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## **EU MEMBER STATES AND FISCAL DECENTRALIZATION– EMPIRICAL COMPARISON**

Žan Oplotnik<sup>1</sup>, Mateja Finžgar<sup>2</sup>

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### **Abstract**

The purpose of an article is to compare systems of fiscal decentralization in EU member states according to selected quantitative criteria and European Charter of Local Self-Government principles. The results show that a higher number of lower levels of government usually indicate a greater share of local finance within the total public finance, however, this finding does not confirm the inverse link. Even though the structure of expenditures in EU countries is similar, the shares of funds for the implementation of individual tasks differ significantly. On average, the countries allocate most funds to education, social security, healthcare, administration and political systems, with only a quarter of the countries recording the same or higher amounts of revenues than expenditures. Most of the countries still cover the existing deficit either through transfers from the central to lower levels of government or through equalization schemes or borrowing, which otherwise represents a departure from one of the basic principles of the Charter, which stipulates that financial resources must be commensurate with the responsibilities of local self-government.

**Keywords:** • fiscal decentralization • international comparison • EU-27 • local financing • local self-government • local expenditures

### **Introduction**

European countries have from the very beginning of the process of their integration been accompanied by the need for the unification and convergence of legal, economic and social aspects of life. Diversity that is otherwise desirable in the area of specific activities (e.g. culture,

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language, etc.) does not have many supporters when it comes to economic benefits of the merging and standardisation of market and administrative functions of states. Literature in the field of fiscal decentralization does not feature any common consensus of how to standardise the different systems of fiscal decentralization of individual countries. Despite the fact that no consensus has been reached at this time on the standardization of fiscal systems of countries at the European level, this issue has been dealt with for quite some time by countries within the scope of lower levels of government (regions, county, provinces, municipalities). The first step in the search for the answer to the above question has already been made in the past, namely by the adoption of the so-called European Charter of Local Self-Government (hereinafter referred to as "the Charter") by the Council of Europe in 1985. The Member States within the Council of Europe undertook, by signing the document, to observe in their legislative regulation of the lower levels of government the guidelines set out in the Charter or the so-called basic principles of the Charter, such as for example:

- the principle of commensurability or adequacy of financial resources with responsibilities – which states that available financial resources of local self-government shall be commensurate with the their responsibilities;
- the principle of autonomy and self-financing – which states that part at least of the local financial resources shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate and of which they may dispose of freely;
- the principle of flexibility – the financial systems on which resources available to local authorities are based shall be of a sufficiently diversified to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks;
- the principle of equalisation - the protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance between individual local authorities;
- the principle of mutual cooperation – this principle states that local authorities shall be consulted, insofar as possible, in due time and in an appropriate way in the planning and decision-making processes;
- the principle of autonomy – despite the fact that a part of the financial resources being given or transferred to them by a central authority, local authorities shall, insofar as possible, be allowed autonomy in their use;
- the principle of borrowing – local authorities shall have autonomy in the management of their debt and shall freely formulate the

borrowing policy, whereby it shall generally hold true that such policies shall be limited by the legislation that prescribes the limits on borrowing.

The Charter is deemed to be the only multilateral legal instrument that directs European countries – based on the defined guidelines for the development of lower levels of government – into the common direction of the establishment of an efficient fiscal decentralization system. This means that the systems of lower levels of government should be designed with the aim of achieving a maximum possible level of compliance with the basic principles of the Charter, which in principle also implies greater efficiency of the functioning of local self-government. The latter is also confirmed by certain findings of authors such as De Mello and Barenstein (2001) and Tanzi et.al. (2008). Research carried out by the mentioned authors relates to the optimum vertical and horizontal fiscal structure and the adequate level of fiscal autonomy, and further emphasises the study of the correlation between the revenues and costs arising from the performance of tasks that fall within the competence of the lower levels of government. The goal is known, namely how to ensure the maximum possible efficiency of the used funds with the given amount of revenues that the lower levels of government can dispose of freely and retaining a suitable level of autonomy in doing so. Each country has a more or less specific own system for the financing of lower levels of government formulated with respect to the defined competencies which is in certain cases focused on greater decentralization and in others on greater centralisation. Even a quick review of fiscal decentralization systems in European countries shows that there is great variety between the systems, both in terms of the structure of local self-government and the associated competencies and in terms of the distribution of fiscal power and financing autonomy between the central (state) level of government and the lower levels of government. It is because of this diversity of the systems that their direct comparison aiming to establish, which system are more efficiently designed is difficult to do. We will focus within the scope of this paper only on the comparison of the systems of lower levels of government based on the selected indicators while the assessment of efficiency shall be the subject matter of one of the future research assignments. Below, we will select a number of indicators, which best represent the level of decentralization of an individual country and make it possible for us to carry out comparisons while they at the same time indicate a lower or higher level of compliance of the individual systems with the abovementioned the Charter guidelines. In this regard, we highlight the principle of commensurability of financial resources with local responsibilities, which is important for the successful functioning of local

government. The indicators that we select as those that best represent the level of fiscal decentralization are:

- the share of local finance within the total public finance;
- the share of local finance in relation to the GDP of a given country;
- the structure of local self-government expenditures in relation to their assigned tasks;
- the ratio between the revenues and expenditures of local finance as an indicator of the commensurability of financial resources with the competencies of local self-government.

Within this scope, we have formulated two shorter working hypotheses, namely: H1: a higher number of lower levels of government in EU country in principle also implies a larger share of local financial resources within the total public finance and with respect to the country's GDP and H2: even though the competencies of local self-government authorities in countries are similar in terms of their structure, there is nevertheless great diversity between them in terms of the scope of funds they allocate to the implementation of certain competencies.

