FINANCING LOCAL PUBLIC SERVICES IN ESTONIA: CHALLENGES AND WAYS FORWARD

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Outline

• Shrinking population: overview of policy responses and fiscal impacts
• Population change in Estonia from municipal perspective
• Assessment of Estonia's multi-level governance model and municipal financing model
• Recommendations
Shrinking population at subnational government level: impacts and potential policy responses
Five approaches to deal with population shrinkage

- **Trivialising:** "The Numbers Are Incorrect"
- **Countering:** "We Are Not Going to Let that Happen"
- **Managing:** "Learning How to Deal with It"
- **Utilising:** "More for Fewer People"
- **Generalising:** "Establishing a Combined Growth and Shrinkage Strategy"

Source: adapted and modified from Hospers and Reverda (2015)
Potential fiscal impacts of shrinkage at subnational government level

• Shrinking own revenue base
  – Pressure to increase local tax rates
  – Risk for deficit budgeting (depending on fiscal rules)
  – Risk for debt accumulation
  – Increasing role of transfers

• Increasing per capita costs
  – Cuts on operating expenditures
  – Cutting back investments (both replacement and new)
    → declining local infrastructure → declining living standards → further population decline
Potential impacts on multilevel governance

• Pressure to reorganize services
  – Closures of facilities
  – Focusing on statutory services
  – Outsourcing service production

• Pressure to find alternative ways for service delivery
  – Intermunicipal cooperation
  – Cooperation with private sector and third sector
  – Municipal mergers (voluntary and compulsory)
Central governments as enablers of smooth adjustment to shrinkage

- **Planning** for the smaller population
  - Administrative reforms
  - Land use and spatial planning
- Helping **build capacity** at the local level
  - Up to date information base
  - Sharing best practices on strategies to tackle shrinkage
- Ensuring the **legal base** allows and encourages intermunicipal cooperation
- Rethinking **spending assignments** between levels of government
  - Regionalisation or centralisation
  - Privatisation
- Reforming subnational government **financing** to enable allocative efficiency
  - Transfer system, subnational government own revenues
Shrinking population and Estonian municipalities
Estonian population is projected to decline by 2040 in all but two counties.
Shrinkage will affect the majority of municipalities

Source: https://www.hendrikson.ee/maps/V%e3%a4ikeasulad/
Shrinking population continues to be a problem at the municipal level

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<thead>
<tr>
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<th>Year</th>
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<tr>
<td></td>
<td>2000</td>
</tr>
<tr>
<td>Number of municipalities</td>
<td>227</td>
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<tr>
<td>Average population size</td>
<td>6 173</td>
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<tr>
<td>Median population size</td>
<td>1 910</td>
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<tr>
<td>Average area, km²</td>
<td>192.1</td>
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<tr>
<td>Average density, inhabitants per sq. kilometre</td>
<td>171.2</td>
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<td>Share of municipalities with negative one year population change</td>
<td>59.5%</td>
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Decentralisation and municipal financing in Estonia
Education is the main task of Estonian municipalities

Source: Statistics Estonia.
Central government plays a key role in municipal financing

Source: Statistics Estonia.
Municipal finances are becoming increasingly dependent on grants

Source: Statistics Estonia.
The importance of earmarked grants is growing

Source: Statistics Estonia.
Estonia is among the least decentralised OECD countries from revenue perspective (right panel)

Applying single-tier subnational government system

Preparing for future reforms

• Reaping the full benefits from 2017 administrative reform
  – Reorganising municipal service structure and administration
  – Building municipal capacity to meet the future challenges

• Raising the awareness of effects of shrinking population
  – Central government could establish an advisory service for municipalities to prepare for shrinking population.
  – Creating a database on local costs to enable benchmarking between municipalities.
Utilising intermunicipal cooperation

• Creating the right conditions for intermunicipal cooperation (IMC)
  – Clarifying the legal base for IMC.
  – Creating financial incentives for voluntary IMC.
  – Utilising piloting and experiments on voluntary IMC.
  – Assisting municipalities to build administrative capacity to organise IMC.

• Rethinking municipal tasks
  – Carrying out a nationwide review of municipal service responsibilities.
Reforming the municipal financing model

• Strengthening the municipal own revenue base:
  – Finalizing land tax base revaluation (already underway).
  – Easing the land tax rate regulation.
  – Considering a local income tax in some form.

• Reforming the transfer system
  – Reducing/abandoning the earmarked grants system.
  – Strengthening the equalization.
  – Increasing the transparency and rethinking the indicators.
  – Taking the population change aspect into account in the grant system.
Thank you!

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