FISCAL DECENTRALISATION IN LITHUANIA IN THE CONTEXT OF EU COUNTRIES

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Abstract: *The paper analyses the key theoretical and legal aspects of the concept of fiscal decentralisation; on the basis of statistical and legal documents it examines the situation of fiscal decentralisation in Lithuania and compares the key indicators of this situation with corresponding indicators of other European Union states. The present research ascribes EU states to five levels of fiscal decentralisation according to 3 features: local taxes, expenses, and subsidies. Fiscal decentralisation is geared towards increasing financial independence and responsibility of the local self-government. However, it can have such negative consequences as corruption, greater social fragmentation and influence of various interest groups. The level of fiscal decentralisation in the state is indicated by the percentage of municipal expenses of the GDP and percentage of the total expenses of the public sector. The present research has demonstrated that fiscal decentralisation indicators are highest in the old-timer EU states (Sweden, Finland, Germany, France), which have strong local self-government and long-time democratic traditions. Lithuania can be ascribed to the countries with medium fiscal decentralisation.*

Keywords: *Fiscal decentralisation, Municipality, Local tax, Municipal debt, Subsidy.*

JEL Classification: *G38, H61.*

Introduction

Fiscal decentralisation (further - FD) theory has been analysed since the middle of the 20th c. It is a theory of great complexity, one that cannot be treated unambiguously, that is why a systemic approach and singling out key aspects are necessary. The rise of the theory of participatory budget and its practical application validates the importance of analysing decentralisation of financial resources. The theory of participatory budget is a democratic innovation striving for more efficient governance. The main aspect of this theory is citizens' participation in making decisions in the process of budget distribution. Assigning decision making to the lower levels of governance (at the same time – to the citizens) while managing financial resources is more and more emphasised not only by FD theory, but also by other theories. This demonstrates a particular importance of the phenomenon.

Practical implementation of FD in Lithuania is little investigated in the context of EU countries. Lithuania, having become a full-fledged EU member in 2004, still lags behind the most progressive EU countries in terms of the level of FD.

The aim of the present research is as follows: having analysed the main theoretical and legal aspects of FD and performed document analysis, the structure of Lithuanian and other EU states' municipal budgets, to single out the main groups of FD of EU countries and to substantiate the trends of FD in Lithuania.

1 Statement of a problem

In 1999, Lithuania ratified the European Charter of Local Self-Government in which provisions regulating financial independence of municipalities are embedded. One of the norms of the Charter states that economic policy of the state grants the right to the local authorities to have their own financial sources, which can be freely used at their own discretion within the limits of their authority. The financial system, on the basis of which financial resources available for the local authorities are dependent, is varied and flexible enough to allow them not to lag behind with the real increase in the costs of implementing their goals. Besides already mentioned provisions, the Charter states that municipalities should get the greatest amount of their income from local taxes and collections, which they are free to impose. In spite of the fact that this legal document has had the legal power in Lithuania for 15 years, the provisions of the Charter have not been fully incorporated into Lithuanian legal system. Financial authority of the 60 Lithuanian municipalities remains very limited. Despite limitations on borrowing, municipal debt in 2014 amounted to 52% of the annual municipal budget, while state subsidies accounted for about 50% of the municipal revenues (data of Ministry of Finance of RL). Municipalities are highly dependent on the state and creditors in terms of their financing. Municipality decisions regarding income and expenses remain very restricted. This determines Lithuania's lagging behind progressive EU states in terms of FD.

In order to analyse FD situation in Lithuania in the EU context, the following problem questions are raised in the present paper: what are the key theoretical and legal aspects of the concept of FD? What is the situation with FD in Lithuania and in other EU countries?

1.1 Theoretical discourse on FD

Bird and Vaillancourt [3] have provided a review of the situations with FD in developing countries. Smoke [8] analysed the benefits and negative effects of FD in developing countries, the elements of a good fiscal decentralization programme to local governments. Aristovnik [2] examined FD in East European countries, Lithuania included. Vulovic [11] researched the principles and models of regulation of municipality borrowing. Amagoh, Amin [1] analysed the impact of FD on the growth of economy. Fiorino, Galliand and Padovano [6] aimed at establishing the ways in which FD can decrease the level of corruption in the country. Martinez-Vazguez and Yao [7] has conducted a cross-country analysis on FD. In Lithuania, Davulis [4] paid most attention to the theory of FD. He mostly analysed one of the components of FD – local taxes. Among international organisations, the World Bank [10], International Monetary Fund, Eurostat [5] and Organisation for Economic Co-operation and Development (OECD) have publications dealing with the topic of FD and collect statistical data. In Lithuania, statistical data on FD is collected by Department of Statistics and Ministry of Finance of RL.