The above indicators and the analysis of the formulated hypotheses will enable us to provide a sound outline of the state-of-affairs in the field of fiscal decentralization in EU. The findings that we arrive at will provide an answer to the question of what level of convergence can be detected among the studied countries, while these findings will according to our estimates also serve as a basis for the further study of this field. The paper comprises two parts. The first part features a short summary of theoretical background while the second features a comparative analysis of the fiscal decentralization in EU.

### **Overview of the Theoretical Background of Fiscal Decentralization**

Literature provides a general definition of the term fiscal decentralization, which is that it represents the transfer of competencies, responsibilities and financial resources from the central (state) level to the lower levels of government. Its original purpose is to establish efficient financing of local self-government, the implementation of the competencies of decentralised units and functioning with the aim of satisfying the needs of the local population. Such a traditional or the first generation of the understanding of the term fiscal decentralization can be seen from authors such as, for example, Tiebout (1956), Musgrave (1959), Buchanan (1965), Olson (1969) and Oates (1972). Taking into account the public finance theory that applied at the time, the established decentralised government would provide a solution for the conceptual

public issue of choice. The central question of the public issue of choice was thus tied to the ability to efficiently transfer competencies, responsibilities and financial resources from the central to the lower levels of government with the presence of the local population, which is diverse and heterogeneous around the world. It was assumed that the lower levels of government in an individual country can function efficiently only when they hold suitable competencies and sufficient financial resources are provided as well as the access to financial resources of which they can dispose off freely (Boex, 2009, 8). The first basic understanding of fiscal decentralization was established already by Tiebout (1956) with the so-called Tiebout fiscal decentralization model. In his discussion, he states that, given high levels of mobility, individuals will chose for their dwelling the environment that will best suit their personal needs in terms of taxes and the offer of public goods. On the other hand, in the event of a potential actual state of complete absence of mobility, we cannot assume that decentralization does not bring a net increase in common benefits. It is thus that, for example, the Samuelson condition of the equalisation of the sum of marginal rates of substitution and marginal costs states that common benefits differ from one jurisdiction to the next (Brezovnik and Oplotnik, 2003, p. 121). The further research of the area according to Tiebout (1956) was tackled by Musgrave who wrote *The Theory of Public Finance* (Musgrave, 1959), in which he presented the three most important functions of public finance and the functions of local finance that are derived from the former, namely stabilisation, allocation and distribution. While the first function, stabilisation, is characteristic primarily of the central level the other two alternate between the central and lower levels of government in a given country depending on the suitability of implementation of certain activities and the supply of public goods (see also Buti and Sapir, 2006, p. 3). The following authors are Olson (1969) and Oates (1972). Olson (1969) presented the principle of fiscal equivalence in his work entitled *The principle of fiscal equivalence: the division of responsibilities among different levels of government* and Oates (1972) presented the correspondence principle in his paper entitled *Fiscal Federalism*. According to them, each public good must be provided by the government level that is best able to provide it, with another important factor being the level where the need occurs or the nature of the needs for a particular good (the needs for a particular public good can arise either in the local environment, such as municipal activities, local road management, etc., or can be goods of a broader character, such as for example national defence, economic policy management, diplomacy, etc.). Among the representatives of the second generation are authors such as Proud'homme (1995), Tanzi (1996), Qian (1997), Oates (2005) and Weingast (1997, 2008). In the research carried out by modern



authors in the field of fiscal decentralization, there is much greater awareness of the need to view the fiscal decentralization system in broader terms. Recent literature in the field of fiscal decentralization as compared to traditional or the first generation of literature does not only focus on the general definition of the term fiscal decentralization, but attributes an important role to the citizens. Citizens can through their cooperation in the discharge of public affairs importantly influence decision-making relating to the environment, in which they live.

### **Research in the Field of Fiscal Decentralization System Comparisons.**

As we have already written in the introduction of this paper, fiscal decentralization systems differ significantly from one another, either because of their historical and geographical or administrative backgrounds, which is why their direct international comparison and unambiguous finding of which fiscal decentralization systems are most efficient is impossible. We can draw conclusions in this regard only indirectly through individual indicators that describe individual relations at the local level. Before we describe the method for the implementation of the comparison of fiscal decentralization systems, we summarise certain research carried out to date by authors dealing with this field and the indicators that were used for this purpose. Even individual authors of previous research in the field do not agree as to how to measure the level of fiscal decentralization, which is why fiscal decentralization is measured differently in the published research with authors focusing primarily on the analysis of revenues and expenditures of lower levels of government. After reviewing literature, we found that the most frequently used indicators of fiscal decentralization are those used by the International Monetary Fund. The main indicators listed by the above source are, among others, the revenues of the lower levels of government according to their structure and in the aggregate as the share in the total revenues of the public sector or according to the GDP of an individual country and the expenditures of the lower levels of government according to their structure and in the aggregate as the share in the total expenditures of the public sector or according to the GDP of an individual country. The above indicators were followed by studies in the field of fiscal decentralization system comparisons, such as Thieben (2003), Darby et al. (2005), Neyapti (2010) and Buser (2011). The usefulness of these indicators for the measurement of fiscal decentralization, such as the share of revenues and expenditures of the lower levels of government with respect to total revenues or expenditures of the public sector, is advocated in his study by Sharma (2004, 52), whereby he also states the limitations of fiscal decentralization measurements that are associated with the statistical

