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FINANCING LOCAL GOVERNMENTS IN THE SLOVAK REPUBLIC

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In the late of 20th century public sector, public administration and public finance reforms were realized almost in all European countries. They focused on decentralization and included the process of fiscal decentralization, which represents an efficient delegation of competences, responsibilities and authorities in providing public goods by local self governments considering local particularities. This paper focuses on evaluating the conception of this process and its main goals in conditions of the Slovak Republic, emphasising its impact on local governments – understanding municipalities and regions. This paper is published within the project VEGA no. 1/0253/08.

Keywords: fiscal decentralization, regional and municipal budget, local revenues, local expenditures

INTRODUCTION

The public sector, public administration and public finance reforms were realized in the late 20th century in all European countries and they focused on decentralization. This process was realized also in the Slovak Republic, despite of its deceleration in 1990's, when the Czechoslovakia was divided into two autonomous republics.

The intensity of the process of public sector, public administration and public finance decentralization increased in the Slovak Republic in the beginning of 21st century and it was completed by the fiscal decentralization.

The fiscal decentralization is a process of efficient delegation of competences, responsibilities and authorities in providing public goods by local self governments considering local particularities.

The opinions of home and foreign economic provenance on fiscal decentralization differ. The main advantage of fiscal decentralization, according to Oates [6], Musgrave [5], Peková [7] or Provazníková [8], is that it allows local governments to provide local public goods considering the local preferences. This increases the public good providing effectiveness and can encourage the democratic process by engaging the citizens making public decisions. But according to Jackson and Brown [4], or Tanzi [9], there exist aspects of fiscal decentralization which can cause that local governments to be unable to eliminate local externalities effects, distorts effects of local taxes and corruption of local electives.

In most of studies focusing on fiscal decentralization authors agree (Provazníková [8], Ebel and Yilmaz [1], Oates [6],) that the process of fiscal decentralization is successful only if the decentralization of the revenue part and the decentralization of expenditure part of municipal budget are realized at the same time.

The decentralization of the expenditure part of municipal budget can be defined as transfer of responsibilities in providing local public goods. In fact it is a transfer of competences in providing public goods from central government level to lower government levels.

The decentralization of the revenue part of municipal budget presents authorities in creating revenues especially tax revenues basing at local taxes. Local taxes should be sufficiently regular and profitable to make local governments autonomous in their financing (increase financial autonomy of local governments).

1 FISCAL DECENTRALIZATION IN THE SLOVAK REPUBLIC

Fiscal decentralization in the Slovak Republic (SR) is a part of new financing system of self-governments. The principal of the system is to fortify financial autonomy of particular territorial self-governments in providing public goods. Tax revenues of self-governments are increased as they represent significant part of own revenues of self-governments. In most countries in transition the process of fiscal decentralization was divided into two stages. This was also the case of the SR. At the beginning, only expenditures were decentralized (Act on Competences 416/2001). Later on, since January 2005 revenues of self-governments have also been decentralized. [3]

1.1 Public administration structure

Public administration in the SR is divided into state administration, where the dominancy is in prevalence of state level of government, and self administration, which is in the conditions of the SR represented by the eight self governed regions and 2883 municipalities.

The regions and municipalities represent lower level of government, they are self administrated by the elected deputies and bureaucracy and they manage their own budgets called local budgets. Revenue part of local budgets includes current and capital revenues understanding tax revenues, nontax revenues, transfers and grants. Expenditure part includes current and capital expenditures which can be divided from the economic and function point of view.

The position in the public administration structure, responsibility, authority and competencies of local governments have changed with the public administration and public finance reforms. Nowadays they reflect the reform realized in the SR in the beginning of the 21st century.

1.2 Fiscal decentralization realizing phases

Reform of public administration comprising decentralization had been prepared in the SR since 1998.

First phase of fiscal decentralization started in 2001 as the consequence of approved Act on Competences. More than 400 competencies were gradually transferred to lower self-governments during period between 2001 and 2004. The delegation of these competences was associated with adequate transfer of property and financial resources. The Act on Competences enabled the decentralization of expenditures but competencies were still financed through subventions.

Second phase of fiscal decentralization started in 2005. In this phase the budget revenues were decentralized. Local self-governments have received even competences in the field of creation of their financial resources. Consequently, financial autonomy of villages, towns and regions were confirmed. Since that time, local self-governments could collect and determine level of taxes where the tax base is fixed and revenue is sufficient as well as regular. Property taxes and income taxes are usually convenient type of the taxes. [3]

Before January 2005 local budgets were financed usually by tax revenues and transfers from the state budget. Tax revenues represented 40% of self-governments budgets and were created by own tax revenues and central tax revenues. Own tax revenues were local taxes (real estate tax collected by self-governments however tax rate had to respect limits determined legislatively, consequently tax competences of self-government was suppressed and market value of real estate was not taken into consideration) and fees (mostly of facultative character). Central taxes (individual income tax, corporate income tax and vehicle tax) had function of shared taxes and their yields were transferred to self-governments. Act on State Budget yearly determinate which part of tax and of which tax will be transferred to self-governments and how the sum will be divided among particular villages, towns and regions. The main criteria how to divide the sum of the taxes was the number of inhabitants living permanently at the territory of a locality. However, there were some negative effects of such a distribution. Revenue of villages was approved by Parliament shortly before the end of next budget year. Consequently, particular self-governments could not plan their revenues in advance.

