Country

Riga Latvia

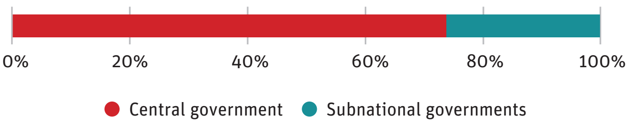
CITY:
0.6 mil. inhabitants

METROPOLITAN AREA
0.9 mil.
(-2.5% pop. change/5 years)

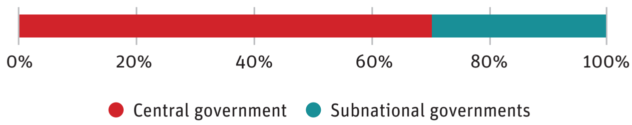
GDP: 88% of the average EU28 GDP
(+4.1% average annual change in GDP/5 years)

How local public finance systems work in Latvia

PUBLIC REVENUE



CAPITAL EXPENDITURE



Latvia has a **one-tier system of subnational government** (SNG), comprised of 110 municipalities (Novads) and 9 “cities of nationwide significance” (Republikas Pilseta). Territorial reform in 2009 changed the previous two-tiered system of 524 local government entities into today’s structure.

The basic legal framework of financing local governments is the Local Government Act (1994), as well as numerous other documents pertaining both to fiscal questions and the relationship between the central government and local governments — the Act on the Budgets and Financial Management (1994 the Act on Local Governments Budgets (1995), the Act on Local Government Finance Equalisation (amendment 2015) and the Act on Taxes and fees (1995).

SNGs account for only 29% of public investment, which corresponds to 1.1% of the GDP (OECD 51% and 1.7%). The investment of Latvian SNGs has been affected by the crisis and consolidation measures; from 2007–2017 investments declined by 4.3% annually. **Latvia is heavily dependent on European structural and investment funds.** By 2020, Latvia will have received up to EUR 5.6 billion (each year roughly 3% of the GDP and 65% of the public investment from 2014–2018).

The share of the SNG revenue in the total public revenue (26%) and GDP (10%) is below the EU28 average (34% and 15%). The main source of SNG revenue are taxes, which are generally shared. Tax revenue is relatively high, accounting for nearly 61% of total SNG revenue (OECD 39%). On the other hand, revenue from transfers and grants (30%) is lower than the OECD average (49%). Other revenue (fees, property income, etc.) represents 9% of SNG revenue and thus accounts for a lower share than the OECD average.

SNG tax revenues are slightly above the average for OECD unitary states (whether measured as a share of GDP or a share of total public taxes) – SNG tax revenue amounts to 5.9% of the GDP and 26% of the total tax collected. **According to Act on Taxes and fees of 1994, all taxes are state taxes; as a result, there are no local taxes in Latvia. The most important shared tax is the personal income tax, which in 2016 accounted for 84% of SNG tax revenue, 54% of total SNG revenue and 5% of the GDP;** the tax is collected by the state and partially redistributed among municipalities; in 2007 municipalities received 80% of the tax collected within their territory.

Another major shared tax is the property tax, levied on all land and buildings used for commercial and residential purposes; in 2016, this tax accounted for 15% of SNG tax revenue, 9% of total SNG revenue and 0.9% of the GDP (OECD 1.1%). This is a voluntary tax and municipalities can modify the rate within the limits set by law. When applying property tax breaks, municipalities also calculate possible financial compensation in the form of increased income tax revenue. The tax thus becomes part of the competition between individual local governments.

SNGs also receive a share of the tax on lotteries and gambling and tax on natural resources. Work is currently underway to rework the public tax system (2017 reform). Key measures focus on reducing personal and corporate income taxes on the state level.

Nearly all transfers from the central government in 2016 were earmarked; 96% of these were current transfers and 4% were capital transfers. Transfers include, in particular, grants for the remuneration of teachers, road maintenance and construction, investment projects or financing of EU projects.

Non-earmarked transfers mainly come from the Local Government Finance Equalisation Fund (LGFEF). Based on an assessment of the financial capacity of individual municipalities, the purpose is to reduce the differences between rich and poor municipalities; the calculations are based on taxes collected and the financial needs of particular municipalities. For certain municipalities, these funds represent a major portion of revenue. In 2013, the fund was fed by 5 “Republic cities” and 13 municipalities around the metropolitan area of Riga, while 92 local governments drew money from this fund; 10 local governments did neither receive nor finance the fund.

Other SNG revenue comes from user fees and fees for administrative services, for issuing official documents, verifying ownership, owning animals, advertising, building permits and more. In 2016, fees amounted to 0.8% of GDP and nearly 8% of SNG revenue. Income from property and municipal companies in the same year amounted to 0.5% of total SNG revenue.

Source: http://www.oecd.org/cfe/regional-policy/Observatory-on- Subnational-Government-Finance-and-Investment.htm