database of the IMF for such purposes. The thus obtained data namely do not provide an answer to certain key questions relating to the study of fiscal decentralization. The limitations summarised by Sharma (2004, p. 52) from the author Byskov (2001) relate to the question of so-called autonomy of revenues and expenditures that local authorities are supposed to be able to dispose of freely. The statistical database delimits revenues and expenditures that belong to the lower levels from the total public revenues, but does not provide a single answer on whether the lower levels of government are truly completely autonomous in freely disposing of these resources. Practice in many countries tells us that the central level of government in many countries is the one that determines the limits for the lower levels of government, both on the revenues side (determination of tax rates is the domain of the central level of government) and on the expenditures side (decisions regarding the eligibility of expenditures are the domain of the central level of government). The statistical database also does not provide an answer to the question relating to the vertical balance, namely to what extent the financial transfers received actually coincide with the original purpose of such transfers. The further study of literature in the field of fiscal decentralization or its measurement brought us to the following finding, namely that certain authors have carried out an international comparison of the different fiscal decentralization systems based on the calculation of a more or less complex fiscal decentralization index (hereinafter referred to as: the "FDI). The FDI is supposed to replace the simple direct indicators, with which we can compare the different aspects of the functioning and management of the lower levels of government of individual countries. It is thus that, for example, Vo (2009) presented his own FDI that enables international comparison of the levels of fiscal decentralization based on fiscal autonomy and fiscal importance of the lower levels of government. The indicator of fiscal autonomy is defined as the share of own revenues of the lower levels of government with respect to the expenditures of the lower levels of government, while the indicator of fiscal importance of the lower levels of government is defined as the share of expenditures of the lower levels of government with respect to the total expenditures of the public sector in a given country. On that basis, Aristovnik (2012) also published the study entitled Fiscal Decentralization in Eastern Europe and he used the FDI to calculate fiscal decentralization levels. Despite the consensus not yet being achieved among authors with regard to the unification of the different systems of fiscal decentralization of countries, the first step in this direction has been made with the adoption of the Charter that defines local self-government as a politically, administratively and financially independent entity, which gives the lower levels the right and responsibility to arrange and discharge public affairs within the scope of

their tasks and to the benefit of the local population. Considering the above, we must view comparative analysis from this point of view and therefore place the search for a common denominator in the suitable context of these principles.

Because the determination of the composition of the FDI that would best reflect the actual state-of-affairs in the field of fiscal decentralization in individual EU-27 countries would go beyond the purpose of this paper, we carried out a comparison of fiscal decentralization systems below on the basis of selected indicators and tied them together with two hypotheses that in our opinion demonstrate compliance with the principles of the Charter, namely that a higher number of lower levels of government in an individual country also implies a larger share of local financial resources within the total public finance (H1) and that despite the similar competencies of local self-governing authorities in EU-27 countries the shares of an individual type of competence differ from one another significantly or deviate from the average (H2).

### **Comparison of Fiscal Decentralization Systems in EU member states**

Below, we carried out a brief comparative analysis of fiscal decentralization systems according to selected criteria for EU-27 countries and verified the hypotheses established at the beginning (H1, H2), all of which was based on the goals and hypotheses set in the beginning of the paper and based on the theoretical findings from the second chapter of this paper. The first phase of the analysis of the systems by individual countries comprises the analysis of the number and composition of lower levels of government, which serves as the foundation for the further interpretation of results acquired within the scope of the international comparison of fiscal decentralization systems based on selected indicators and the testing of the established hypotheses.

Table 1 shows the number of lower levels of government in countries that are otherwise full-fledged members of the European Union and at the same time signatories of the Charter and are the subject of the comparison of fiscal decentralization systems. As we can see, the differences in the number of local self-government levels are significant between EU-27 countries, which, among others, are the result of their different historical, geographical and cultural backgrounds. This causes rather differently distributed competencies of local authorities in different countries and, of course, their method and scope of financing. As is evident from Table 1, seven countries have all three lower levels of

government with these most frequently being termed “regions” or “provinces”. The autonomy levels differ significantly between them. The greatest autonomy is present in the division of Great Britain and German “federal states”. Eleven countries have two lower levels of government, while nine have only one level most often referred to as “municipality”. There are nearly 90,000 municipalities in total in EU-27. The size of municipalities varies significantly between countries, whereby countries like the Czech Republic, Slovakia and France have the lowest number of inhabitants per municipality (less than 2,000) and the countries such as Denmark, Greece, the Netherlands, Sweden and Great Britain have the highest number with respect to the total average (more than 20,000). Extreme values in the observed category are achieved by Great Britain that had more than 152,000 inhabitants per municipality in 2010.

Table 1: Number of lower levels of government in EU (2010)

		No. of residents (in 000)	Area (in km <sup>2</sup> )	First level of LSG	Second level of LSG	Third level of LSG
<b>Countries with one level of LSG</b>						
Bolgaria	BOL	1.747	111.002	264	-	-
Cyprus	CYP	804	5.695	378	-	-
Estonia	EST	1.34	45.227	226	-	-
Irland	IRL	4.476	69.797	114	-	-
Latvia	LAT	2.239	64.589	119	-	-
Litva	LIT	3.287	65.3	60	-	-
Luxemburg	LUX	507	2.586	105	-	-
Malta	MAL	414	316	68	-	-
Slovenia	SLO	2.042	20.273	210	-	-
<b>Countries with two level of LSG</b>						
Austria	AUS	8.37	83.871	2.357	9	-
Finland	FIN	5.363	338.145	342	2	-
Portugal	POR	10.636	92.152	308	2	-
Czech R.	CZR	10.538	78.868	6.250	14	-
Denmark	DEN	5.546	43.098	98	5	-
Greece	GRE	11.305	131.957	325	13	-
Hungary	HUN	10	93.029	3.177	19	-
Netherland	NET	16.611	41.528	430	12	-
Romania	ROM	21.431	2.385.391	3180	41	-
Slovaki	SL	5.43	49.034	2.928	8	-
Sweden	SWE	9.378	449.964	290	20	-
<b>Countries with three level of LSG</b>						
Belgium	BEL	10.883	30.528	589	10	6
France	FRA	64.812	632.834	36.682	100	26
Germany	GER	81.744	357.027	12.104	301	16
Italy	ITA	60.468	301.336	8.094	110	20
Poland	POL	38.191	312.685	2.479	379	16
Spain	SPA	46.073	505.997	8.116	52	17
Great Britain	GBR	62.195	243.82	406	28	3
<b>Total EU-27</b>		<b>501.636</b>	<b>4.409.047</b>	<b>89.699</b>	<b>1,125</b>	<b>104</b>

Source: Dexia 2011, 6.