Transfers were also important revenues of self-governments. Competences transferred from central (state) government institutions to self-governments were financed through transfers. Amount of transfer was approved at central level by Act on State Budget. [3]

Consequently, during the second stage of fiscal decentralization in the SR, the act determined fixed rules for division of revenues from individual income taxes among state, regional and municipal budgets. There were defined objective criteria that determined how to share revenue among municipalities and regional self-governments. Besides number of inhabitants, area, altitude, social and age structure, density of inhabitants in self-governments was also taken into consideration. It enabled to respect position of smaller municipalities as well. Another acts specified budget determination of other direct taxes (corporate income tax is a state tax, vehicle tax is a regional one, real estate tax is in the full competence of municipalities, etc.) and budget rules of self-administrations. Creation of revenues became more transparent and even simpler. At the same time local specifics were respected. [3]

1.3 Goals of fiscal decentralizations

The main goals of the fiscal decentralization in the Slovak Republic were:

- § to increase the power to tax, tax assignment and financial autonomy of the municipalities in SR,
- § to share the revenues from the income tax among government levels on the basis of objective criteria
- § to provide the public goods by the local governments themselves considering local particularities and inhabitants preferences and
- § to increase local government authority and responsibility. [2]

Part I: Local Budget Revenues

2. Revenue part of local government budgets

After realizing the second phase of fiscal decentralization in the SR (2005 – up to now) local revenues increase steadily. Their structure is following: total revenues are divided into tax revenues, nontax revenues, transfers and revenue financial operations. Tax revenues belong to current revenues, nontax revenues and transfers can be either current or capital revenues.

The next text analyzes each group of revenues in the period of 2005 – 2009. The data is made available online by the project [11].

As we can see in the, tax revenues increased all threw the monitored period. Tax revenues are higher in the municipalities than in regions, because of the larger tax base – municipalities are administrating more local (municipal) taxes.

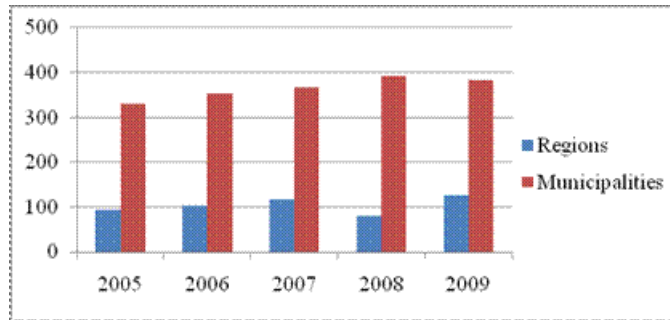


Fig 1 Tax revenues (mil. Eur)

Income tax of physical bodies is the most profitable tax. As was mentioned before, this tax is divided to state - state budget (6,2 % of gain of this tax), self government regions – regional budgets (23,5%) and municipalities – municipal budgets (70,3%).

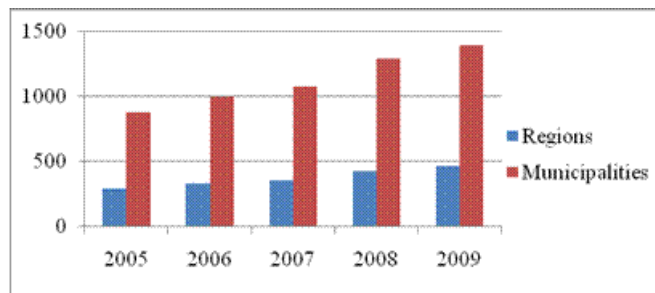


Fig 2 Local revenues from income tax of PB (mil. Eur)

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shows, that revenues from the mentioned tax increased in the monitored period threefold and they are higher in municipalities. Increasing revenues from this tax were caused by the real GDP rising. The big difference between municipal and regional revenues is resulting from the tax assignment.

Local revenues from other local taxes are creating approximately one third of the local tax revenues. For the municipalities other local taxes are the following: real estate tax (tax from residences, land and buildings) and other taxes with the object of taxation as dog, using the public area, driveway to the historical part of the city, vendor, no gaining game machine, ownership of nuclear device and communal and building waste. The only local tax of the self governed regions in the SR is the vehicle tax.

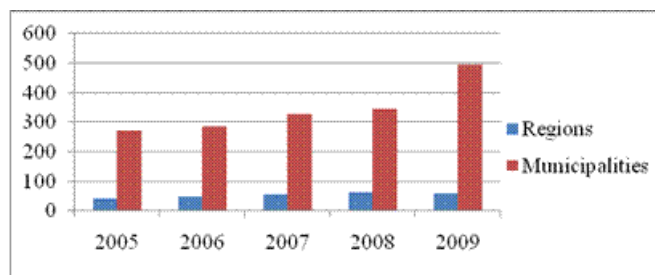


Fig 3 Revenues from other local tax (mil. Eur)

As the Fig 3 shows the revenues from other local taxes are much higher in municipalities than in regions.

