Fiscal decentralisation and subnational finance: strengthening local level capacity

Isabelle CHATRY

Project Manager, Subnational finance and territorial reforms
Regional Development Policy Division
OECD
The governance system of subnational government in the OECD

35 countries: 9 federal and 26 unitary including 137,635 subnational governments in 2015-2016:

- 133,007 municipal-level entities
- 4,108 intermediary-level entities
- 520 regional or state-level entities
The OECD: an institutional landscape very diverse and complex at subnational level

- The OECD institutional landscape which has dramatically changed over the last 20 years, especially since the crisis as a result of decentralisation or recentralisation processes and territorial reforms (municipal and regional mergers).

<table>
<thead>
<tr>
<th>9 countries with only one level:</th>
<th>18 countries with two levels:</th>
<th>8 countries with three levels:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Municipalities</td>
<td>- States/regions - Municipalities</td>
<td>- States/regions - Intermediary gov. - Municipalities</td>
</tr>
<tr>
<td>9 federations and quasi-federations</td>
<td>Australia Austria Canada Mexico Switzerland</td>
<td>Germany Belgium Spain¹ United States</td>
</tr>
<tr>
<td>26 unitary countries</td>
<td>Chile Korea Denmark Greece Hungary Japan Norway</td>
<td>New Zealand Netherlands Czech Republic Slovak Republic Sweden Turkey</td>
</tr>
<tr>
<td>Estonia Finland² Ireland Iceland</td>
<td>Israel Latvia Luxembourg Portugal² Slovenia</td>
<td>France Italy Poland United Kingdom³</td>
</tr>
<tr>
<td>Ukraine</td>
<td>Around 11 400 SNGs as of 2016</td>
<td></td>
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</tbody>
</table>

Notes: 1. Spain is a quasi-federal country. 2. Finland and Portugal have autonomous regions on part of the country. 3. There is an intermediary level only on part of England.
Decentralisation process needs to adopt an open-systems perspective linking political, administrative and fiscal reforms

Adopting an “open-systems” perspective

Overall process of state modernisation including public sector reform

Democratisation and wider governance reforms

National development strategies and processes

Decentralisation process

Political

Administrative

Fiscal

(elected)
Local governments municipal development

Local democracy and governance citizen participation

Local development strategies and processes

Global and regional context


Fiscal decentralisation is often the weak linkage of decentralisation reforms:

• Unsufficient transfers of financial resources compared to transferred spending responsibilities
  >> under or unfunded mandates

• Inadequate transfers of financial resources: lack of own resources
  >> fiscal imbalances
Subnational governments are key economic actors in Ukraine and in the OECD

Subnational government as a % of general government 2014 for OECD and 2015 for Ukraine

OECD  Minimum  Maximum  Ukraine

Expenditure

- Greece 40%
- New Zealand 33%
- Chile 59%
- Canada 63%
- Canada 89%**

Staff expenditure*

- Chile 66%
- Greece 33%

Investment

- Canada 59%

Tax revenue

- Estonia 18%
- Greece 20%

Debt***

- Greece 1%
- Canada 1%

*: No data for Chile and Australia
**: data to be checked.
***: Debt OECD definition ie including, in addition to “financial debt”, insurance reserves and other accounts payable. No data for Mexico, Chile and New Zealand.

Source: OECD except for Ukraine (IMF).
SNG expenditure as a % of GDP and public expenditure

Source: OECD except for Ukraine (IMF).
In Ukraine, SNG expenditure has increased in relation to GDP but not to public expenditure.
In Ukraine, primary areas of subnational spending are education, social protection and health.

[Bar chart showing spending distribution across different countries and categories.]

- Education
- Social protection
- Economic affairs
- Health
- Housing and community amenities
- Environment
- General public services
- Recreation, culture and religion
- Public order, safety and defence
Education, social protection and health are the main subnational spending items in relation to GDP (11%) but SNGs are main providers of housing, community amenities, health, education and recreation services.

Subnational government expenditure by area as a % of GDP

- Education: 4.2%
- Social protection: 3.7%
- Health: 3.0%
- Economic affairs: 1.0%
- General public services: 0.8%
- Housing and community amenities: 0.8%
- Recreation, culture and religion: 0.5%
- Environmental protection: 0.1%
- Public order, safety and defence: 0.0%

Subnational government expenditure by area as a % of public expenditure

- Housing and community amenities: 100%
- Health: 83%
- Education: 74%
- Recreation, culture and religion: 59%
- Economic affairs: 50%
- Environmental protection: 27%
- Social protection: 20%
- General public services: 15%
- Public order, safety and defence: 1%

Source: OECD except for Ukraine (IMF).
Subnational governments are key economic actors in Ukraine and in the OECD

Subnational government as a % of general government
2014 for OECD and 2015 for Ukraine

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Source: OECD except for Ukraine (IMF).
SNG staff expenditure account for 38% of SNG expenditure in Ukraine, higher than for OECD unitary countries

Source: OECD except for Ukraine (IMF).
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In 2015, SNG investment has represented a very large share of public investment.