## **Share of Local Finance in the Public Finance and GDP**

Below, we deal with the analysis of local revenues or local financial resources primarily by using the indicator of the share of local finance in the total public finance and GDP. Based on this, we analyse the share of decentralization in EU-27 countries in the context of the verification of the first working hypothesis (H1) that states that the greater scope of funds allocated by countries to local self-government is closely tied to the level of decentralization which is indirectly indicated also by the number of lower levels of government in an individual country.

**Tabel 1: Share of Local Finance in the Public Finance and GDP**

		Share of Local Finance in Total Public Finance (%)					Share of Local Finance in GDP (%)				
		19 95	20 07	20 10	Change % 95-07	Change % 07-10	19 95	20 07	20 10	Change % 95-07	Change % 07-10
Belgium	BEL	34,9	37,9	38,5	3,0	0,6	16,6	18,2	18,8	1,6	0,6
Bolgaria	BOL	22,4	16,1	19,8	-6,3	3,6	8,4	6,6	6,9	-1,8	0,3
Czech R.	CZR	30,3	27,5	29,0	-2,8	1,5	12,2	11,1	11,4	-1,1	0,3
Denmark	DEN	57,8	57,2	66,3	-0,6	9,1	32,6	31,8	36,8	-0,8	5,0
Germany	GER	36,8	39,1	38,8	2,3	-0,4	16,7	17,1	16,9	0,4	-0,2
Estonia	EST	24,8	24,7	25,2	0,0	0,5	10,5	9,0	10,3	-1,5	1,3
Irland	IRL	33,2	19,1	19,2	-14,1	0,1	12,9	7,0	6,8	-5,9	-0,2
Greece	GRE	5,2	6,1	6,6	1,0	0,5	1,9	2,5	2,6	0,6	0,1
Spain	SPA	37,6	46,5	49,0	8,8	2,6	14,0	19,1	17,8	5,1	-1,3
France	FRA	18,8	21,0	23,2	2,2	2,2	9,2	10,5	11,5	1,3	1,0
Italy	ITA	28,3	32,2	32,5	3,8	0,4	12,7	14,8	14,9	2,1	0,1
Cyprus	CYP	3,7	4,2	5,4	0,5	1,1	1,2	1,9	2,2	0,7	0,3
Latvia	LAT	19,7	29,2	31,3	9,5	2,1	7,3	10,4	11,3	3,1	0,9
Litva	LIT	24,3	23,8	33,7	-0,5	9,9	8,0	8,0	11,4	0,0	3,4
Luxemburg	LUX	13,5	11,8	11,8	-1,8	0,1	5,7	4,7	4,9	-1,0	0,2
Hungary	HUN	28,2	25,7	25,9	-2,6	0,2	13,3	11,7	11,7	-1,6	0,0
Malta	MAL	1,7	1,5	1,8	-0,2	0,3	0,6	0,6	0,7	0,0	0,1
Netherland	NET	48,3	33,5	35,3	-14,8	1,8	22,8	15,2	16,3	-7,6	1,1
Austria	AUS	34,1	31,5	31,6	-2,6	0,1	17,2	15,0	15,2	-2,2	0,2
Poland	POL	23,1	33,0	36,3	9,9	3,3	10,0	13,3	13,6	3,3	0,3
Portugal	POR	13,4	15,6	15,1	2,1	-0,4	4,9	6,4	6,3	1,5	-0,1
Romania	ROM	13,1	26,9	28,5	13,8	1,6	4,2	9,5	9,7	5,3	0,2
Slovenia	SLO	17,7	19,6	22,1	1,8	2,5	7,8	8,3	9,8	0,5	1,5
Slovakia	SL	6,9	18,5	17,0	11,7	-1,5	3,1	6,0	5,5	2,9	-0,5
Finland	FIN	36,1	35,3	41,7	-0,8	6,4	20,0	18,6	21,9	-1,4	3,3
Sweedden	SWE	42,2	43,9	48,0	1,7	4,2	24,3	23,9	25,3	-0,4	1,4
Great Britain	GBR	28,9	30,2	34,2	1,2	4,1	11,0	12,4	13,8	1,4	1,4
Total EU 27			26,4	28,4				11,6	12,4		