1.1.1 The concept and kinds of FD

FD as a kind of decentralisation appeared in the second half of the 20th c. It became especially prominent in Western countries, where more and more attention started to be paid to increasing the efficiency of public governance. At that time, the popularity of centralised states started to decrease, and it became obvious that decentralisation is a means of developing the system of public sector, improving provision of public services, enabling municipalities and communities to assume more responsibility for the management of local affairs, making representatives of authorities closer to the citizens and stimulating their participation in the processes of formation and implementation of public policy. In post -communist and African states, decentralisation appeared as a reaction to the authoritarian regimes and the inability of the state to provide certain services. Since 1990, decentralisation reforms have been carried out in a number of developing states, including political, administrative and fiscal aspects. Recently, FD has been getting more and more attention on the part of scientists, representative of authorities and international organisations. Such international organisations as OECD, the World Bank, African Development Bank encourage development of FD, because it strengthens participation in decision making on the level of the local government, stimulates economic development and expansion. According to the World Bank, properly executed FD can decrease political instability and increase the efficiency of the authorities [10].

Most researchers agree that FD helps stimulating the efficiency of allocation of resources, efficiency of provision of public services and greater transparency. Federal states can provide public services and goods in a more efficient way when those who make local and regional policies are closer to the people, because then their needs are better understood. FD makes the principle of allocation of financial resources on separate levels of authority meaningful [2].

Sum up the definitions of FD provided by various authors it can be said that fiscal decentralisation is a process when regional or municipal level government is given responsibility to manage their financial resources independently. The authors of the present paper adhere to this definition.

1.1.2 The structure of FD

Fiscal decentralisation is divided into distribution of expenses, distribution of taxes, borrowing mechanism and distribution of subsidies.

Distribution of expenses. According to Davulis [4], the share of municipal expenses in the GDP and in the national budget is the main criterion of decentralisation. Municipal expenses are divided into four groups: 1) consumer expenses, including wages for the state sector (municipal) employees and expenses for the goods acquired by the municipality; 2) municipal investments: these are various capital expenditure, for instance building roads, ports, etc.; 3) transfer payments for the private sector – these are payments for which municipality doesn't receive goods or services directly (e.g., pensions, unemployment reliefs, subsidies for companies, etc.); 4) municipal debt interest.

Distribution of taxes. Taxes paid to the municipal budgets have recently been referred to as 'local taxes' in research literature. Davulis [4] describes them as follows: "monetary payments made by legal entities and natural persons, set by the national law that are universally binding and individually unrequited and irrevocable and are credited to the municipal budget in order to get municipal revenues necessary for the financing of public needs". According to Davulis [4], it is local taxes that are one of the main conditions of FD. Conferring all or most of the taxation powers to the state authorities is inefficient because of the gap that appears between the expenses and income in the lower level of governance, while financial independence and responsibility of local authorities is restricted. On the other hand, conferring particularly big taxation autonomy to the lower level of governance can be inefficient in terms of macroeconomic stability and redistribution of public resources. In order for the local authorities to receive enough funds to finance their functions, the European Charter of Local Self-Government states that "local authorities get at least part of their financial resources from local taxes and collections, the amount of which is determined by themselves according to the law".

Research literature [4] singles out some criteria depending on which taxes are allocated to either state or municipal budgets: 1) taxes generating most revenues should be allocated to the state budget; 2) the base of taxes that are allocated to the municipal budgets has to be evenly spread across the territory and easily established; 3) local taxes should be easy to administrate and correlate with the benefits for the local population. This correlation stimulates tax payers to pay taxes voluntarily and correctly.

According to the World Bank, while distributing taxes, three very important criteria should be taken into consideration: 1) sources of municipal revenues should be linked with the services provided by municipalities. Functions requiring large resources should be financed via the system of subsidies; 2) it is necessary to establish the degree of autonomy of local authorities, i.e., to define the powers of municipalities in setting the tax base, tariffs, and administration of revenues; 3) it is important to evaluate the efficiency of the increase of income on all the levels of authority with regard to administrative skills and economic trends [10].

Borrowing mechanism. During the last 20 years, a lot of municipalities in East and Central European states were given an opportunity to borrow on the basis of certain rules meant to safeguard municipalities from too heavy financial burden and ensure that they borrow only from reliable sources. To assess the independent borrowing potential, the borrowing autonomy index is calculated, the methodology of which was proposed in 1997 by the Inter-American Development Bank [10].

