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### **LOCAL GOVERNMENTS BUDGETING: A PORTUGUESE ANALYSIS OF CENTRAL DEPENDENCY**

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## **Abstract**

The most recently challenges in Public Management are felt in several countries, which lead to the appearance of a set of innovative initiatives in the field of the Public Administration. This concept, more or less global (kellt, 2001), of administrative reform is known as the New Public Management and appears with the goal to improve the efficiency, the effectiveness and citizen satisfaction in public services. Is mainly based in the introduction of market type mechanism and the adoption of private management tools. It promotes the competition between public and private agents in order to succeed an improvement in service quality, at the same time that it reduces production costs (Hartley, Butler e Benington, 2002, p. 388).

According to NPM models presented by Ferlie, Ashburner, Fitzgerald e Pettigrew (1996) that takes into account that there isn't a clear definition of what it's the NPN, the agenda of administrative reform in Portugal, is base on the two first's models. It's settled in politic of budgetary restriction, decentralization and atomization of Public Administration. Although it's autonomy, the local governance also is affected by theses options of Central Administration.

If in the countries of Anglo-Saxon origin, the model of reform of local power, it's based in the adoptions of specific programs of management as the *Compulsory Competitive Tendering*, o *Best Value*, in Portugal the reality is different. The administrative modernization was made mainly by changes in the administrative organization and in the transfer of power between the different levels of Portuguese Public Administration, rather than by the implementation of specific management programs of modernization. This is due to the classic/continental administrative model which still is the Portuguese administrative mainframe. Reforms nowadays are still being implemented through financial legislation as a way of Central Administration spread reforms ideology to Local Governments.

The local administration stars to win relative importance after 24 of April of 1974. This level of administration is characterized by autonomy and decentralization principles. Actually, this local power is guide by a new law of local financial. It's relevant to analyse and debate the consequence of this new law and understand it's proposed in a NPM reform context. This paper is based on a Master project and it seeks this objectives. This constitutes a challenge to analyse in comparison with the others the degree of bigger centrality and/or autonomy that the same ones reflected.

## **Perspective of Change in Public Administration**

The last decades of twentieth century, represented an enormous challenge to the public sector management in the most developed countries. The administrative changes appeared in different contexts to solve similar problems, with complementary strategies.

From all these changes the concept of New Public Management arises, identifying an emergent paradigm in Public Administration. The New Public Management (NPM) as a management model is difficult to be correctly defined. Even the academic community is divided when considering or not the NPM as a true management theory of Public Administration (McLaughlin, 2002) denomination, although, allow us to identify all efforts made over the last few decades of twentieth century to modernize and to reform Public Management Model. To Hood (1991, p. 4) and Lane (2000), it's an international movement based on the reaction to the dissatisfaction adopted by the management model of Welfare State and in the increasing tax burdens over the citizens. The objective is to improve efficiency in Public Administration and to adjust it's reality to the information era, in other words, to move on the bureaucratic paradigm (Gray & Jenkins, 1995, p. 76). NPM is based on the introduction of market type mechanisms and the adoption of private management tools to solve the problems of Public Administration. It promotes the competition between suppliers of public goods and services in the expectation of an improvement of the service delivery for the citizen (at quality level) and, at the same time, a reduction of production costs (Hartley, Butler, & Benington, 2002, p. 388).

Hood (1991) presents us the different dimensions of analysis and changes that characterize the NPM and the paradigmatic change in Public Administration. A concern for the financial control is denoted through the reduction of the expenditures, the professionalization and decentralization of the Public Administration. Moreover, it also seeks the use of new management tools (to rethink and to improve flexibility in contracting staff and the budgetary system) and to control and evaluate the management by the results and not only for the processes.

The introduction of the NPM carries out the decentralization of public units, the reorganization of management processes, the redefinition of organizational objectives and a higher concentration on customer satisfaction (Denhardt & Denhardt, 2000, p. 550). NPM intends to transfer the power to the managers of each administrative agency and to cease the hierarchic dependence relations within other levels of Public Administration. The bureaucratic control was substituted by a new system of auditorships. The creation of new independent regulating organisms for each one of the liberalized markets is needed (Hood, James, Jones, Scott, & Travers, 1998).

**Figure 1 - The New Public Management**

<b>Doctrine</b>	<b>Meaning</b>	<b>Justification</b>
1. Professional Management	Public Manager with freedom to act	The Responsibility needs managers perfectly identified
2. Performance Measures	Definition of performance Indicators	Responsibility and efficiency
3. Output Control	expenditures and rewards linked to performance	Focus on achievements not in process
4. Fragmentation of Public Units	Creation of more flexible and decentralized units	Use of contracts between public units and private ones
5. Competition in Public Sector	Liberalization of the use of contract mechanism	Rivality make lower cost
6. Use of Private Management Tools	Freedom to punish inefficiency and reward effectiveness	Better Management seizing market opportunities
7. Discipline in Management	Cut back in cost and raise of productivity	Need to do more with less

Source: Adapted from Hood 1991

This theory of public management reform challenges some organizational purposes, used in Public Administration. Although, having a high level of stability and there for hardly substituted for others, the principles of the self-sufficiency, direct control, political accountability and the coordination by processes standardization are affected and suffer mutations that transform the face of Public Administration (Stewart & Wlash, 1992).