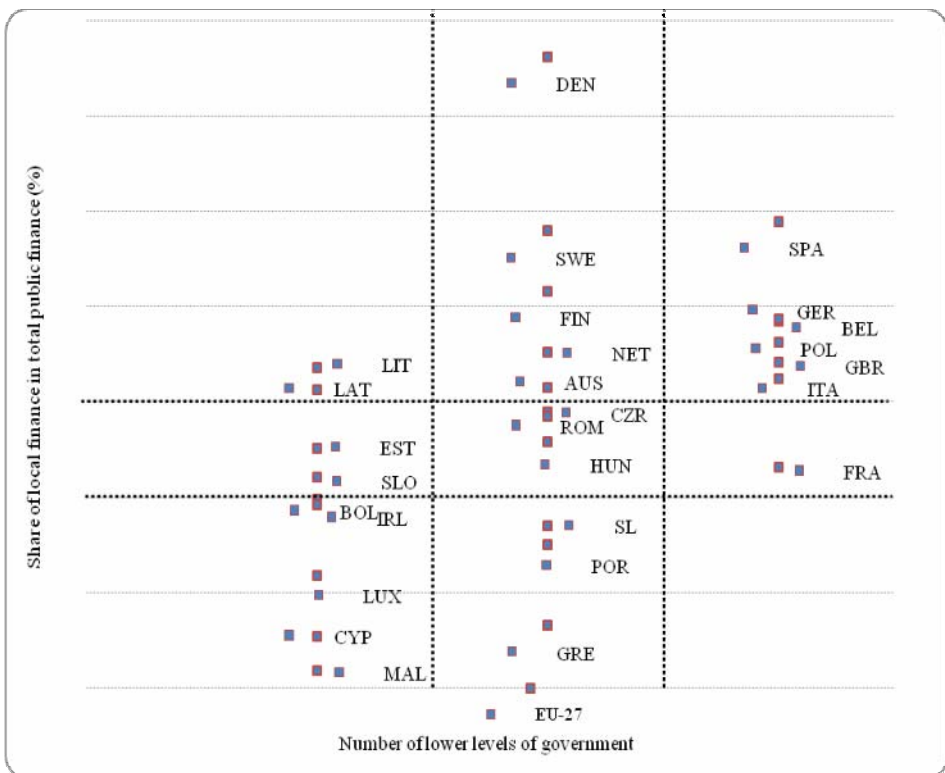
Source: EC 2012, own calculation.

In order to perform the tasks stipulated by the constitution, laws and other regulations, both the state and the lower levels require financial resources or revenue. In theory and general practice, the scope of financial resources differs significantly from country to country both in terms of scope and structure. Table 2 above and Table 1 below<sup>1</sup> show

<sup>1</sup> In Table 2, the revenues of the lower levels of government comprise all of their own revenues (so-called fiscal revenues; taxes, contributions and fees) and financial transfers or revenue equalisations. As stated by EC (2012, p. 176), numerous authors of related research take into account only own revenues of the lower levels of government without financial transfers, which is why differences may appear between the data presented within the scope of this chapter of the paper and certain other analyses.

the share of financial assets allocated by EU countries for the implementation of the tasks of the lower levels of government within the total revenues of the public sector and with respect to the GDP as well as the size of the change of both indicators. We can discern from Table 2 that the share of local finance in the total public finance in the 1995–2010 period increased in a total of 20 countries, while the share of local finance in the GDP increased in a total of 19 observed countries. Aiming to verify the established H1 we compared the number of local self-government levels and the share of local finance in the total public finance, which is shown in Figure 1, where the vertical axis shows the share of local finance in the total public finance and the horizontal axis shows the number of lower local self-government levels by individual EU countries.

Figure 1: Local finance in public finance (as %) and lower levels of government in EU



Source: EC 2012, own calculation.



Within the scope of the analysis, we divided the countries into three groups, namely countries that are strongly decentralised according to the criterion of the scope of local finance within the total public finance, meaning that the central (state) levels allocates more than one third of all local finance revenue to the lower levels, followed by the countries with a medium level of decentralization where we classified those countries that have the value of the vertical axis indicator between 20% and 30%, while we classified countries with the value of the same indicator below 20% as countries with a low level of decentralization with respect to the said criterion in comparison with the group and the average of the analysed EU-27 countries. We will further verify how many lower levels of government the countries in each individual group have on average. Based on this, we will be able to either confirm or refute H1. Out of all EU-27 countries, a total of 13 were classified in the group of strongly decentralised countries. The most funds were allocated in 2010 for local self-government by the countries such as Denmark (66% of public finance or 37% of GDP), Spain (49% of public finance or 18% of GDP), Sweden (48% of public finance or 25% of GDP), Finland (41% of public finance or 22% of GDP). These are followed by Germany, Belgium, Poland, the Netherlands, Great Britain, etc. On the other hand, the countries that are least decentralised out of all EU-27 countries are Malta, Cyprus and Greece as they allocate less than 10% of all revenues of the public sector to the lower levels of government, which represents less than 3% of GDP. In addition to those already listed, we also classify the following countries into the group with a low level of decentralization: Bulgaria, Ireland, Slovakia, Portugal and Luxemburg. The remaining six countries are classified into the group of countries with medium-level decentralization. A quick glance at Figure 1 which shows all EU-27 countries shows that the upper right quadrant mostly comprises countries with several levels of government with the majority of these having three local self-government levels (e.g. Spain, Germany, Belgium, Poland, Great Britain, etc.). All of the mentioned countries are classified into the group of strongly decentralised countries (according to the selected criterion of the share of local finance in total finance), but we cannot entirely claim that it is exclusively the three levels of government that are a condition for strong decentralization from the point of view of the share of local finance. This is corroborated by countries such as Denmark, Sweden, Finland, the Netherlands and Austria that only have two levels of government but nevertheless fall into the group of strongly decentralised countries according to the selected criterion. On the other hand, we can claim that most countries (with the exception of Latvia and Lithuania) with only one lower level of decentralization do not exceed the average share of local finance in total public finance (approximately 30%). The bottom left quadrant therefore

comprises 5 out of a total of 9 countries that only have one lower level of government whereby these are classified into the group of countries with low-level decentralization. Most countries that have at least two levels of government (with the exception of Greece, Portugal and Slovakia) meet the criterion that ranks the country into the group of medium-level decentralization, whereby the share of local finance in the total public finance is between 20 and 30%.

