Optimization of the Local Government Decision, Case of Basic Budget

Māris Pūķis, Jānis Upenieks

University of Latvia

Problem

- Budget in all systems, based on representative democracy used to be decided by representative body (Local Government Council)
- In some cases codecision is used (other elected or executive bodies)
- Theoretically budget as distribution of public resources needs optimization, which is finished by voting
- Problem of this research:

What stages of budgetary procedure allowe applying of optimization ?

Zero budget and Basic budget

- Zero budget is expression of rational policy
  - For annual budget be used only in crisis situations and in very simplified way (Latvia, annual budget of 2010)
  - Could be used for multi-annual budgets (example – EU 7 years budget)
- Basic budget is expression of incremental policy
  - Small improvements in the previous year policy

Basic budget procedure consists of 5 stages:

1)preparation of the new policy initiatives in the form of projects proposals;

2)collecting proposals for sectors in the limits of budget basis;

3)prognosis of revenues and finding of the fiscal space for the new policy initiatives;

4)choose among new policy initiatives in the Budget and Finance Committee (purchasing among factions about interest groups priorities);

5)council meeting about budget with the step by step voting about each proposal.

Optimization in 1st stage

- Departments and other executive structures prepare projects:
    - Based on policy documents
    - Predicting influence on performance indicators (impact, outcome and output) from policy documents
    - Choice between several alternatives
    - Taking into account legislative restrictions

Sources of the new policy initiatives (projects)

- Pressure of the interest groups
- Pre-election programs of ruling coalition
- Long term and middle term development programs
- Commands from national and EU level
- Beliefs in the values and theories
- Initiatives of local government bureaucrats

Fiscal space

- FS – fiscal space
- NR – predicted net revenues (taxes, fees, revenues from payed services, transfers from other budgets etc,…)
- BE – basic expenditure (maintenance expenses)
- ND – expenditure for LG functions and CG tasks, which starts in next year according the legislation
- CF – co-financing, necessary for projects started in previous years (example – EU funded projects)
- DEF – allowed budget deficit