First, the self-sufficiency estimates that the Public Administration while one solid organization, can give efficient answers to all citizen's requests. So, administrative structures had been created, in the direct dependence of politician power, with the mission to satisfy the collective necessities. Thus, these organizations spread beyond the central services offices, also having local executive services as a way to cover all territory needs. Although this apparent multiplicity of agents with responsibilities in public services, the fact is that in all the cases we're dealing with Central Administration integrated in the different ministries. As a consequence, Public Administration is as a heavy structure of formal communication, where orders normally flow from top to bottom. The NPM purpose a course of action based on the creation of agencies and the fragmentation of public units<sup>1</sup>. This can be done in two dimensions. One through the decentralization, higher autonomy and specialization of public organizations, another, through the act of contracting out as a market agent capable to produce efficiency and improvement of service.

Second, direct control implies a relation of hierarchy and/or political dependency between the promoter and the producer of goods and services. Acting as an all unit, politicians use legitimately their hierarchic powers to emit orders, to revoke decisions and to sanction public servants. In many cases the standardization by processes and by

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<sup>1</sup> Mostly based on the assumption that that's a good solution to the efforts of better efficiency

qualifications is the method more suitable to co-ordinate and to control the activities developed in organizations with the dimension and stability of the Public Administration (Mintzberg, 2004). With the introduction of new actors (private and the third sector) as well as with the atomization of the public units, hierarchic power is substituted by contracts regulations. Thus, the power of the politicians is created by the celebration of the contract and is limited to the terms in it was written.

Third, the political accountability is based on the fact that acting under the same organization, the responsibility over the action of the Public Administration falls on the politician's sphere. The proliferation of contracts allows a change in the traditional accountability. Nowadays it's made by multiplied actors in different terms. Politicians continue to have a responsibility to evaluate the performance of the contracted agent, however they do it on behave of the contract terms. This responsibility, to control the contracted agent, is now also shared with the citizens who are invited to have an active paper in the evaluation of the performance of the consumed public service.

Fourth, the formal coordination through a hierarchic mechanism of government implies a high level of formalization. It is associated with authority and domination from the top management to the remaining elements of the organization. It seats on the distribution of responsibilities and the establishment of direct lines of control. Top-down formal structure of communication is created to allow each element to know what it expects of him, at what time in what way. NPM implies others mechanisms of governance. One made through market mechanism where the coordination is based on the natural competition between the agents. The self interest leads to the coordination of efforts (Bradach & Eccles, 1991). And another through networks with the creation of partnerships between actors in order to create permanent interaction between agents. This will promote an integrated mechanism of decision making, combining complementary competences.

## **MODELS OF NEW PUBLIC MANAGEMENT**

As we said before, NPM produces different impacts in several dimensions of traditional management. As an aggregation of experiences of administrative reform it's natural that the NPM has different consequences or impacts in each country, mostly in spite of each socioeconomic reality, and each administrative and cultural system used. Ferie, Ashburner, Fitzgerald and Pettigrew (1996, p. 10) suggest us four different models of NPM (or if we want four moments of evolution).

### *MODEL 1 –STRESS ON EFFICIENCY*

This model assumes a negative vision on the previous model of Public Administration (bureaucratic model of the constructed Professional Administration during the Welfare State), considering it as a model without alternatives to motivate the workers, too much expensive and with an exaggerated level of bureaucratic procedures. The main objective is an economic and financial equilibrium of Public Administration, obtained through the

introduction of private management initiatives is a way that the public sector will be more similar to the private.

In this perspective, the administrative reform has as objectives, to guarantee an effective costs saving through the control and financial situation. So, it's necessary to use a portfolio of management mechanisms. The bureaucratic mechanisms of control are replaced by external auditorships procedures with the purpose to evaluate the efficiency of public money use; Definition control and monitorization of organizational objectives centralized in top management; the flexibility of legal labor relationships;

This phase of NPM sometimes reveals itself, a too economist view, proceeding to blind cut backs, stopping investment expenditures that could help economic growth and development. However, it has the virtue to control public expenditures. Nevertheless, Public Administration still was too big and too slow when answering to external challenge.

#### *MODEL 2 – FOCUS ON DECENTRALIZATION*

There is an attempt to invert the logic followed until the decade of 70 in constructing organizations that promoted vertical integration. NPM suggests a transformation within Public Administration towards the construction of more flexible and orientated to specific missions units. The bureaucratic organizations give place to new agencies with the capacity to adapt and to identify itself to different and more challenging environments, respecting the interests of the users whom they intend to serve.