Distribution of subsidies. State subsidies are meant to finance functions assigned to the municipalities or to compensate the lack of necessary funds. According to Davulis [4], state subsidies can be allocated directly as general or target subsidies or via distributive tax mechanism. In the case of distributive taxes, one part of taxes is allocated to the state budget, and the rest is given to the municipal budget.

The World Bank, while analysing the component of financial transfers, singles out three main principles of a good system of subsidy distribution: 1) the system has to have a clear aim, it has to be transparent, stable and predictable; 2) the system has to be just in solving the problem of a vertical dis-balance between different levels of authority; it has to implement a compensation mechanism in order to solve regional differences problem; 3) the system has to stimulate local authorities to make right decisions [10].

Different states have different subsidy distribution systems. They depend on the possibilities of municipalities to independently collect financial resources to implement their functions.

In general it can be stated that singling out the components of FD theory remains problematic. Researchers suggest different structural parts of FD, thus making this theory of public finance even more complicated. However, the review of research literature on the question allows stating that the main components of FD are distribution of taxes, distribution of expenses, borrowing mechanism, and distribution of subsidies. It is these structural parts that are analysed in the present paper.

2 Methods

In the theoretical part, comparative analysis of research literature and generalisation methods were employed. For the analysis of the situation of FD in Lithuania and other EU states the methods of document analysis, analysis of legal documents, statistic data analysis, case study and contrastive analysis were used. Statistical data were analysed for each component of FD separately. The research examines statistical information of all 28 EU countries; however, information concerning Lithuania is analysed in more detail.

3 Problem solving

Most EU countries are unitarian countries with two levels of governance: state and municipal. Only 3 countries (Germany, Austria and Belgium) out of 28 are federal states with three levels of governance, including the federal one. As is demonstrated by EU experience, in bigger countries with the three levels of governance or with large territories and greater numbers of population, those that stayed in the EU for a longer period, FD has a deeper tradition in managing public finance in comparison with the smaller unitarian states that joined the EU in 2004. Besides, in states with high levels of income and strong economies FD indicators are higher.

This section analyses the main components of FD in Lithuania and other EU states described in the first section: distribution of taxes, distribution of expenses, borrowing mechanism, and distribution of subsidies. On the basis of this analysis, FD groups of EU countries were singled out and FD trends for Lithuania were substantiated.

3.1 Legal regulation of FD

A common legal document for all EU states regulating financial rights of municipalities is the European Charter of Local Self-Government. This Charter is an international convention, prepared in 1985 by the Congress of Local and Regional Authorities, established by the European Council. It came into force in 1988. Lithuania, when joining the European Council (1993), obliged itself to sign and ratify this Charter. The document was ratified by Seimas of the Republic of Lithuania without reservation in 1999. By ratifying the Charter, Lithuania committed itself to coordinate the laws regulating local self-government with the provisions of the Charter and to adhere to the norms set by the document. The European Charter of Local Self-Government has the force of law in Lithuania.

However, not all the principles of the Charter have been transferred to the national legal documents, although more than 15 years have passed since the ratification. One of the principles established in the Charter is economic and financial independence of municipalities, set in Article 9. This principle means that municipal institutions in order to carry out functions ascribed to them by the law, have to have their own financial resources, i.e. a budget. The formation of municipal budgets is regulated by Article X of the Law on Local Self-Government of the Republic of Lithuania; however, practical possibilities of municipalities in forming their budgets are limited. Article 9 of the Charter states that “local authorities get at least part of their financial resources from local taxes and collections, the amount of which is determined by themselves according to the law”. In Lithuania, municipal councils can set the tariffs only for the land and real estate as well as tax exemptions, thus the mentioned principle is not fully implemented. Besides, Lithuania doesn’t have any tax statutes. Article 9 of the Charter also states that “Financial system <...> is sufficiently varied and flexible, so that it doesn’t allow them to lag behind the real rise in the costs of implementing their goals”. In Lithuania this provision is also not fully implemented, because municipalities, while collecting funds into their budgets, are strictly limited by the law.

The most important internal document of the state, in which the financial and tax systems of the state are embedded, is its Constitution. Section X of the Constitution of the Republic of Lithuania “Local Self-Government and Governance” is dedicated to the constitutional regulation of local self-government. Article 121 of this section states that municipalities form and approve their budgets and can establish local collections, but it doesn't give the municipalities the right to determine local taxes and their tariffs, because this function is given to Seimas. Municipal councils can only set tax exemptions at their own expense. The conditions for these exemptions are set every year by the municipal council.