Based on this, we can conclude that the first working hypothesis (H1) established in the introduction can only be partly confirmed. The hypothesis is valid for the direction stating that a higher number of lower levels of government in principle also implies a larger share of financial resources within the total public finance (which is confirmed by a total of 6 out of 7 countries, with the exception of France), while the hypothesis in the opposite direction does not hold up to a test according to the selected criterion as we cannot confirm that countries with only one lower level of government also exhibit, as a rule, a low level of decentralization. Countries such as Lithuania, Latvia, Estonia and Slovenia namely deviate from this rule. They have only one lower level of government but are nevertheless classified into the group of medium or strongly decentralised countries. Considering the findings, we could conclude that the level of decentralization is also affected by certain other factors such as, for example, the country size factor that should according to our estimates be closely tied to the number of decentralization levels, but these assumption were not verified within the scope of this paper. Below, we will devote attention to the expenditures of the lower levels of government in EU-27 countries. Within this scope, we will compare the countries with one another according to the selected criterion of expenditure structure and strive to determine whether more or less the same structure of the expenditure of local self-government implies the same share of expenditures in the structure of expenditures of local self-government. Within this scope, we will verify our second hypothesis (H2) that states that even though the competencies of local self-government authorities in analysed countries are similar in terms of their structure, there is nevertheless great diversity between them in terms of the scope of funds they allocate to the implementation of individual competencies.

### **Expenditures of local self-government in EU-27 Countries**

The purpose of this chapter is to analyse the expenditures of local self-government in EU-27 countries in terms of their structure. This involves the implementation of competencies in the field of education, social security, administration and political system, healthcare, economic

affairs, social activities etc. Within this scope, we will initially verify our second hypothesis (H2) that states that even though the competencies of local self-government authorities in analysed countries are similar in terms of their structure, there is nevertheless great diversity between them in terms of the scope of funds they allocate to the implementation of individual competencies. If the hypothesis is confirmed, this will further strengthen the awareness of the diversity of fiscal decentralization systems of EU-27 countries. The data on the extent of the share of expenditures the local self-government in individual EU-27 countries have allocated to the implementation of individual competencies and tasks are shown in Table 3. This involves the tasks and competencies prescribed for the local self-government by either the constitution or the national legislation. When defining the fields of competencies of local government, we limited ourselves to the fields that are defined as such by the EU, more precisely Eurostat (2013). This is the so-called Classification of the Functions of Government (COFOG) that distinguishes between 10 fields or functions. In doing so, our aim was to provide a clearer representation so we highlighted only those fields that account for a higher share within the total structure of expenditures because EU-27 countries have on average as much as around 70 per cent of all expenditures concentrated in four fields, namely education (20.5%), social security (19.5%), administration and political system (15.5%) and healthcare (13.3%)<sup>1</sup>.

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<sup>1</sup> The COFOG classification is used for the analysis of the structure of expenditures either at the central level or the lower levels of government for a total of 10 fields or functions, namely education, social security, administration and political system, healthcare, economic affairs, social activities (recreation, culture, etc.), public order and safety, housing and community amenities, environmental protection and defence.

Table 3: Expenditures of local levels in EU in 2010 with respect to competencies

	Education	Social security	Administration	Health care	Social activities	Other
EST	39,4%	8,1%	8,2%	16,2%	9,2%	28,2%
SL	38,8%	6,8%	15,5%	0,3%	6,9%	38,5%
LAT	36,9%	9,8%	8,9%	8,7%	6,9%	35,8%
SLO	35,1%	9,8%	9,8%	10,3%	11,9%	35,0%
LIT	34,4%	11,9%	5,3%	20,0%	4,3%	28,5%
GBR	32,8%	29,9%	5,7%	0,0%	3,7%	31,6%
BOL	32,8%	7,2%	10,4%	9,0%	4,5%	40,7%
BEL	31,9%	19,2%	17,2%	1,0%	5,8%	30,7%
HUN	29,3%	12,5%	17,4%	14,9%	6,1%	25,8%
CZR	29,1%	11,0%	12,4%	2,0%	8,3%	45,4%
NET	28,3%	15,2%	7,9%	1,6%	9,0%	47,0%
POL	26,2%	12,4%	9,5%	14,6%	7,4%	37,4%
IRL	22,7%	12,9%	3,3%	0,0%	5,2%	61,1%
GER	21,5%	24,1%	23,3%	2,4%	3,8%	28,6%
ROM	21,3%	17,1%	11,8%	8,4%	6,8%	41,4%
SWE	21,2%	26,5%	11,1%	27,3%	3,6%	14,1%
EU-27	20,5%	19,5%	15,5%	13,3%	5,1%	31,1%
SPA	19,2%	7,1%	18,3%	25,1%	5,7%	30,3%
FIN	18,7%	24,8%	14,4%	29,4%	3,9%	12,6%
AUS	18,5%	19,6%	0,2	22,4%	0,0	24,2%
LUX	17,0%	6,2%	25,1%	0,3%	13,0%	51,4%
FRA	15,3%	17,7%	17,0%	0,7%	9,8%	49,3%
DEN	10,7%	55,2%	4,0%	22,4%	2,3%	7,8%
POR	10,5%	6,3%	29,6%	4,9%	8,9%	48,7%
ITA	7,6%	5,2%	13,7%	46,6%	2,8%	27,0%
GRE	1,5%	12,1%	45,3%	0,0%	3,8%	41,1%
CYP	0,0%	0,0%	43,4%	0,0%	14,9%	56,6%
MAL	0,0%	0,0%	52,3%	0,0%	4,0%	47,8%