Therefore, this model provides the appearance of organizations with lower dimension favors the specialization in production, frees the government from the responsibility to produce public services. The fragmentation of public sector and the liberalization of its market has allowed the competitiveness of new agents, with the objective of increasing efficiency to citizens. It allowed, with the use of contracts, a greater and better control over agencies. However it was necessary, after the financial equilibrium and the use of market type mechanism under a organizational revolution, to give the next step towards quality in public management.

#### *MODEL 3 – IN SEARCH OF EXCELLENCE*

While the previous models of reform had focus on internal aspect of the Public Administration organization, next will focus on the citizens satisfaction and his part on public management. To promote this kind of change we must understand the need to modify management process as well as ethical values and believes of public servants. Which is the same as to promote the organizational development.

The administrative modernization is seen as processes that cannot be performed top-bottom, but it need to be a desired process by all the elements of the organization. The changes have to be presented and accepted by all employees in order for them to understand its need and importance. The organizational culture is considered to be stronger than any hierarchic control.

It is in this process of change that NPM proposes the Total Quality Management and the search of Excellence as a management philosophy. The Total Quality Management intends to be a global philosophy that all the elements of the organization do in an effort for the satisfaction of the customer. The age of mass production was already exceeded, we are in the age of “post-fordism” as a mechanism of capital accumulation. The consumer preferences change every day and that leads to market segmentation. The efficiency of the organizations is obtained whenever the organization achieved integration in each branch of market that it intends to reach.

As a consequence of the previous models it's a priority that public agencies, with bigger autonomy and acting within market pressures, assume product differentiation and quality as a main target. We also seek a better identification with citizens' needs and better customer services. (Berzelay, 2001; Gains, 1999).

#### *MODEL 4 – DOWARD A BETTER CITIZENSHIP*

This model, accepts the necessity to readapt the very notion of Public Service. In order to do so, the introduction of market mechanisms and tools of private management can be absorbed with a lot of advantages without however, destroying the concept of Public Service. It's necessary to understand that Public Administration is not a company, although it can be managed similarly (Ferlie, Pettigrew, Ashburner, & Fitzgerald, 1996, p. 57; Van Gramberg & Teicher, 2000, p. 488). That is, it's understandable all the efforts to be efficient, to decentralize organizational responsibilities. Financial concerns are also acceptable, but Public Administration can't be mistaken about its main objective, to serve the citizen. In this perspective citizens are seen and considered in two levels, one as consumers and another one as an active element of the Public Administration management. Assuming the notion of citizens as customer they can foment the quality of the services, and at the same time, valorizing their citizenship, acting as a control and evaluator on the contracted agent.

These models can be understood as an evolution process. The starting point is a producer State with the responsibility to deliver public services. Feeling the necessity to control the increase of its expenses, the State appeals to cut backs and to the introduction of internal control systems. Wanting to improve the management capacity and the levels of efficiency, NPM introduced public-private partnerships. Bit by bit the big State has been transformed into a regulator one. The question of the quality is assumed as a necessary issue to control its lost. Finally, the citizen ends to play a central role in public management, acts as a judge towards public agencies

## **Changes in Local Governments**

The conception of a State and a Public Administration, highly centralized, legalist and bureaucratic has, nowadays, few defenders. Is more common the existence of different levels of government (“multi-level governance” according to Hooghe and Marks 2003), that is, a system where power is dispersed for several levels of authority - supranational, national, regional and local.

The dispersion in the decision process imply some decentralization, in other words, the transference of attributions and competencies of the Central Administration for the sub-national levels; for what it's necessary to establish rules that regulate the existence of these different levels of government and its inter-relations. The Local Governments have direct democratic legitimacy, considering that the representatives of these governments are elected democratically for the citizens. In other words, they have political decentralization (Pollitt, 2003). They, also, have financial decentralization. It refers to the way how the functions and the public resources are distributed by the several levels of government, including the expenditures decentralization (distribution of the competences) and the revenue decentralization (distribution of the financial resources).

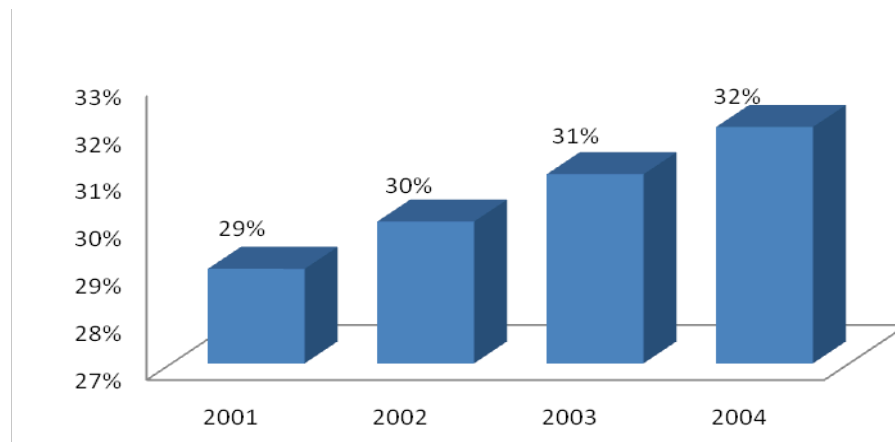
According to John (2001), and comparing some countries of the Western Europe, it's possible to distinguish two systems of Local Governments: the South and the North. Local Governments have a great autonomy and are responsible for a vast set of functions, in the South (in which are includes Portugal), although have political importance, Local Government have less responsibilities, indicating a more centralized system.