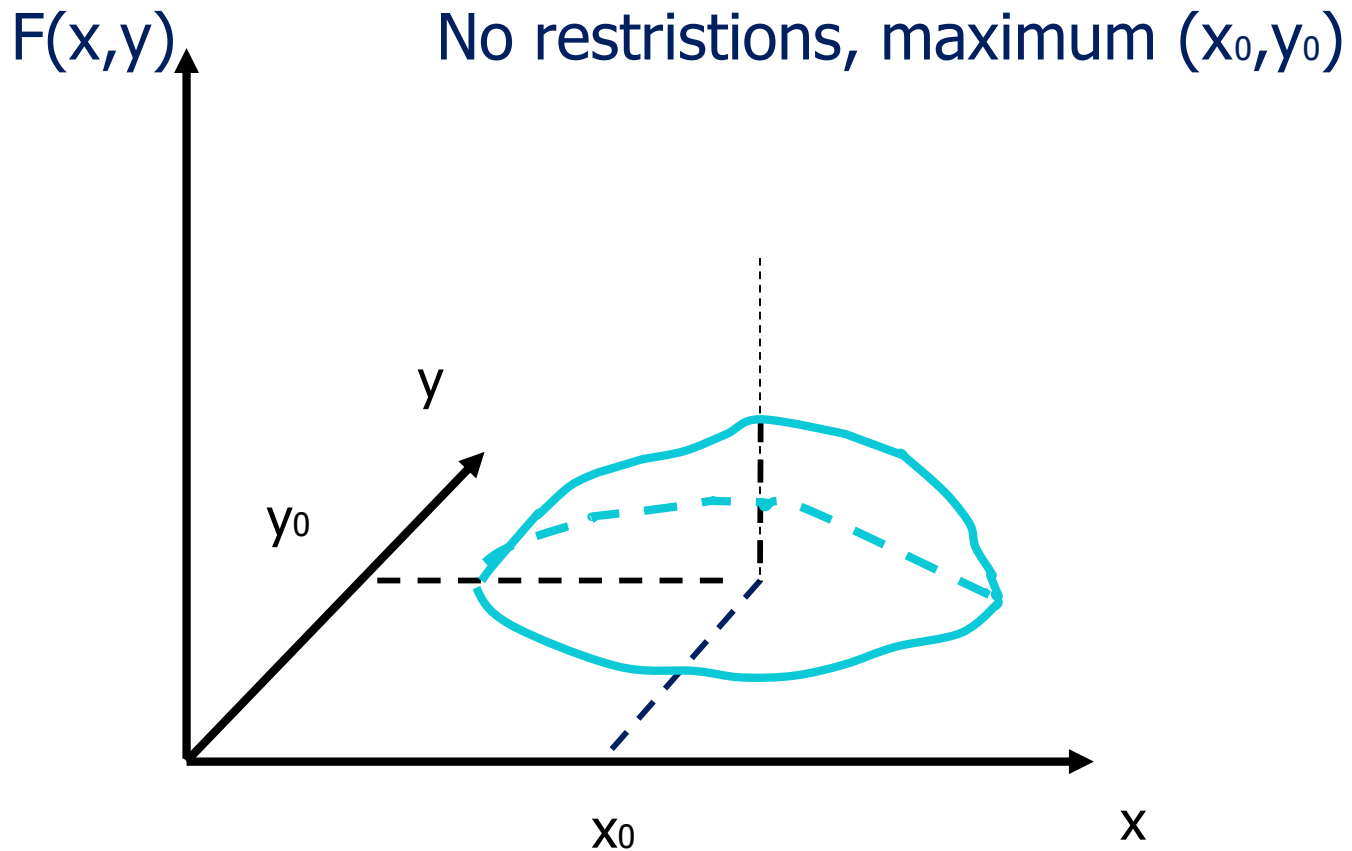$$FS = NR + DEF - BE - ND - CF$$

Choice among projects

- Set of S projects, candidates for acceptence:
$$\{P_1, P_2, ..., P_S\}$$

- Set of expences
$$\{F_1, F_2, ..., F_S\}$$

- Optimization – choice of K projekts (smaller subset) in order to

  - Utility (Public Good) will be maximal
$$G(P_1, P_2, ..., P_K) = max$$

  - Sum of expences shall be less than fiscal space
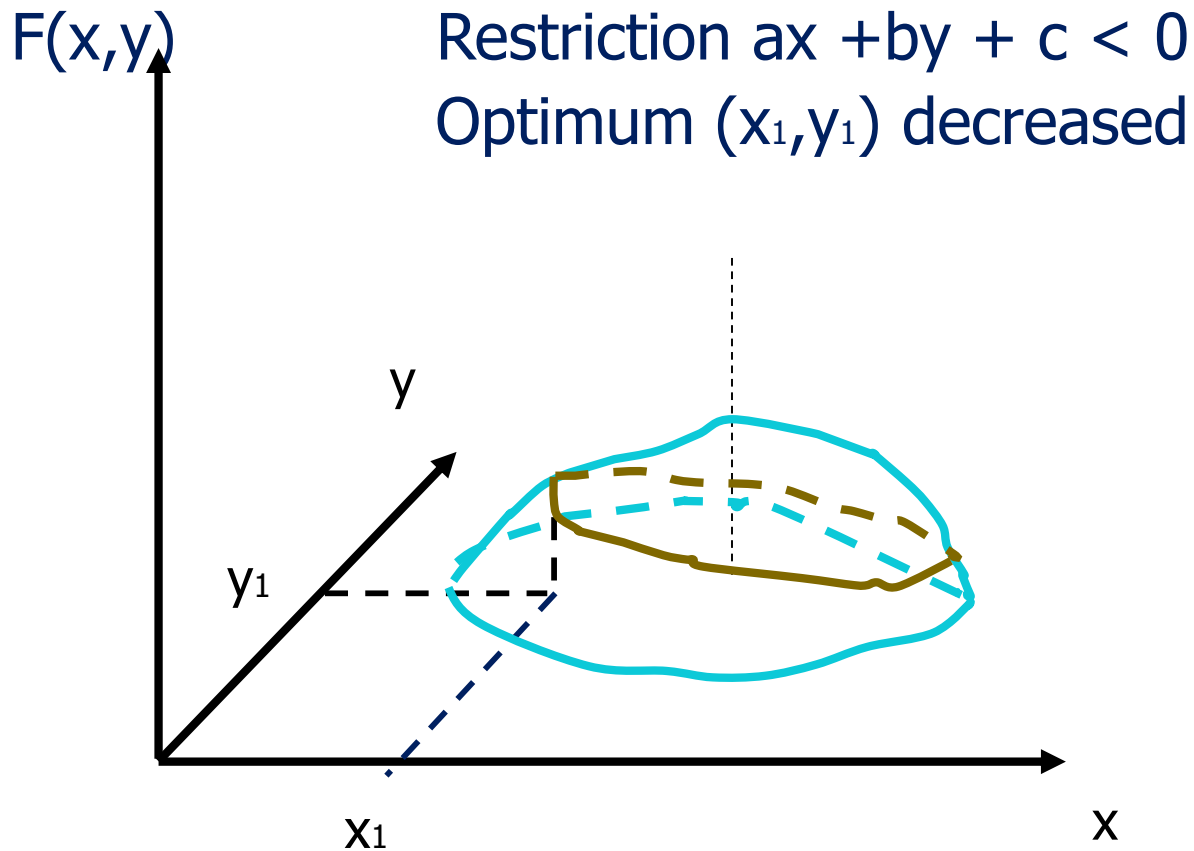$$F_1 + F_2 + ... + F_K \leq FS$$