Most EU states have principles of local tax embedded in their constitutions. Constitutional regulation of local taxes gives an opportunity to collect major part of funds necessary for the implementation of their functions; it ensures sufficient financial autonomy and independence from the central government.

Germany has the most detailed constitutional regulation of local taxes. Its Constitution states not only what taxes go to which level of governance but also provides tax distribution principles. Germany is in this respect one of the most exemplary countries in the whole EU. Among the three Baltic states it is only in Estonia that municipalities have the right to independently set and collect taxes. In Latvian Constitution there is no section dealing with constitutional regulation of local self-government. Ireland and Croatia don't have this regulation either.

In every EU state the processes of FD are regulated by the national law and other legal documents. In Lithuania, the following main laws determine the regulatory mechanisms coordinating financial matters between the state and municipalities: the Law on Local Self-Government, the Law on the Constitution of the Budget, the Law on Tax Administration, the Law on the Municipal Budgetary Revenue Estimation Methodology, the Law on Approving Financial Indicators of State and Municipal Budgets.

3.2 The structure of municipal budgets in Lithuania and other EU countries

For the analysis of municipal budgets of Lithuania and other EU countries, data of Eurostat [5], World Bank [10], International Monetary Fund, Department of Statistics of Lithuania [9], Ministry of Finance and the data of statistical websites of other EU countries were used.

3.2.1 Tax distribution

According to Article 22 of the Law on Local Self-Government of Republic of Lithuania, municipal budget revenues consist of tax income, non-tax income and state subsidies. Between 2008 and 2014, state subsidies in average accounted for 50%, while tax income for about 45% of the budgets of all 60 municipalities of Lithuania. Non-tax income, generated by municipal assets, municipal institutions, local collections, and fines made up only a small percentage of 3-7%.

The analysis of the structure of municipal budgets of other EU countries reveals various trends. Most tax income to the municipality budgets comes in EU old-timers. In 2008 in Sweden municipalities got 64.8% of their budget income from taxes. This is the highest indicator among the EU countries. In France and Spain tax income accounts for about 50% of the budget income, in Germany slightly over 40%. Among the Baltic states, Latvia collects most income to its municipality budgets from taxes, and Lithuania collects least. In Malta almost all municipality income comes from state subsidies. The share of tax income in municipal budgets in Holland, Romania and Greece is also insignificant.

The main revenues from tax in Lithuanian municipal budgets are income tax, real estate tax and tax on land. Between 2008 and 2014, income tax accounted for about 75% of the municipal income in all 60 municipalities of Lithuania, and this made up about one-third of all municipal revenues.

The next most important tax is real estate tax, paid by those whose assets are above 220,000 EUR. Although in 2014 this tax accounted only for 7.5% of the municipal revenues, Municipal councils can set the tariffs for this tax within the limits prescribed by the law. The tariff fluctuates between 0.3 and 3%, depending on the value of the property.

Since 2013, municipal councils have the right to establish the tariffs on the tax on land between 0.01% and 4% with regard to the land use. Before that, tariffs in all municipalities were the same (1.5%). Having this fact in mind it can be stated that Lithuania is gradually moving towards greater financial independence of municipalities in taxation issues. On the other hand, municipal councils are getting more powers in collecting those taxes that account for a very small share in the budgets.

3.2.2 Distribution of expenses

The share of expenses in self-government shows the level of decentralisation, the importance of local self-government in the state and the number of functions performed. The Law on Local Self-Government in Lithuania differentiates between independent, state functions and those of local government, public administration and provision of public services. Recently the number of municipal functions in Lithuania has been constantly increasing, e.g., since 2014 all municipalities have the right to distribute social benefits.

It can be stated that the greater part of expenses is allocated to municipalities, the more important is local self-government. On the basis of Eurostat data of 2013, the highest level of expenses on the level of local self-government in comparison with the national GDP was in Denmark (37.5%), Sweden (26.0%), and Finland (23.9%). The situation in these states was similar between 2009 and 2012. The lowest level of expenses on this level in 2013 was in Malta (0.8%), Cyprus (1.7%), and Greece (3.4%). In Lithuania the percentage is also low N – 8.4. It can be stated that the level of FD in Sweden, Finland and Denmark is higher than in Malta, Cyprus and Greece. General average in EU countries in 2013 was 11.6% of GDP, i.e. slightly over one- tenth of expenses of the public sector was on the level of local self-government.