Nontax revenues are not so important part of local revenues as tax revenues. They include revenues from administrative and customer fees, revenues from imposed sanctions and revenues from municipal or regional entrepreneurship in the form of profit.

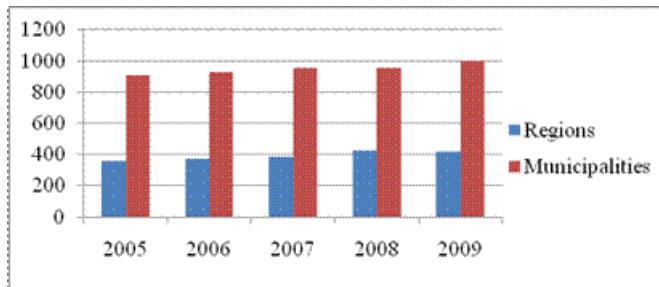


Fig 4 Nontax revenues (mil. Eur)

The

shows that the nontax revenues are higher in municipalities than in regions. In municipalities these revenues increased steadily and in regions they stay approximately the same during the monitored period.

After tax revenues transfers are another very important part of local revenues. Local government can usually receive a transfer from the higher level of government; it means that for region it is common to receive a transfer from state level and for municipality both from state and regional level. In the dimension of national and abroad cooperation the region or the municipality can obtain a transfer from the same level of government. In the monitored period municipalities received larger volume of transfers as shows the Fig 5.

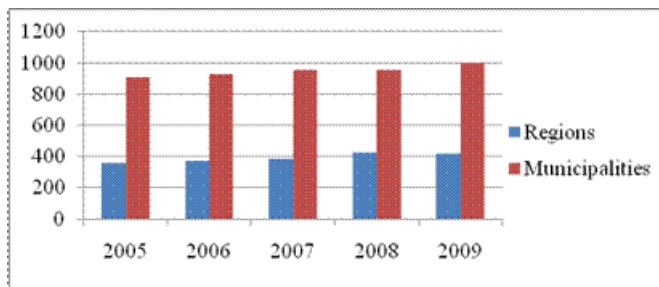


Fig 5 Transfers (mil. Eur)

Revenue financial operations represent revenues from received loans and revenues from municipal or regional stocks. This group of local revenues is the only one which decreased in the end of the monitored period (see).

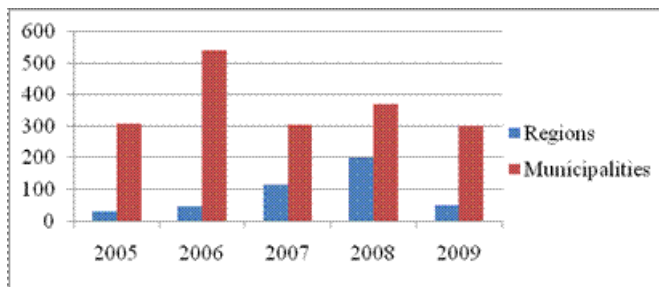


Fig. 6 Revenue financial operations (mil. Eur)

The lower volume of financial operations revenue in the regions is caused by the fact, that regions exist only since 2002 and they did not enhance their debt.

Part II: Local Budget Expenditures

Expenditures of governments are representing their mission and function. Goods are provided through public expenditures. Respecting the subsidiarity principle (European chart on municipalities) some of them are provided not only on central level of government, but also in lower government levels. In the Slovak Republic (SR) we mean the regional level of government represented by the regional self-governments, and municipal level of government.

In the SR were the functions of regions and municipalities were specified by the Act on Competences in 2001, which was the beginning of the first phase of the fiscal decentralization realized in the SR. This phase represents decentralization of the expenditure part of local budgets.

Thereafter it is essentially clear what the local governments' functions are. Corresponding expenditures, which are clearly divided into ten divisions using the classification known as The Classification of the functions of government, belong to each local function or competence.

3. Expenditures of local government budgets

The **Classification of the functions of government (COFOG)** was developed in its current version in 1999 by the OECD and published by the United Nations Statistical Division. The classification has three levels of detail: divisions, groups, classes. Divisions represent the broad objectives of government, groups and classes represent the means by which these broad objectives are achieved (see Appendix 1). [10]

The next text analyzes each division in the period of 2005 – 2009. The data is made available online by the project [12].

1. Division: General public services

Expenditures on general public services include expenditures of executive and legislative organs, financial and fiscal affairs, external affairs foreign economic aid, basic research, research and development related to general public services, public debt services, transfers of a general character between different levels of government. Evolution of these expenditures of local governments in SR is illustrated in

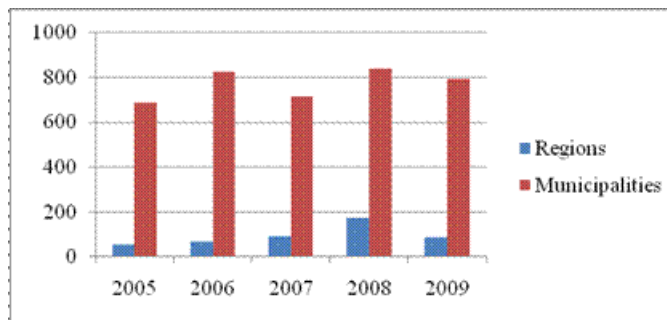


Fig 7 Local expenditures on general public services (mil. Eur)

Expenditures on general public services include the expenditures on office running. They are higher in municipalities. For example the following belong to this group of municipal expenditures: officers' salaries and salaries of other office employees, their insurance, rewards, energies, water, fuel, communication, interior equipment, computer equipment, software and licenses, cars, servicing, building maintenance, books, journals, rental, expenditures on Register Office, trainings and courses for employees, transactions of public dept as interest payments to the banks and state funds, leasing. As in SR there are only 8 self government regions their expenditures on office running are lower than the expenditures of municipalities. Regional expenditures in this field are nearly the same and include also expenditures on procurement of capital actives, financing of EU projects and financing of budget organizations.