In terms of "multi-level governance", Portugal doesn't represent an exception, being possible to identify at least two levels of government composed by the Central Government and for several Local Governments. The Portuguese Local Governments began to gain relative importance from April of 1974. Up to this date, and in the "*Estado Novo*"<sup>2</sup> (New State) period, the local power was still, in terms of administrative activity, strongly centralized and didn't have financial autonomy. With the Democratic Revolution of 1974, the representatives of the local power began to be elected by citizens (political decentralization). Add to this, the financial autonomy passed to be a reality in the Law of Local Finances and increased the attributions and competences of the Local Governments. Now, and in spite of some limitations, the Local Governments fulfill a primordial role in the provision of goods and public service at local level. In a short evolutive synthesis, the relation between the Central Administration and the Local Administration has been ruled for several Local Finances Laws that were approved along the years (from 1974 even to the present). These diplomas define the rules of existence of these two levels of government, indicating between other aspects, the underlying beginnings to the Local Governments, when are standing out the beginnings of the financial autonomy and the decentralization and the specific rules that regulate the transfers of the Central Government for the Local Governments. Relatively to this question, in our opinion, it's a good indicator of financial dependence of the municipalities and they appoint one of the instruments of control used by the central power on the local power, indicating, in this way, a system more centralized (figure 2).

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<sup>2</sup> Designation of Portuguese State and Legal Constitution since 1933 until 1974, during the dictatorial period

**Figure 2 – Financial Dependence of Local Authorities<sup>3</sup>**



Source: Adapted from General Directorate of the Local Government 2006

Thus, this paper seeks to analyze two initiatives of reform that in our opinion, have substantially impact in Local Government organization and management reform. First, we analyze the mechanisms of creation of Municipal Enterprises as an entity that makes possible the ideas of organizational decentralization and flexible management. Secondly, we will proceed our analysis of the new Local Finances Law, trying to understand its tendency to be more or less centralized.

#### *MUNICIPAL ENTERPRISES*

While in Anglo-Saxon countries, the local power reform's model passed for the adoption of specific programs of management as the Compulsory Competitive Tendering, the Best Value. Changes in Portuguese Local Government followed the Continental European model of Public Administration which emphasized the legal influence through the publication of legislation. Over the years several Laws and Decree-Laws transferred competencies from central government to local government to strengthen the powers and competencies of Local Government. Preceding this initiative was always a new law to reform local finances.

Traditionally, Local Government were organized and structured in municipal services, administrative units which report directly to the Mayor under a strong hierarchic chain of command. Municipal services, together with departments and division, are part of the municipal structure responsible to implement the City Council's decisions (Oliveira, 2001, p. 128). In order to deal with the requirements of local public services like water supply, garbage collection, sewage, and street cleaning, which required a more flexible, autonomous and entrepreneur approach to service production and delivery, municipalities created municipalized services (Pereira and Almeida, 1985:214).

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<sup>3</sup> Considering only the transfers of the Central Administration in way of municipal funds, given that the local authorities receive other types of transfers, it is possible to conclude that these have a significant weight in the revenues of the Local authorities.

Municipalized services, despite being under the direct control of the City Council, have a special statute which exempts them from some regulation of the municipal services.

Municipalized services are an evolution of municipal services to deal with the specific issues raised by the industrial nature of the services mentioned above. They do not have juridical personality, but they have administrative and financial autonomy. That is, their decisions do not constitute definite administrative acts, but they have autonomy to elaborate their plan of activities, the budget and to manage personnel. They also have the power to charge tariffs for the public service.

The strength of local government and the transference of competencies from central government to municipalities pressured the need to increase efficiency and the need to look for more flexible and modern model of organizations to deliver local public services. Thus, in 1998 the Law 59/98 allowed the creation of Municipal Enterprises, responsible for the delivering of local services. Municipal Enterprises are agencies with juridical personality and administrative, financial and patrimonial autonomy. They are regulated by the law of public Enterprises and by the commercial society's code. Municipal Enterprises were created with a similar approach to those of the private sector, but with the mission of developing activities under the monitoring of the Local Government. This process transfers the responsibility to produce and deliver local public services from the municipalities to such Enterprises in order to improve efficiency and quality.