In Lithuania, municipal subsidies are allocated according to functions of the state. Most subsidies go to the spheres of education and social security; e.g., in the largest municipalities in 2015, the following was allocated to education: in Vilnius 47.2%, in Kaunas – 51.6%; for social security in Vilnius – 17.5%, in Kaunas – 17.7% of the municipal budget. While the national budget of Lithuania for 2015 according to the functions of the state is predominated by economy – 24.6%, followed by education – 18.7%, general services of the state – 16.7%, and social security – 13.3%. It can be said that education and social security are given relatively more funds in the municipal budgets. However, in 2014 local government expenses accounted for only 22.8% of the total governance expenses. That is why it is obvious that a much greater share of subsidies for education and social security comes from the state budget.

3.2.3 Borrowing mechanisms

A borrowing mechanism allows municipalities to finance their functions when there is a lack of funds. Lithuanian municipal debt is increasing: in 2009 it was 31.6%, while as of April 1st 2015 it was 52.3% of the total amount of all municipal budgets. The increase has been largely determined by the debt of major municipalities. Here Vilnius municipality is the leader, its debt in 2015 accounting for 39.5% of all municipal debts. The second biggest debt is that of Kaunas municipality, and it accounts for only 8%, Klaipėda municipality debt is 4.2% of the total municipal debt.

Most municipalities started borrowing in 2004, when it became possible to finance projects from EU funds. According to the Law on the Structure of the Budget of RL, municipalities can take long and short-term loans. Long-term loans account for most municipal debts. It is these loans that are aimed at financing EU investment projects in municipalities.

The Law on Approving State and Municipal Budget Financial Indicators, approved for every budget year, foresees municipal borrowing limits. In 2015, it was the average of 4.3% of the total municipal revenues, which fluctuates for separate municipalities between 0% and 15.4%. Besides, the total amount of municipal debt cannot exceed 75% of the annual municipal income. Exception is made only to Vilnius municipality – it should not exceed 120%; Vilnius municipal debt in 2015 makes up 116.6% of the annual municipal income.

In most EU countries, a "golden rule" applies, which means that municipalities are allowed to borrow only to finance their main expenses. In some EU countries, municipalities are more independent than those in Lithuania in making decisions regarding borrowing. In Sweden, these administrative units are completely independent in deciding the necessity to borrow, the way of borrowing and the choice of creditors. They do not need state approval and there are no legal restrictions. Municipality meetings decide upon the limits of borrowing themselves. Similar processes are typical of self-government institutions in Germany, the UK, and Finland. In Lithuania, strict requirements and concrete limits are set for municipalities. Municipal councils have little influence in making decisions regarding borrowing. That is why it can be stated that borrowing opportunities of municipalities in Lithuania can be ascribed to the model of centralised discipline and control. In Slovenia, Romania, and Portugal, the authorisation of municipalities to borrow are most limited.

The debt of Lithuanian central government as of 31st May 2015 was 36.6% of the expected GDP for 2015. According to this indicator, Lithuania's debt is one of the smallest in the EU. The debt of municipalities accounted for only 4.7% of the national debt. Besides, foreign debt of the central government made up 79.1% of the total amount of debt, while foreign debt of municipalities accounted only for 9.3% of the total amount of the municipal debt.

As can be seen from Eurostat data for 2013, in comparison with the central government debt, relatively largest municipal debt is in Italy, France, and Holland. Although Greece has the largest national debt among the 28 EU countries (about 175% of GDP), local debt accounts only for a few percentage. Lithuanian national and local institutions' debt in the context of EU is small, although national press often criticises municipalities for running into too much debt.

3.2.4 Distribution of subsidies

Subsidies are allocated to municipalities to perform their state functions. The greater the share of subsidies in the local budget, the more dependent the municipality is from the central government. Since subsidies and taxes make up almost all municipal budgets, the less the municipality receives from taxes, the more it has to get in the form of subsidies.

In Lithuania, subsidies for municipalities are approved annually on the basis of the Law on the Approval of Financial Indicators of State Budget and Municipal Budgets.

Lithuania, according to the share of subsidies in municipal budgets (30-60%) is a state with average decentralisation, the same as Latvia, Estonia and most EU countries. High level of decentralisation (with subsidies in municipal budgets below 30%) is in Sweden, Austria, Finland and Slovakia. Low level of decentralisation (with subsidies in municipal budgets above 60%) is in Greece, Bulgaria, and Hungary. In terms of the types of subsidies, general purpose and target subsidies predominate in the EU states.