2. Division: Defence

Military and defence is a so called public service with national character. It means that only the highest government level is able to provide such type of public good. On regional and municipal government level it is not possible to provide this service in national sense.

3. Division: Public order and safety

Division Public order and safety includes expenditures on police, fire-protection services, law courts, prisons and R&D related to public order and safety. Evolution of these expenditures of local governments in SR is illustrated in Fig 8

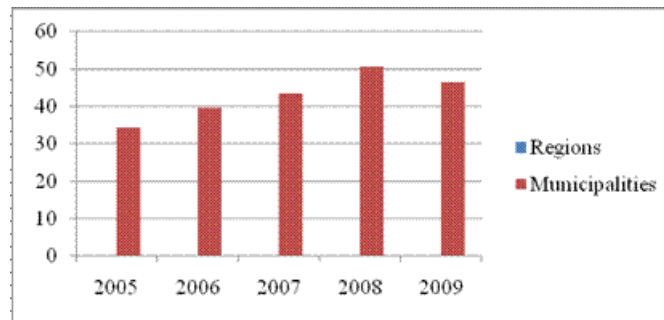


Fig 8 Local expenditures on public order and safety (mil. Eur)

Expenditures on public order and safety are the domain of municipalities. Self government regions do not have any competences in this field of public services. In municipalities, especially in big cities, the most commonly provided public services are municipal police, law courts and prisons. Fire protection stations are in all municipalities and their providing is very expensive and problematic for small villages from the technical point of view. This group of municipal expenditures includes expenditures on municipal policemen and firemen salaries and insurance, rewards, travelling compensation, energy, fuel, water, communication, work clothing, servicing the machines, cars, maintenance of buildings, collision insurance, trainings and courses.

4. Division: Economic affairs

Fourth division includes expenditures on general economic, labour and commercial affairs, agriculture, forestry, fishing and hunting, fuel and energy, mining, manufacturing and construction, transport, communication, other industries, related R&D. Evolution of these expenditures of local governments in SR is illustrated in

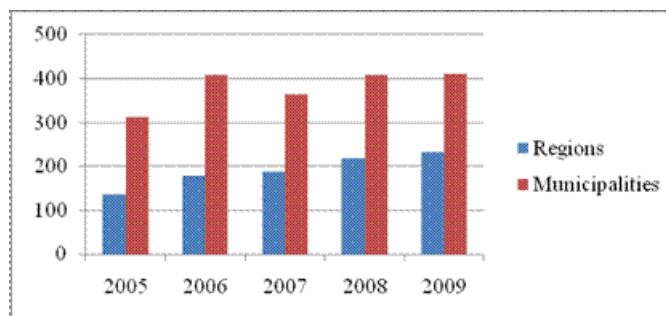


Fig 9 Local expenditures on economic affairs (mil. Eur)

Competences in the field of highway transportation are divided to municipalities and regions and they are higher in municipalities. Municipalities take care of basic school pupil transportation, maintenance of municipal highways (reconstruction and modernization of highways) and municipal public transportation. Regions' expenditures are related to PPP projects, financing EU projects, financing the Integrated transportation system and maintenance of highways of II. and III. class, servicing the vehicles and machines. In municipalities this division includes also expenditures on forestry (salaries, insurance, working clothes, special material) and expenditures on community services aiming the reduction of unemployment in municipality.

5. Division: Environmental protection

Division Environmental protection includes expenditures on waste and water waste management, pollution abatement, protection of biodiversity and landscape and expenditures related research and development. Evolution of local governments' expenditures on environmental protection is illustrated in

Competencies in waste and water waste management are exclusively related to municipalities. Water waste stations and waste treatment stations are usually run by private companies or companies where the municipality is a shareholder. The case of municipal water waste or waste treatment station, where the municipality is the only owner, is sporadic. To this group of expenditures includes expenditures on routine and standard servicing of vehicles and machines, buildings, and expenditures on special material.

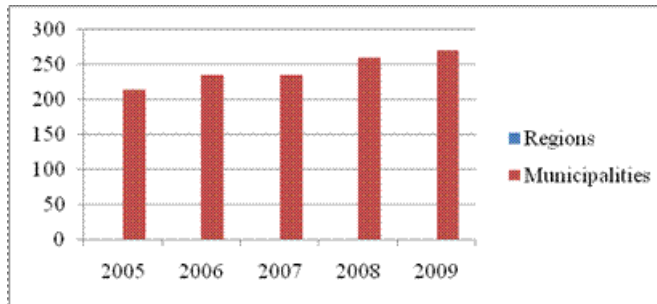


Fig 10 Local expenditures on environmental protection (mil. Eur)

6. Division: Housing and community amenities

Expenditures on housing development, community development, water supply, street lighting and research and development related belong to the sixth division, Housing and community amenities. Evolution of this group of expenditures is illustrated in Fig. 11.