So, we can affirm that Municipal Enterprises solution is an alternative to promote the decentralization and specialization of public units. The fact is that Local Governments are heavy bureaucratic organizations, managed with a formal and mechanist systems, having difficulties to adapt itself to unstable environments and to redefine its strategy and management process (Bilhim, 2000). They had been structured with physic and human resources in order to accomplish a certain objective. The problem is when it's necessary to modify his objective or when alterations in external environment occur. The introduction of new technologies, or the sprouting of new segments of market, can induce a necessity of strategical change and actualization. However this update cannot be an isolated act. The lack of adjustments of the other organizational elements, such as the process and structures is a dangerous drawback (Miles and Snow, 1984). The intention is that with the Municipal Enterprises provide the organizations with more agility, flexibility and greater capacity of integration with its environment. In short that they become more efficient.

These Municipal Enterprises cease to be multi-objectives organizations, with a vast field of action to be an agency with a perfectly identified core business. Nowadays there isn't much place for organizations with a medium level of citizen's satisfaction. It's necessary to create the excellency in organizations. It's necessary to stress attention on customer and to be specialize in the satisfaction of their necessities. The idea is to adjust the structure of the Local Governments to current conjectures and challenges. It's also through this gradual autonomy that Municipal Enterprises managers obtain greater control capacity over their performance. When concentrating in nuclear activities and defining performance indicators, objectives accomplishment will become easier to control (Pollitt, 1990; Osborne & Gaebler, 1992). Thus, the organizational

configurations of the Local Government are modified. The traditional structures give to place the structures with a different logic of share (figure 3).

**Figure 3 - New Public Management agencies and traditional structures**

Traditional Structures	Municipal Enterprises
Focus on the fulfillment of the rules	Focus on Efficiency
Monopoly Environment	Market
Hierarchy Structures	Organic System
Focus on stability	Focus on innovation and adaptability
Few Competition	Great Competition
Focus on Politics	Focus on the productions of public services

**Source: Adapted from Rehfuss 1991**

Thus, the creation of Municipal Enterprises fit in NPM model described previously as the one concerned to the organizational decentralization and responsibility distribution. With the use of this mechanism we verify changes in the way that organization were structured, especially in what concerned public unit fragmentation and mechanism of governance through market mechanisms. Actually Municipal Enterprises act in quasi-markets and use private management tools. They plan and define objectives. They possess greater management freedom and flexibility dealing with partnerships and labor management. Partnerships are created and the Local Government acts as a broker combining specialized competences of different agents. However, the acceptance of NPM ideas is limited in some aspects and dimensions. Although the bureaucratic mechanisms of control had been replaced by the external systems of auditorships and fiscalization, an organizational relation between the Local Government and Municipal Enterprises still is very strong. Thus, we verified that Local Government influences Municipal Enterprises management through political appointments to the Administrative Councils and, in some cases, those management positions are occupied by elected politicians in a clear function accumulation. This fact injure the management autonomy and the need to separate administrative business and political fields argued by different authors (Osborne & Gaebler, 1992; Wilson, 1887). It's also limiting the use of accountability to evaluate the performance of public managers. The use of contracts, as element of the administrative reform, is substancially diminished.

The so called specialization of public units is, in some cases, far from the truth. Many Municipal Enterprises are constituted theoretically with a well defined and clear nuclear objective, however there are cases where the define objectives is so wide that it almost empty the Local Government responsibilities. In what concerns the use of market mechanisms, we notice that this solution is a bit different of contracting-out private agents. Thus, when the Local Government decides contract out to a private agent, the expectation is that the market competition produce a profitable solution. Opting for Municipal Enterprises we verify that this competition doesn't exist, at least in a direct way, because they are created by Local Government without any type of procedure that implies competition with another agent (Rodrigues, 2005).

So, the solution of the Municipal Enterprises isn't the total expression of NPM. It's a more flexible and innovative form of delivering public services. However, from it's application we verify that it exists 203 Municipal Enterprises (in a total of 308 Local Governments) that, in its majority (about 50%), they are used to manage public equipment (theaters, swimming pools, among others) and the treatment of water and wastes. Many of them have an unbalanced financial situation with harmful impacts to Local Government. Thus, this solution of organizational decentralization didn't take the Central Government, to the situation desired initially. In such a way, urged to reorganize the local finances, with a more responsible spirit and the rationality.

#### *LOCAL FINANCES*

Only from 1987, with the Law 1/87, of several laws approved from 1979, it's possible to find a real share system of the public resources between the Central Administration and the Local Administration. Until then, these systems didn't follow any rule, leaving the local authorities to the free will of the Central Government. With that Law the situation was changed, because, the discretionary used by the Central Government in the share of the public resources was limited by the introduction of a fixed and automatic formula that allows to know, at the beginning, the amount to transfer to the local authorities. But, this law has a problem: the calculation of the transfers took as support the amount predicted in the State Budget and not the amount effectively collected. This situation would become to be resolved with the subsequent law. However, in any way, this situation allows to the local authorities a bigger autonomy in his management.