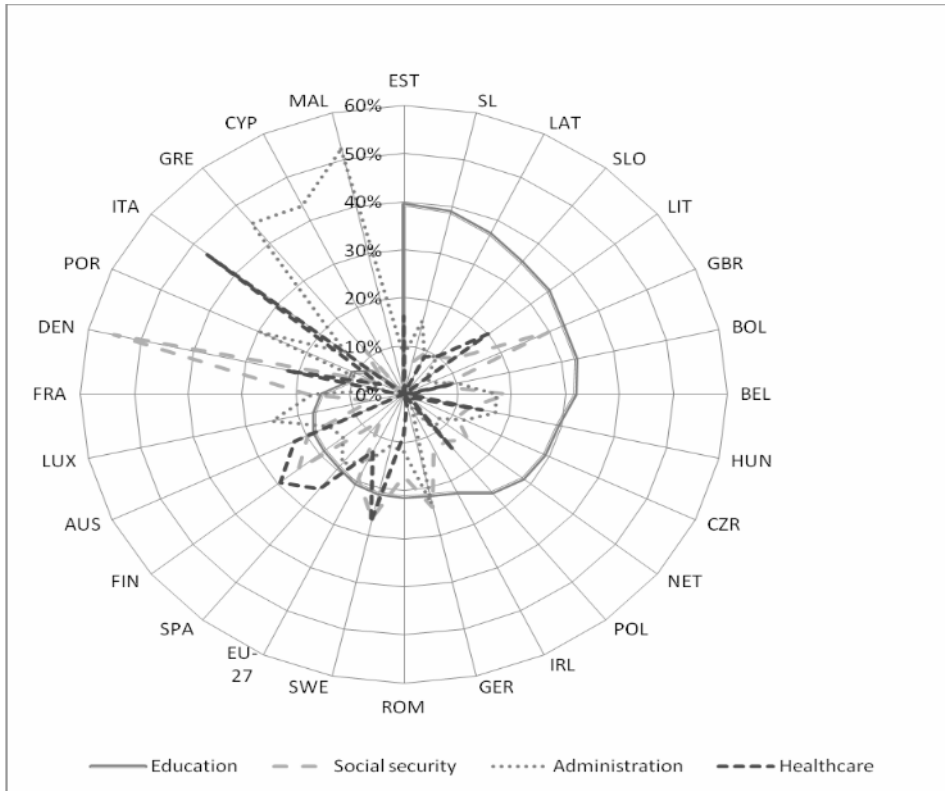
Source: Eurostat 2013, own calculation.

The remaining fields that do not exceed 5% in the structure of all expenditures of local government were merged into a single category under the name “other”. This category comprises competencies and

tasks in the field of maintaining public safety, housing and community amenities, environmental protection and defence. One of the main fields, for which local government spend the most funds is education with its implementation accounting on average for around a fifth of all expenditures of local government in the studied countries. The exceptions to this are only the countries that do not disclose any expenditures for education (e.g. Malta and Cyprus) or whose share of these expenditures is significantly below the average (Greece, Italy). On the other hand, countries such as Latvia, Slovakia and Estonia spend more than 35% of all expenditures on education.

Another important field of competencies of local authorities is social security that is especially pronounced in Denmark as it represents as much as 55% of all local expenditures. It is followed by countries such as Great Britain, Sweden, Finland, Germany and Austria that report expenditures higher than the average in EU-27 countries. We should highlight at this point the countries of Cyprus and Malta that do not report any expenditure for social security and education at the local level, but report the highest expenditures in addition to Greece when compared to other studied countries for administration and political system. The fourth field that is also deemed to be one of the main fields is healthcare. Expenditures for the performance of these tasks exceed 25% in four countries, namely Italy, Sweden, Finland and Spain, where the lower levels of government are competent for the provision of specialised healthcare services and basic healthcare.

Figure 2: The main fields of local expenditures in EU-27 countries in 2010



Source: Eurostat 2013, own calculation.

On the other hand, the responsibility for the financing of healthcare in countries such as Great Britain, France, the Netherlands, Belgium and Germany is for the most part in the hands of the central (state) level of government. Based on the international comparison of EU countries carried out from the point of view of the structure of expenditures that the lower levels of government report as arising from the performance of individual competencies, we can confirm the initially established hypothesis (H2). The shares of individual types of expenditures of local authorities for the implementation of tasks differ significantly from one another, but despite this, their structure is unified (based on the common classification of government functions, the COFOG). If we only focus on the main fields of expenditures, we see significant deviations between countries in terms of the value of reported expenditures arising from the implementation of competencies with respect to the calculated average values of total local expenditures of all EU member states for this

purpose. Our international comparison of fiscal decentralization systems of EU was complemented in the last part of this paper with an analysis of the compliance of fiscal decentralization systems with one of the basic the Charter principles, namely the principle of commensurability of financial resources of local self-government authorities with their assigned competencies and tasks. We verified this with the indicator of expenditure coverage with revenues or with the available financial resources.

### **Commensurability of Resources with the Competencies**

Table 4 shows the level of local expenditure coverage with revenues for the purpose of the implementation of tasks that is recorded by individual EU-27 countries. In this respect, we were interested primarily in whether these countries are managing to cover all disclosed expenditures with their resources or revenues, which would imply that they meet one of the main principles of the Charter in its entirety, namely the one stating that resources or revenues of local authorities should be commensurate with their competencies and tasks. The coverage of expenditures with revenues is most easily observed through the indicator of the ratio between the revenues of local government and expenditures disclosed by the local government in the period. This is the difference between the nominal value of revenues and expenditures (current and investment) of the lower levels of government. In case the calculated indicator is lower than 1, this means that local government in an individual country are not managing to cover all legally prescribed tasks or implement their competencies in the current accounting period without the help of the central (state) level, namely state transfers or the reallocation of funds between individual lower levels of government. This can also mean that they must borrow in order to implement their competencies whereby they accumulated a certain deficit that is certainly not sustainable in the long-term and represents a sort of erosion of the autonomy of the local self-government authorities in the long-term.