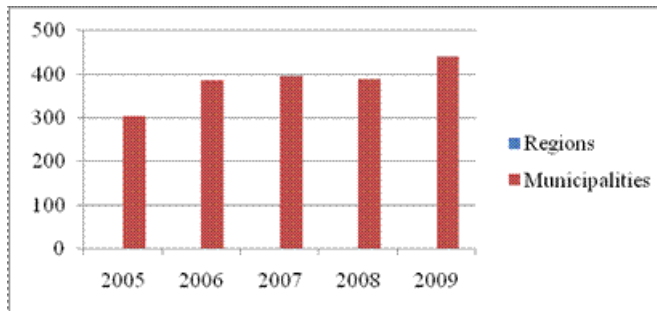


Fig 11 Local expenditures on housing and community amenities (mil. Eur)

Next field of competences which are exclusively related to municipalities are competences represented as expenditures on municipal development including financing of several projects focusing on education, geometric documentation, construction of the water pipelines, parking places and polyfunctional centres, purchase of land etc. Public services as water supply and street lightening are also very important groups of municipal expenditures and they include payments for energy, communication, purchase and servicing the vehicles and machines. Expenditures on housing include construction or purchasing of new buildings (blocks of flat). This division also includes financing the energy costs of local public broadcasting.

7. Division: Health

Expenditures on medical products, appliances and equipment, outpatient, hospital and public health service, research and development related to health belong to the seventh division of expenditures. Their evolution in regions and municipalities is illustrated in

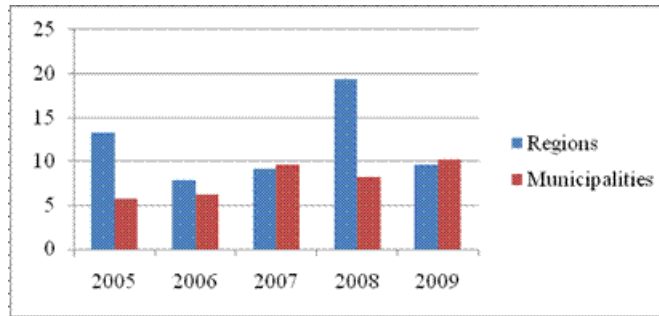


Fig 12 Local expenditures on health (mil. Eur)

More competences were delegated to the regional self governments as to the municipalities in this field, so the expenditures on health are higher in regions. The biggest part of this expenditures is represented by the financing the hospitals. Nowadays the hospitals, their equipment, ambulances and crew, are the main problem for many regions in the SR. Municipalities have competences and expenditures belonging to this division related to the making decisions in licensing the ambulances and their surgery hours.

8. Division: Recreation, culture and religion

Eight division includes expenditures on recreational and sporting, cultural services, broadcasting and publishing services, religious and other community services and expenditures on research and development related to recreation, culture and religion. Evolution of expenditures in this division is illustrated in.

Competences in recreation, culture and religion are divided in the SR into regions and municipalities. The shows that expenditures in this division are higher in municipalities than in regions. The municipalities' expenditures are related to courthouses activities understanding the costs on energy, salaries, routine and standard maintenance, transfers within the public administration, transfers to the municipal budget organizations and allowance organizations, transfers to the non-profit organizations focusing on culture, sport and religion, transfers to the clergy and financing the local broadcasting and publishing. From the capital expenditures it is construction, reconstruction and modernization of the buildings utilized for the activities in the question. Regional expenditures are related to financing their budget and contributory organizations and EU projects.

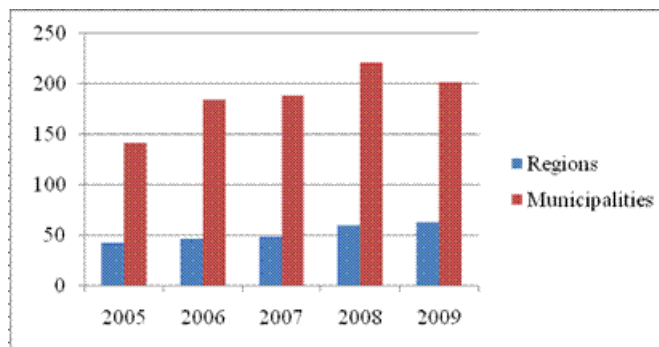


Fig 13 Local expenditures on recreation culture and religion (mil. Eur)

9. Division: Education

Pre-primary, primary, secondary and tertiary education, post-secondary non-tertiary education, education nondefinable by level, subsidiary services to education and research and development related are the most important group of expenditures almost in all local budgets and it represents approximately 30 – 40% of local expenditures. Evolution of expenditures on education is illustrated in