Nowadays, the Local Finances have a new legal diploma – Law 2/2007. This new law appears in a context of budgetary consolidation in which the objective of the Central Government it's the reduction of the public expenditures. In this way, it seems opportune to us fits this new fact in the global process of reform. Will be that constitutes a reflex of the administrative reform and has an inclination more decentralized? Or will be that, in spite of all the efforts, the sense of this new law is more centralized?

#### **Participation of Local Government in the Taxes of the State**

One of the forms where it's possible to evaluate the existence of a more centralized or decentralized system is the existence of Central Administration transfers to Local Administration. In Portugal, the share system is result of the several Local Finances Laws. This system aims to guarantee the financial the vertical balance (understood like an equitable distribution of the taxes collected between all level of administration) and the financial horizontal balance (understood like the form of redistributing the resources for the most discriminated regions) (Street-vendors, 1998). It's constitute a fact that a significant number of the Portuguese local authorities depend of the amount of the transfers of the State to be able to bring his responsibilities into effect. However, there are authors, such as Watt (2006), that defend that is preferable a system that allows to the Local Governments an appropriate power of local taxation (that does not exist in the Portuguese case) than a system where the local authorities depend of the transfers of the State.

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Comparatively with the previous law, the new Local Finances Law introduces several modifications, concerning to the share of public resources between the State and the Local Governments. This sharing includes three new different forms (figure 4).

**Figure 4 – Share of the Public Resources between State and Local Governments**

Law 42/98		Law 2/2007	
<b>FBF</b>	33% * [(PIT+CIT+VAT) /3]	<b>FBF</b>	25,3% * [(PIT+CIT+VAT) /3]
		<b>PIT</b>	Variable participation of 5 % in the PIT of the passive subjects with fiscal residence in the local authority.
		<b>MSF</b>	Item to transfer annually by State Budget signed to the financing to the social functions of the local authorities.

First, the Local Governments maintains the right to a participation in the Financial Balance Fund (FBF) (figure 5).

**Figure 5 – Share of the Financial Balance Fund**

Law 42/98			Law 2/2007		
33% * [(PIT+CIT+VAT) /3]	30,5% Municipalities	20,5% MGF	25,3% * [(PIT+CIT+VAT) /3]	25,3% Municipalities	50% GMF
		4,5% BMF			50% CMF
		5,5% CMF			
	2,5% Parishes				

In a first analysis, it seems that the new law demonstrates a reduction of the transfers in the global amount of the municipal revenues. From 30,5 per cent of the average of the revenue from the Personal Income Tax (PIT), the Corporate Income Tax (CIT) and the Value-Added Tax (VAT), the municipalities passed to have 25,3 per cent of the same average. Add to this, the value of the FBF pass to be shared in function of two funds: the Municipal General Fund (MGF) and the Municipal Cohesion Fund (MCF). The Municipal Base Fund (MBF) created with the purpose to permit the Local Governments the minimum conditions to his functioning it was extinguished by the new law.

About the MGF, it was it's propose to guarantee to tLocal Governments the monetary resources appropriated to the fulfillment of the attributions defined by law. With new law, the value of this fund increases to 50 %. The share criteria of this fund were changed, distinguishing positively the Local Governments which one part of the territory it's affected to Rede Natura 2000<sup>4</sup> or protected area not joined that Rede Natura and the population (figure 6).

<sup>4</sup> Project of environmental nature that aims to affect part of the territory to the protection of habitats, animal and vegetable sorts.

**Figure 6 – Share criteria of Municipal General Fund**

Law 42/98		Law 2/2007	
<b>1.ª Phase (Three T.U.)</b>	50% Resident Population	<b>Share by each municipality</b>	5% Equally for all
	30% Number of municipalities		65% Population
	20% Area.		25% Area and 5% area Rede Natura 2000 and protected area
<b>2.ª Phase (Municipality T.U.)</b>	40% Resident Population		OR
	5% Resident Population with fewer 15 years.		20% Area and 10% area Rede Natura 2000 and protected area (municipalities with more than 70% of territory affected to Rede Natura 2000 and protected area).
	30% Area.		
	15% Number of Parishes		
10% PIT			

The share of the remainder 50 per cent of the FBF is effectuated through the MCF. This fund has the objective to correct the asymmetries in benefit of the municipalities less developed, being reserved to the Local Governments that have values below the national average. It's calculated on the basis of the Tax Need Index (TNI) and the Inequality of Opportunities Index (IOI). This increase (of 5, 5 per cent for 50 per cent) aims to promote the territorial cohesion to fill in inequality situations. This mechanism is essential to guarantee equity in the share of the resources, that is, it claims more justice in the redistribution of the resources.