The system of allocation of subsidies has certain specificity in each EU country. It depends on the size of the country, the number of the levels of governance and other indicators; however, the share of subsidies in municipal budgets very much depends on the level of financial independence of municipalities.

4 Discussion: groups of fiscal decentralisation of EU states

It is very difficult to establish exact indicators of FD due to the specificity of every EU country. Three main indicators of FD have been singled out: 1) the share of local taxes in municipal budgets, 2) the percentage of municipal expenses of the total governance expenses, 3) the share of subsidies in municipal budgets. Since the share of local self-government institutions' debt in comparison with national debt is small in all EU countries, the percentage of municipal debt of the total national debt was not included.

Every indicator was subdivided into three categories: low, moderate and high level of the manifestation of the indicator. When tax indicator in municipal budget is up to 20%, the state is ascribed to the low category, between 20 and 40% – to moderate, and over 40% – to high. Such grouping was chosen with regard to the fact that the highest level of taxes in municipal budgets is slightly over 60%. When the percentage of municipal expenses of the total governance expenses is up to 20%, the state is ascribed to the category of low level of FD, when it is between 20 and 40% – to moderate, and when expenses are over 40% – to high level of FD. When subsidies for municipalities are up to 30%, the state is considered to have a high level of FD, when they are between 30 and 60% – moderate, when subsidies are over 60% – low manifestation of FD indicator.

With regard to such categorisation of FD indicators and other available information on fiscal statistics in EU countries, three FD groups of EU states were singled out and presented in Table 1. Two medium variants were also singled out for those states whose FD indicators belong to different decentralisation groups.

Table 1: Groups of fiscal decentralisation of EU states

Group	Low level of FD	Medium variant I	Moderate level of FD	Medium variant II	High level of FD
Description	States with low level of the share of taxes, low level of expenses and high level of subsidies in municipal budgets.	Most states have low level of the share of taxes, medium level of expenses and high level of subsidies in municipal budgets.	States with moderate indicators of taxes, expenses and subsidies.	Most states have high level of the share of taxes, medium level of expenses and medium level of subsidies in municipal budgets.	States with high level of taxes, high level of expenses and low level of subsidies in the municipal budgets.
States	Greece, Malta, Ireland	the UK, Holland, Romania, Bulgaria, Hungary, Luxembourg, Portugal, Belgium, Cyprus, Slovakia, Croatia	Lithuania, Poland, Slovenia, Denmark	Estonia, Italy, France, Latvia, Spain, Czech Republic, Germany, Austria	Sweden, Finland

Source: Data of statistic websites of EU states

In general it can be stated that most EU states have a low or moderate level of FD. High level of FD is only in Sweden and Finland. Having analysed statistics of many years we can argue that fiscal policy in Lithuania is geared towards decentralisation, i.e., the level of its FD is going up.

Conclusion

Fiscal decentralisation allows reforming the system of public sector and developing local self-government, because responsibility for managing public resources is delegated to the institutions of the lower level of government. Often FD is associated with distribution of taxes and expenses, the mechanism of borrowing and the system of state subsidies. FD has the greatest impact on the provision of public services and goods and increasing the responsibility of the institutions of local authorities.

The common legal document on FD for all EU countries is the European Charter of Local Self-Government. Legal acts of each EU state regulate taxes received by the municipalities, distribution of expenses, borrowing specificity and the system of subsidies in detail. In order to provide municipalities with more authorisations to solve financial issues independently, it is necessary to develop relevant legal acts.

The level of FD in a state is demonstrated by the percentage of the municipal income of GDP and the percentage of expenses of the total public sector expenses. These indicators are largest in EU old-timers.

The municipal debt in Lithuania in the context of EU countries is relatively small. In recent years Lithuanian municipal debt has increased due to co-financing of EU investment projects.

The greater the share of subsidies in the budget, the more dependent municipalities are on the central government. The analysis of the budgets of EU countries shows that subsidies is the main source of income in Malta, Greece, Bulgaria, Hungary, Romania, and Ireland. In Lithuania, subsidies in municipal budgets recently account for about 40–50% of municipal revenues.

FD indicators are highest in EU old-timers (Sweden, Finland, in most part –Germany and France), where local self-government is strong and democratic traditions have been nurtured for a long time. Lithuania can be ascribed to the countries with a moderate level of FD.

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