**

The Appeal of our CLRAE Delegation to the Council of Europe was largely induced by the fact the first supplementary budget of 2009 decreased the receipt of the personal income tax to local budgets from 11,94 per cent to 11.4 per cent. In the opinion of the author of the overview, fulfilling the point of Recommendation 294 (2010), incl. the issue of local taxes, where the *Riigikogu* and the Government of the Republic have regrettably receded from CLRAE Recommendation and that not only in practice (legislation) but also in their principle positions. The President of the Republic acknowledged at the opening session of the *Riigikogu* in the fall of 2011 that at the suggestion of the government and approval of the parliament the revenues of cities and rural municipalities have been steadily decreased.

Unfortunately, local authority experts, incl. also the scientists of the field often emphasise in a too unilateral manner the small share of taxes allowed by the Local Taxes Act in the revenue of local budgets. The problem is not that much in taxes provided for in our Local Taxes Act, although it is weird here too that on 23 September 2010 the *Riigikogu* abolished another two local taxes in the Local Taxes Act – sales tax and boat tax. The objective should be increasing the revenue received in the local budget that would ensure a bigger economic autonomy for local

authorities. The final protocol of the state budgetary negotiations of 2012 between the Local Government Associations Cooperation Assembly and the Government Committee includes a suggestion that local personal income tax would be applied in Estonia as of 2013. In this case, each inhabitant of the rural municipality and city would sense through the income tax his connection with the services provided by the local authority. In Estonia, land tax is the only direct connection between the local authority and the people operating in it, which as of 1996 is received in the local budget in the scope of 100%. Abolishing land tax from the land under dwelling was a direct intervention in the tax return basis of local authorities that the *Riigikogu* enacted on 16 June 2011.

In spite of the fact that the programme of the government association of the parties Pro Patria and Res Publica Union and the Estonian Reform Party at the parliamentary elections of 2011 says that in modernisation of local administration the government association considers it important ... to increase the independent income basis for local authorities, regional balance ..., fast amendment of the legislation concerning the CLRAE Recommendation 294 (2010) is probably unrealistic.

**Thus:** The recommendation has not been fulfilled, more specifically – it has been even distanced from it during 2010-2011. That both concerning taxes imposed by the state (land tax exemption), as well as by local taxes (abolishment of sales tax and boat tax). Concerning the financing of municipal duties, national legislation has not been amended for the proportion of the financial means allocated to local authorities were bigger, that it would be as extensive as the obligations determined to local authorities by the Constitution of the Republic of Estonia and national legislation.

#### **4. Take measures to ensure that local authorities receive adequate revenues from shared taxes, and that these are allocated in a transparent way.**

As of the second part of the 1990s, our national local government associations have considered it important to divide the personal income tax in two – a state and local authority income tax, whereas in case of the latter one the rural municipality or city council should be entitled to either decrease or increase the tax rate within certain limits. When answering the interpellations in the *Riigikogu*, the Prime Minister has recognised the possibility of imposing a local income tax, but without increasing the tax rate. That, however, would be an incomplete solution. In accepting the scope of the local economic autonomy, we have to answer a question – do we consider it feasible to develop a local authority model similar to the Mediterranean countries, or with an emphasis similar to the Scandinavian countries?

**Therefore:** CLRAE recommendation has not been implemented.

#### **5. Set up a support fund for local authorities particularly affected by the economic crisis so that they are able to continue delivering certain social services**

In addition to the subsidies foreseen to local authorities (incl. equalisation fund) in the state budget, the Government of the Republic has from time to time allocated additional sums to the budgets of rural municipalities and cities. Already the State Budget Act of 2010, as well as the State Budget Act of 2011 contained a provision that in case of financial difficulties (long-term inability to satisfy the claims of creditors) the local authorities were entitled to apply for assistance for rehabilitation of the budget. But that measure cannot be considered to be in compliance yet with

CLRAE Recommendation 294 (2010) of setting up a support fund for rural municipalities and cities in difficulties so that they would be able to continue delivering social services.

**Thus:** To some extent the rural municipalities and cities affected by the economic crisis are being supported, but the support fund recommended by CLRAE has not been set up.

## **6. Start wide-ranging consultations with local authorities on the planned financial reform**

As of 1994, negotiations have been taking place between the Government Committee and a Delegation of the Local Government Associations Cooperation Assembly that at least partially covers the requirement of consultations on the financial reform. E.g., Local Government Financial Management Act was adopted after discussions in the expert group of finance and tax policy at the negotiations of the Government Committee and the Delegation of the Local Government Associations Cooperation Assembly. But CLRAE Recommendation 294 (2010) was approved in Strasbourg knowing the above-mentioned facts, whereas additional extensive consultations are assumed.

**Therefore:** Consultations take place to some extent, but no new extensive forms of consultation have been added after the presentation of CLRAE Recommendation 294 (2010).

## **7. Clarify the procedure of consultation with local authorities and national associations of local authorities in order to make consultations and discussion possible prior to the final decision making**

At the negotiations of the Government Committee and a delegation of the Local Government Associations Cooperation Assembly (incl. also at the negotiations of 2011), a question on the competence of negotiations has been repeatedly raised. Both parties have acknowledged the need to provide for a bigger competence of the negotiations in a more specific wording in the act. There are certain developments in this field (although obviously insufficient), as in summer 2011 the Ministry of Finance submitted an analysis on whether it was necessary and possible to give the suggestion (i.e., negotiations) of the Local Government Associations Cooperation Assembly a legal effect?

**Therefore:** Relevant discussions have been held, but the recommendation has not been fulfilled.

## **8. Ratify the Additional Protocol to the European Charter on Local Self-Government on the right to participate in the affairs of a local authority (CETS No. 207) as soon as possible.**

The *Riigikogu* ratified the Additional Protocol to the European Charter on Local Self-Government on the right to participate in the affairs of a local authority on 16 February 2011.

**Therefore:** The recommendation has been fulfilled.

## **9. Wants the Estonian authorities to notify the Congress of the follow-up measures implemented on the basis of the recommendations of this report**

After the submission of this overview, the Government of the Republic approved the action plan for implementation of the OECD report “Towards a single state management” on 13 October 2011. Nothing equivalent has been done to implement the CLRAE Recommendation 294 (2010) as known to the author.