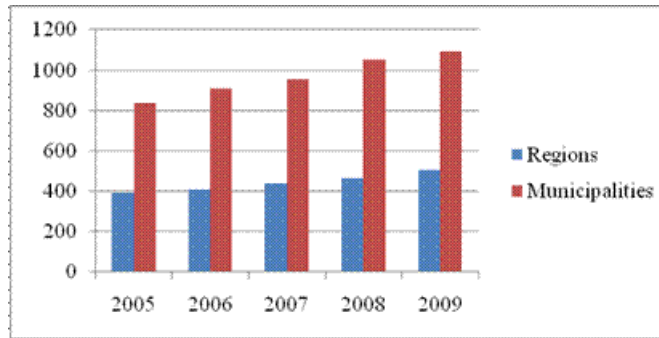


Fig 14 Local expenditures on education (mil. Eur)

Competences in education in the SR are divided into regions, municipalities and state so, that municipalities take care of pre-primary and primary schools, regions take care of secondary schools and tertiary education is supported by the state. Even though providing the education burdens all local budgets, the expenditures on pre-primary and primary education provided by the municipalities are much higher than regional expenditures on secondary education. The important part of local expenditures on education is financed through grants and transfers from the state budget – there are transfers of teachers' salaries and insurance and transfer of pupils' cost limits. Expenditures on maintenance, reconstruction and modernization of school buildings, machines, vehicles and other equipment are financed from own local revenues.

10. Division: Social protection

Expenditures on sickness and disability, old age, survivors, family and children, unemployment, housing, social exclusion and research and development related belong to the division Social protection. Evolution of this division shows

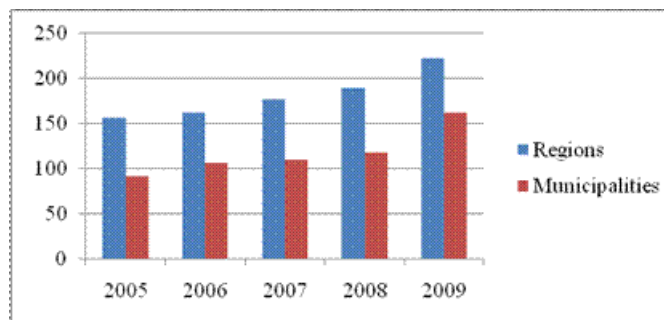


Fig 15 Local expenditures on social protection (mil. Eur)

Expenditures on social protection are higher on the regional level of government than on municipal level. In the SR the regions have prevalence in competencies in this field. They are financing the retirements' houses, retirements' clubs, day care services and social welfare. Municipalities are financing activities as social aid for people in indigence, community employees, retirements boarding and also retirements' clubs.

4. Revenues and expenditures of local governments in the SR in the context of financial crisis

The financial crisis touched the Slovak economy in the late of 2008 and it is lasting up to now. That is the reason why we compare local revenues and local expenditures in 2008 and 2009.

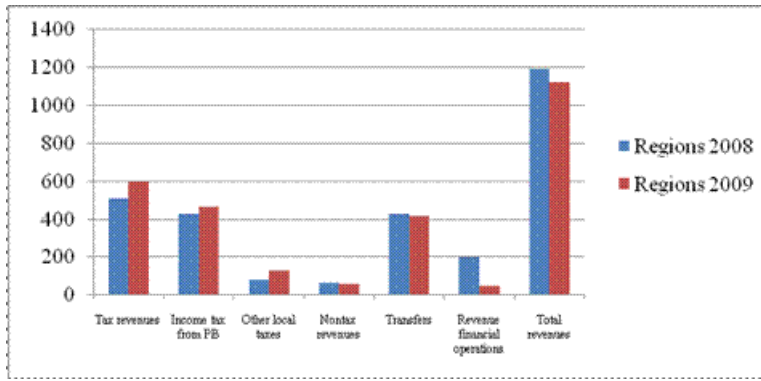


Fig 16 Revenues of regions in the SR in 2008 and 2009 (mil. Eur)

As we can see in self-governed regions received in 2009 in the comparison with year 2008 less transfers and loans and their total revenues decreased in 2009.

Revenues of municipalities decreased only in the field of revenue financial operations and their total revenues stagnated (see).

However the main fail in revenues was expected from income taxes, regions and municipalities did not suffer from it in 2009. In 2009 the fail of these revenues occurred but they will pervert local budgets (as well as state budget) in 2010, because the sum which was set to share among different levels of government was calculated in advance – for the year 2009 it was calculated in the 2008, and then the financial crisis did not appear in the SR yet.

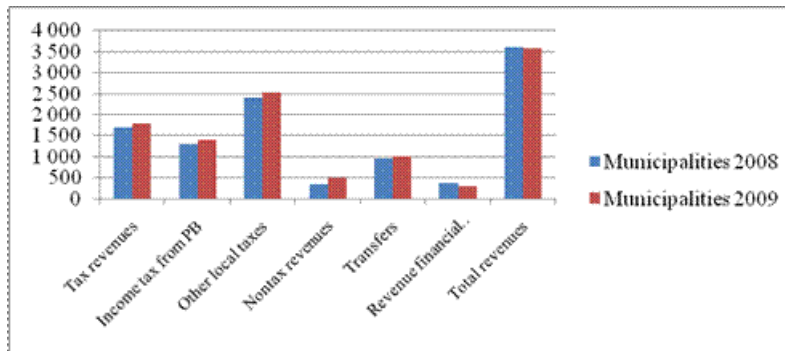


Fig 17 Revenues of municipalities in the SR in 2008 and 2009 (mil. Eur)

The main tendency in regional expenditures is an increase, but as we can see in the Fig 18, there are some exceptions (or see Appendix 2).