Secondly, the Local Governments have the right to a variable participation of 5 per cent in the PIT of the passive subjects with fiscal residence in the local authority. This participation its composed by a fixed part of 2 per cent and for a variable part that can reach 3 per cent, being the Local Governments the one to define which the percentage of the income of PIT they want to collect (between 0 % and 3 %). When the local authority did not decide to collect the maxim value, the difference will be considered as a deduction to the taxpayer. There exist some aspects to take into account with this new instrument. First of all, this mechanism will be able to have implications in the fiscal load of the individuals that does not agree with the beginning of the contributive capacity (two individuals who fulfill similar functions and enjoy of the same profit, they will be able to have a fiscal different load). In the second place, this new mechanism will be able to be understood like a reinforcement of the tax capacity of the local authorities, promoting its autonomy to collect revenues. Add to this, it's possible to discuss the practice or not of different taxes, in other words, if a given local authority adopts, for example, the percentage of 5 per cent what will be the justification for another local authority adopts the percentage of 2 per cent? The only reservations it's for local authorities more rural, who needs developing mechanisms of fixation of people and families. On the other side, for the urban local authorities, the difference isn't so relevant. Even supposing that the local authorities practice different taxes, it was necessary that the person's mobility was a reality and those percentages justifying this same mobility. For last, this new aspect can promote the fiscal intermunicipal competition, increasing the responsibility of the local elects for his financial decisions and where the citizen will be able to have a more active paper. Even so, only with the time it will be possible to evaluate the impact of this situation, but having in account the necessity of the local authorities to collect revenues and the apparent reduction of the

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transfers of the State it's seems consensual the application of the maximum tax, excepting the local authorities that consider this mechanism one form of fixation persons and families.

Third, the local authorities also have right a so-called Municipal Social Fund (MSF). This fund is new and it's consigned to finance the competences associated to social functions (education, health and social action). It seems to represent an instrument of decentralization. However, the new law defines a fund to finance expenditures associated to social functions, but doesn't indicate a rule for his application, returning to the situation previous to 1987. The Central Government has total discretionarity to decide annually the value to distribute, evidencing the centralized system to get a bigger efficiency and control of the expenditures.

In synthesis, and after a more deep analysis, it seems that the reduction of the transfers of State is not so significant. The reduction of the FBF, in our opinion, is compensated by the participation of 5 per cent in the PIT. In our opinion, the main problem resides in MSF. This new mechanism represents a retrocession face to the previous law, due to the discricionarity of the central power, evidencing the centrality of the Central Government and the limitation of the autonomy of the local authorities in his management.

What concerns to the Parishes, these continues to have a participation in the State taxes equivalent a 2,5 per cent of the average of the revenue from the PIT, the CIT and the VAT. However, the share criteria had suffered some modifications: half of the Parishes Financing Fund (PFF) passes to be distributed consonant the Parishes is integrated in predominantly urban areas, medially urban areas or predominantly rural areas (figure 7).

**Figure 7 – Share Criterion of Parishes Financing Fund**

Law 42/98		Law 2/2007		
1.ª Phase (Three U.T.)	50% Resident Population	Share by each Parishes	50% Typologies	14% Predominantly urbane areas
	30% Number of parishes.			11% Medially urbane areas
	20% Area.			25% Predominantly rural areas
2.ª Phase (Parishes U.T.)	25% equally by all.		5% Parishes	
	50% Number of habitants.		30% Number of habitants	
	25% Area.		15% Area	

### The New Indebtedness Limits of the Local Government

Beyond the financial transfers system constitute one of the forms of evaluating the existence, or not, of a more centralized system, the credit recourse by local authorities also could be understood like that. The fact of the Central Government define rules to limit credit recourse represents, by itself, a mechanism of control practiced by that level of Government. On the other hand, this mechanism also could be understood as a form of the Central Government limited the form as the Local Government manages his resources, promoting a more efficient management. Following logic of budgetary consolidation, rigour and efficiency, the new Local Finances Law redefines the indebtedness limits of the local authorities (figure 8).

**Figure 8 – Indebtedness Limits of Municipalities**

Law 42/98		Law 2/2007	
		Municipal net indebtedness	<b>125% Revenues</b> Municipal Taxes, FBF, PIT, municipal surcharge and the results of entities of the enterprise sector.
Short-term Loans	<b>10% Revenues</b> MBF, MGF and MCF	Short-term Loans	<b>10% Revenues</b> Municipal Taxes, FBF, PIT, municipal surcharge and the results of entities of the enterprise sector.
Medium and long-term Loans	<b>Annual charges with capital:</b> - 1/8 MBF, MGF and MCF; or - 10 per cento of the investment expenditures in the previous year.	Medium and long-term Loans	<b>100% Revenues</b> Municipal Taxes, FBF, PIT, municipal surcharge and the results of entities of the enterprise sector..

Analyzing the figure, we can conclude that the new Local Finances Law introduces some changes. Most significant will be, perhaps, the substitution of the form as the indebtedness limits is calculated, having a global option for municipalities revenues. The indebtedness limits passed, thus, to be calculated in function of municipalities revenues.