As can be discerned from Table 4, the total scope of financial resources in EU countries that belongs to the lower levels of government does not cover the disclosed expenditures (costs) of the lower levels of government in their entirety. The coverage of expenditures with revenues at the cumulative level of all studied countries is 95.1%. In the table, we specifically marked the countries that disclose a sufficient scope of financial resources with respect to the financial burdens of the lower levels of government (Bulgaria, Ireland, Cyprus, Lithuania, Luxembourg) or those whose lower levels of government dispose of financial resources that exceed the expenditure in the year under observation (Estonia, Sweden). In terms of the operating efficiency ratio,

we can classify these countries into the group with a high level of compliance with the studied principle of the Charter, i.e. the principle of commensurability of resources with the tasks. Into the second group of countries with the medium level of compliance, we classify the countries that have the value of the operating efficiency ratio that is higher than the calculated average of all EU countries (i.e. the coverage of expenditures with revenues is higher than 95.1%). The remaining 9 countries are classified into the group with a low level of compliance with the studied Charter principle because their coverage of disclosed expenditures of the lower levels of government with the financial resources at their disposal is lower than 95.1%.



Table 4: The coverage of local self-government expenditures with financial resources (OP ratio = revenues/expenditures) \*

	In Bill. of €	Local resources	Local expenditures	OP ratio
Belgium	BEL	75,1	78,3	0,959
Bolgaria	BOL	2,5	2,5	1,000
Czech R.	CZR	17	17,8	0,955
Denmark	DEN	87,5	88	0,994
Germany	GER	494,7	523	0,946
Estonia	EST	1,5	1,4	1,071
Irland	IRL	10,7	10,7	1,000
Greece	GRE	5,9	6,4	0,922
Spain	SPA	211,7	255	0,830
France	FRA	227	228,7	0,993
Italy	ITA	237,1	244,6	0,969
Cyprus	CYP	0,4	0,4	1,000
Latvia	LAT	1,9	2	0,950
Litva	LIT	3,1	3,1	1,000
Luxemburg	LUX	2,1	2,1	1,000
Hungary	HUN	11,5	12,3	0,935
Malta	MAL	0	0	0,000
Netherland	NET	96,4	101,2	0,953
Austria	AUS	47,7	51,2	0,932
Poland	POL	48,8	53,1	0,919
Portugal	POR	11	12,4	0,887
Romania	ROM	11,8	11,9	0,992
Slovenia	SLO	3,5	3,6	0,972
Slovakia	SL	4,2	4,8	0,875
Finland	FIN	40	40,5	0,988
Sweedon	SWE	89	88,5	1,006
Great Britain	GBR	237,3	238,3	0,996
Total EU - 27		1.979,40	2.081,80	0,951

Source: Dexia, 2012.

\*There is no data for the value of the revenues and expenditures of the lower levels of government in Malta, which is why the country is excluded from the international comparison for the purpose of determination of commensurability of financial resources with the tasks of the lower levels of government.

## **Conclusions**

The basic purpose of the paper was to carry out an international comparison of the otherwise different fiscal decentralization systems of EU countries in relation to certain basic principles of the Charter that direct countries to standardize the systems of fiscal decentralization in order to ensure these systems are more efficient. After reviewing the existing literature and the international comparisons carried out to date, we selected four comparative indicators for the purpose of this analysis and tied them together with two working hypotheses. The first hypothesis states that a higher number of lower levels of government in an individual country consequently also implies a larger share of local finance in the total public finance, while the second hypothesis states that despite the relative similarity of the structure of competencies of the local authorities in different countries, there is still great diversity between them in terms of the scope of funds that they allocate to the implementation of individual competencies.

The results of the analysis have shown that there are still significant differences between EU-27 countries, both in terms of the number of lower levels of government as in terms of the fiscal power and autonomy of financing. The countries compared thus have from one (municipalities) and all the way up to three levels of local self-government (municipalities, provinces, regions and federal states, etc.). The scope of funds they allocate to local issues is also significantly different from country to country. The most funds are allocated to local issues in Denmark (66% of total public finance or 37% of GDP), Spain (49% of public finance or 18% of GDP), Sweden (48% of public finance or 25% of GDP) etc., while the least funds are allocated to these issues by Cyprus and Greece (less than 10% of all public sector revenues or less than 3% of GDP). Despite this, our working hypothesis that more local self-government levels imply a higher share of local finance in the total finance cannot be entirely confirmed. It is true that a higher number of lower levels of government in principle also implies a larger share of financial resources within the total public finance (which is confirmed by a total of 6 out of 7 countries, with the exception of France), while the hypothesis in the opposite direction does not hold up to a test according to the selected criterion.

Next to that we carried out a comparative analysis of the expenditures of local self-government in selected countries within the scope of their competencies and tasks. The results show that despite the competencies and tasks of countries being quite similar, the scope of funds allocated for individual fields is nowhere near the same for all of them and there is extensive deviation from the average structural shares of local expenditures. Our international comparison was completed with an analysis of the compliance of the systems with one of the basic the Charter principles, principle of commensurability of financial resources with the competencies of local self-government. We verified this with the indicator of the coverage of expenditures with the financial resources available to the local authorities for the implementation of the tasks assigned to them. Out of all the countries, only seven exhibit a sufficient level of local revenues with respect to their needs, while on the whole, EU-27 countries have at their disposal approximately 95% of the funds required with respect to expenditures, meaning that they must acquire the difference either through transfers from the central level of government or through equalization schemes or borrowing.

Even though we are aware of the limitations of the comparative analysis of fiscal decentralization systems as compared to the comparative analysis using the index of fiscal decentralization, our estimate has provided a realistic description of the state-of-affairs in this field, while the findings and data can serve as a relevant basis for further in-depth study of this field.

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