Comparing their evolution in 2008 and 2009 we can observe a diminution of regional expenditures in two divisions.

The most significant fall was in division General public services. Other decrease we can observe in division Health. The rest expenditures division increase despite of the rising crisis.

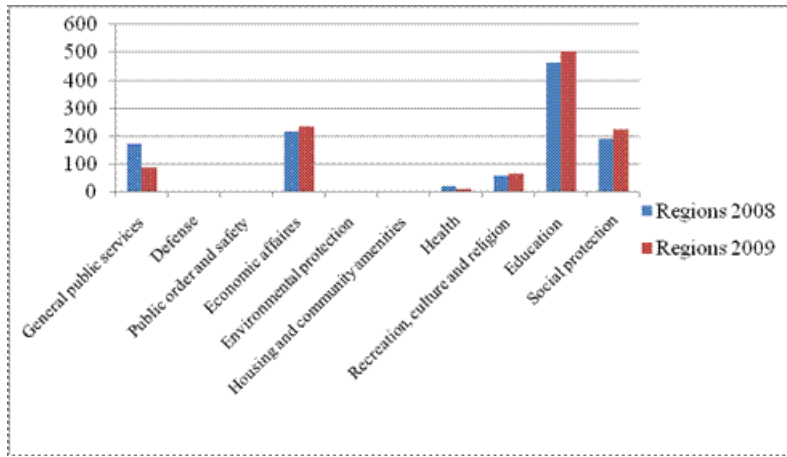


Fig 18 Expenditures of regions in the SR in 2008 and 2009 (mil. Eur)

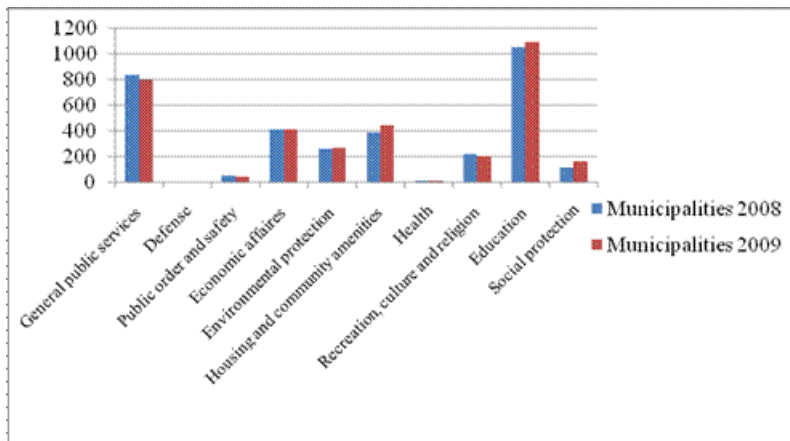


Fig 19 Expenditures of municipalities in the SR in 2008 and 2009 (mil. Eur)

Increasing trend is typical for almost all divisions of municipal expenditures. For our research we compared municipal expenditures in 2008 and 2009 as shows (or see Appendix 3).

Decreasing is observed only in three divisions of municipal expenditures. These divisions are: General public services, Public order and safety and Recreation, culture and religion. Municipalities in 2009 fought the crisis by reducing their expenditures primarily in these fields through diminution of the number of employees on municipal offices which reached the retirement age, reducing the office hours or the workweek from five to four days, cancelling the budget or contributory organizations or cancelling the municipal police stations. They also stopped their investment project and other capital expenditures.

CONCLUSION AND DISCUSSION

In the beginning of realizing the process of fiscal decentralization in the SR, responsibilities, authorities and competences of self governed regions and municipalities were defined. Responsibilities and authorities touched the tax assignment, defining the tax base and tax rates, what affected the revenue part of local budgets. Competences represent expenditure part of local budgets and expenditures are their financial expression.

From the local revenues point of view self - governed regions received in 2009 in the comparison with year 2008 less transfers and loans and their total revenues decreased in 2009. Revenues of municipalities decreased only in the field of revenue from financial operations and their total revenues stagnated.

The main fall was expected in revenue part of local budgets by decreasing the individual income tax (income tax from physical bodies). In fact regions and municipalities did not suffer from it in 2009 and this situation is caused by the way of calculating the share on this tax. In 2009 the fall of these revenues occurred but it did not pervert local budgets yet.

COFOG classification of expenditures is used in the SR, which divides expenditures into ten groups. In this paper we showed the evolutions of each expenditure division from 2005 to 2009 with the exception of division of Defence and with the exception of some divisions of expenditures which are not accounted by the regions. The biggest group of expenditures of both regions and municipalities is the division of Education, after that comes the division of General public services and Economic affairs.