Another changing is the inclusion of an indebtedness global limit, so-called municipal net indebtedness. It's defined by law that the total amount of debt of each municipality cannot exceed 125 per cent of the amount of the revenues from the municipal taxes, FBF participations, PIT participations, municipal surcharge and from the results of the entities of the enterprise local sector, relative to the previous year.

In parallel with this limit, the new law defines new indebtedness limits for the short-term loans and medium and long-term loans. In case of the short-term loans (as it's showed the figure 8), it's seem that the indebtedness limit was enlarged. Previously, the annual average amount of this type of loans could not exceed 10 per cent of the MBF, MGF and MCF participations. Now, the municipalities can use short-term loans until his amount does not exceed 10 of the amount of the revenues from the municipal taxes, FBF participations, PIT participations, municipal surcharge and from the results of the entities of the enterprise local sector, relative to the previous year. However, we must have in attention that the short-term loans are assumed only to resolve cash constraints and must be amortized in one year. This situation seems to bring some flexibility to the municipalities, but it doesn't have implications in the investments that are financed by medium and long-term loans.

About medium and long-term loans, the new law seems to be more restrictive. The previous law defined that the annual charge with capital (interest plus amortizations) could not exceed the biggest of the limits (um oitavo of MBF, MGF and MCF

participations or 10 per cent of the investment expenditures in the previous year). With the new law the total amount of the medium and long-term loans cannot exceed the value of the most important revenues: municipal taxes, FBF participations, PIT participations, municipal surcharge and results of the entities of the enterprise local sector, relative to the previous year. Thus, the limit of the debt is now calculated on base of the most important municipalities revenues.

In what concerns to the Parishes, these only can use the short-term loans. The new Local Finances Law maintains the same indebtedness limit, that is, 10 per cent of the PFF participations and included a new limit for the supplier's debt. These debts can not exceed 50 per cent of the total revenues collected in the previous year (figure 9). In our opinion this limitation indicating one more restriction imposed by the central power, evidencing the existence of centralized system.

**Figure 9 – Indebtedness Limits of Parishes**

Law 42/98		Law 2/2007	
Short-term Loans	10% PFF	Short-term Loans	10% FFF
		Suppliers debt	50% Total revenues in the previous year.

In our opinion the indebtedness limits in the new Local Finances Laws are more restrictive. In spite of a greater flexibility in the short-terms loans, the existence of global indebtedness limit, the change in the form of how the indebtedness limits of medium and long-term loans is calculated and the restrictions in Parishes borrowing, showing the control used by Central Government and, consequently, a more centralized system.

### **The new Law of Municipal Enterprises and its impact on Local Finances**

It was already possible to see that the Municipal Enterprises solution has a perspective to promote the decentralization and the fragmentation of public unities, allowing individualize responsibilities and potentiating a more flexible management. Has we said, from the implementation of this mechanism there resulted financial imbalance situations of the Municipal Enterprises. So, to stimulate an efficient management of the resources of Local Government, the present law that regulates the enterprise local sector – Law 53-F/2006, changing the responsibility type of Local Governments regarding his enterprise sector. Thus, in the case of the Municipal Enterprise presents negative results (adding operational results and financial charges), the municipalities are obliged to transfer the necessary financial amount to balance the accounts.

## **Conclusion**

Como pudemos verificar, os Governos Locais em Portugal atravessam uma fase de desafios importantes, no âmbito de um processo generalizado de reforma

administrativa. Existe um esforço, por parte de todos os agentes envolvidos, para melhorar o nível do serviço público. Desta forma, foram adoptadas práticas e experiências identificadas com o movimento conhecido por Nova Gestão Pública. Assim, segundo este modelo de gestão, a tradicional Administração Pública, deve evoluir para uma estratégia onde cria pontes e estabelece parcerias com os demais agentes do mercado. Com isto promove a especialização e ganha em termo de eficiência, permitindo ainda que o poder público se concentre na definição de opções para as políticas públicas e de regulação do mercado, onde as tarefas operacionais da Administração Pública estão a cargo de outros agentes (públicos, privados e do 3º sector). Pretende-se também flexibilizar e adaptar instrumentos de gestão disponíveis, à nova realidade da globalização, dos constrangimentos financeiros e da maior exigência por parte dos cidadãos. Advoga-se também, a necessidade de implementar práticas de responsabilização e avaliação dos resultados obtidos pela gestão pública, baseando-se sobretudo em critérios de gestão em vez dos de confiança política.

Desta forma, os Governos Locais promoveram a criação de Empresas Municipais, transferindo a responsabilidade operacional, de alguma das suas competências, para uma estrutura criada formalmente para agir à luz dos princípios de eficiência e eficácia, sujeita as forças de mercado. Apesar de ser obrigada a respeitar alguns princípios básicos da Administração Pública, às Empresas Municipais são permitidas práticas de gestão semelhantes as usadas pelos privados. Como verificamos, apesar de se traduzir numa evolução de configuração organizacional, outros instrumentos careciam de ser aplicados de maneira a permitir que a gestão pública atinja os objectivos da reforma.

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