Political purchasing in the Committee of Budget and Finance

- Pressure groups are supported by factions and by councillors in the internal discussions among members of factions
- In the role of pressure group can be secoral ministries of central government
- Optimization, performed on the basis of rationally determined public good, can be argument during political purchasing
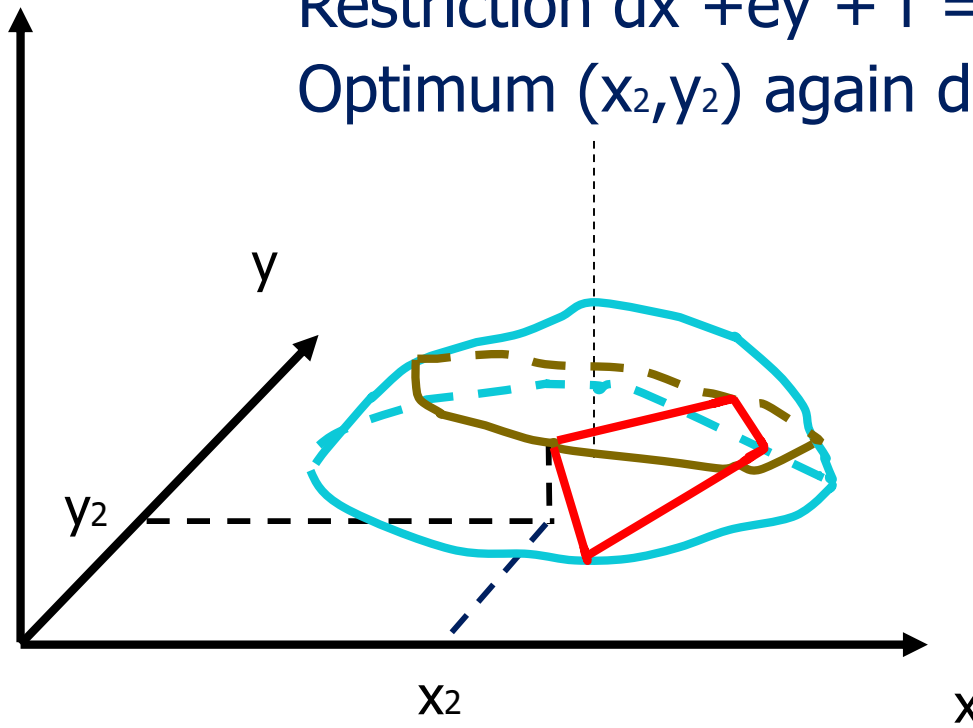
Optimization without restrictions

No restrictions, maximum (x_0, y_0)

$F(x,y)$

y

y_0

x_0

x

One restriction in the form of inequality

F(x,y)

Restriction ax +by + c < 0
Optimum (x_1, y_1) decreased

y

y_1

x
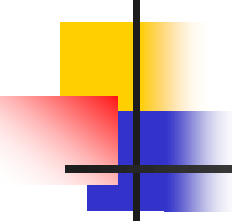
x_1

Two restrictions

F(x,y)

Restriction ax +by + c < 0

Restriction dx +ey + f = 0

Optimum (x_2, y_2) again decreased

y

y_2

x_2

x

Over regulation leads to mission impossible

- In practice it happens each year
- Fulfilling of all autonomous functions and all delegated tasks, imposed by new legislation, is impossible, if strongly fulfil normatives
- Until over regulation will take place, rule of law is mission impossible

Main restrictions

- Impact is discutable – partly positive, partly negative:
  - Social beliefs
  - Public procurement procedures
  - Consultations with society procedures
  - Competition policy
  - Environment protection
  - Decreasing of local decisions flexibility

Thank you for attention

- maris@lps.lv
- janis.upenieks@lps.lv