Source: OECD except for Ukraine (IMF).
Strong fluctuations of subnational investment

Subnational investment as a % of public investment

Source: OECD except for Ukraine (IMF).
Strong fluctuations of subnational investment which is highly volatile

Subnational investment as a % of GDP

Source: OECD except for Ukraine (IMF).
Subnational governments are key economic actors in Ukraine and in the OECD

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**Data to be checked.
***Debt OECD definition ie including, in addition to "financial debt", insurance reserves and other accounts payable. No data for Mexico, Chile and New Zealand.
Main categories of subnational resources

- **Tariffs/fees** (from users)
- **Property income** (financial / physical assets)
- **Public contributions** (from taxpayers)
- **Borrowing**

**Transfers / grants and subsidies**
- Central government transfers
- International grants (e.g. EU funds)
- Other subnational governments (e.g. regional subsidies for municipalities)

**Direct and indirect taxation**
- **Own-source taxes** (property and land taxes, local company tax, game tax, tourist tax, waste disposal tax, etc.)

**Shared taxes** (personal income tax, company income tax, VAT, etc.)
The structure of subnational government revenue varies greatly across countries (%, 2014)

Source: OECD except for Ukraine (IMF).
Subnational resources and autonomy: no clear cut frontiers between grants and taxes

### Grants/transfers: Operating vs Investment

<table>
<thead>
<tr>
<th>Earmarked</th>
<th>General</th>
<th>Shared</th>
<th>Own-source / exclusive</th>
</tr>
</thead>
</table>

#### Ukraine
- Education grants for teachers salaries (Eastern EU countries)
- Social grants (Nordic countries, Netherlands)
- Healthcare grants (Spain, Italy, Sweden)
- Social housing (Ireland, Hungary)
- Infrastructures (Estonia, Ireland,)
- Environment (Poland)

#### Local government funds (France, Belgium, Denmark, Italy, Portugal, UK, Chile, Korea, Mexico, Netherlands, Norway etc.)

#### Equalisation Funds (Iceland, Sweden, Finland, Korea, etc.)

#### Shared taxes considered as grants (Austria, Slovak republic, Estonia)

#### Local surtaxes:
- CIT in Denmark and Finland
- PIT (Slovenia, Hungary, etc.)
- PIT and CIT in Poland, Switzerland
- PIT, CIT and VAT in Germany and Czech Rep.
- PIT in Italy, Norway
- PIT and CIT (Switzerland)
- Local consumption and inhabitant taxes in Japan (surtax on VAT and PIT)

#### Local business taxes (Germany, Luxembourg, Italy, Spain, Austria, France, Japan, etc.)

#### Property tax (in almost all countries)

#### Local income tax (Finland, Denmark, Sweden, Iceland)
Spending is more decentralised than revenues: the risks of fiscal imbalances

Source: OECD except for Ukraine (IMF).
SNG tax revenue accounted for 4.5% of GDP in Ukraine in 2015

Source: OECD except for Ukraine (IMF).
Subnational tax revenues as a % of GDP have declined since 2000

Source: OECD except for Ukraine (IMF).
SNG tax revenues has also strongly declined as a share of public tax revenues.

[Graph showing the decline in SNG tax revenues from 2001 to 2015. The peak is in 2002 at 38.3%, and by 2015 it has dropped to 17.8%.]
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Subnational government as a % of general government 2014 for OECD and 2015 for Ukraine

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***: Debt OECD definition ie including, in addition to "financial debt", insurance reserves and other accounts payable. No data for Mexico, Chile and New Zealand.
Ukrainian subnational government debt is low and dropped in 2015

Subnational government debt as a % of GDP and public debt

Source: OECD except for Ukraine (IMF).
THANK YOU

Isabelle.Chatry@oecd.org
Session 2: Key Questions for Discussion
Сесія 2: Важливі питання для обговорення

• Has fiscal decentralisation strengthened the ability of Ukraine’s hromadas to more effectively perform their responsibilities?
  
• Чи бюджетна децентралізація підсилила здатність українських громад більш ефективно виконувати їх функції?

• What are the main financing challenges for local infrastructure? How can they be addressed?
  
• Що саме становить головні проблеми фінансування місцевої інфраструктури? Яким чином їх можна розв’язати?

• What could be improved with respect to central government funding, own source revenues (local taxes, user tariffs, etc.) and external sources (borrowing)?
  
• Як можна збільшити фінансування з центрального рівня, доходи з власних джерел (місцеві податки, тарифи користувачів, тощо), а також фінансування із зовнішніх джерел (шляхом кредитування)?