During the whole monitored period (2005 – 2009) an increasing trend of local public expenditures prevails. Because of the financial crisis which came in the end of 2008 regions reduced their expenditures in 2009 in the divisions General public services and Health, municipalities reduced their expenditures in the divisions General public services, Public order and safety and Recreation, culture and religion. We can state that the impact of the financial crisis on local budgets from the expenditure part of budget view in 2009 was not dramatic and economy measures were established mainly by the municipalities in the field of reducing employees and office hours.

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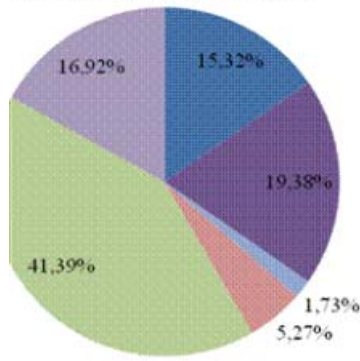
Appendix I Classification of the functions of government

Government broad objective (division)	Sub-items
General public services	Executive and legislative organs, financial and fiscal affairs, external affairs foreign economic aid, basic research, R&D related to general public services, public debt services, transfers of a general character between different levels of government
Defence	Military and civil defence, foreign military aid, R&D related to defence
Public order and safety	Police, fire-protection services, law courts, prisons, R&D related to public order and safety
Economic affairs	General economic, labour and commercial affairs, agriculture, forestry, fishing and hunting, fuel and energy, mining, manufacturing and construction, transport, communication, other industries, related R&D
Environmental protection	Waste and water waste management, pollution abatement, protection of biodiversity and landscape, related R&D
Housing and community amenities	Housing development, community development, water supply, street lighting, R&D related
Health	Medical products, appliances and equipment, outpatient, hospital and public health service, R&D related to health
Recreation, culture and religion	Recreational and sporting, cultural services, broadcasting and publishing services, religious and other community services, R&D
Education	Pre-primary, primary, secondary and tertiary education, post-secondary non-tertiary education, education nondefinable by level, subsidiary services to education, R&D
Social protection	Sickness and disability, old age, survivors, family and children, unemployment, housing, R&D, social exclusion, etc.

Source: [10]

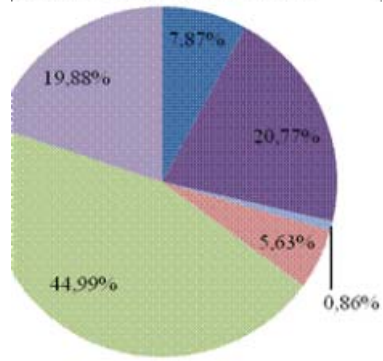
Appendix 2 Comparison of regional expenditures in 2008 and 2009

Expenditures of regions in 2008



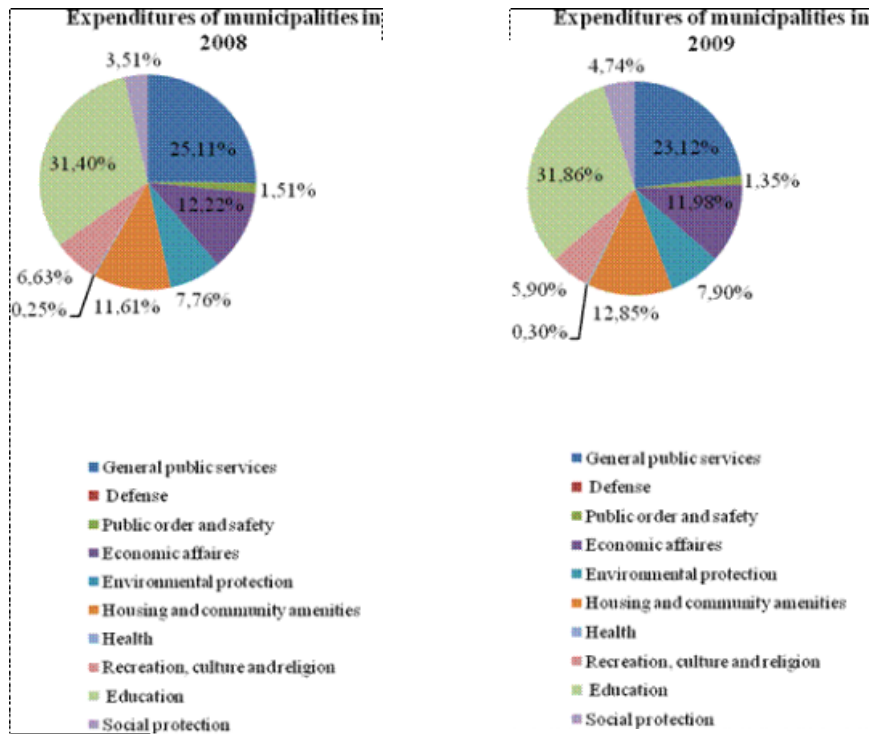
- General public services
- Defense
- Public order and safety
- Economic affairs
- Environmental protection
- Housing and community amenities
- Health
- Recreation, culture and religion
- Education
- Social protection

Expenditures of regions in 2009



- General public services
- Defense
- Public order and safety
- Economic affairs
- Environmental protection
- Housing and community amenities
- Health
- Recreation, culture and religion
- Education
- Social protection

Appendix 3 Comparison of municipal expenditures in 2008 and 2009



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