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FISCAL DECENTRALISATION IN EU APPLICANT STATES AND SELECTED EU MEMBER STATES

REPORT PREPARED FOR THE WORKSHOP ON "DECENTRALISATION: TRENDS, PERSPECTIVE AND ISSUES AT THE THRESHOLD OF EU ENLARGEMENT"

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Executive summary

Within the next few years the EU will expand it's existing membership to include 10 or more economies in transition. This will be one of the most profound changes in the history of the Union. The combined 25 States will form a powerful economic and political block from the Russian border to that of Turkey and the Seas of Mediterranean and the Atlantic. The population make up around 480 millions inhabitants, as such constituting the largest single global market. The expansion is expected to have a profound impact on the functioning of the EU in a whole range of fields.

Recent years have seen an intense debate on how this expansion will inpact on economic performance and competitiveness, the functioning of labour markets, the balance of power between small and large EU countries, the achievement of a single market and a host of other issues. And yet one issue, which has received little attention, is how will this expansion affect the relationship between different levels of government within the 25 member States and, of equal importance, the relationship between these levels of government and the European Union.

At the outset of it taking the Presidency, the Danish government decided that these issues needed to be discussed. It had already commissioned the OECD – which is one of the leading actors in this area – to provide a first comparison of the fiscal relationships between different levels of government in the existing and new member States.

Carrying out this mandate was not easy since there is a clear lack of internationally comparable statistics. Fortunately, OECD, in co-operation with the World Bank, the Council of Europe, the UNDP and OECD Member countries (the Fiscal Decentralisation Initiative) was underway to complete surveys on fiscal design across levels of government in 10 European economies in transition. This information was the material used for this report, together with information currently available for a representative sample of EU countries.

The present report brings few recommendations. Rather it is seen as the starting point for an on-going debate and for that purpose the main findings and conclusions in the report are reported below.

Institutional arrangements

The constitutional arrangements for relationships between the different levels of government vary considerably between existing EU members. Some members are federations. Among the others, some have traditions for 'strong' local government, some for 'weak' local government, and some for an intermediate position.

The EU has a direct interest in sub-national government because it relies on sub-national authorities to carry out many of its functions, and it is committed to becoming closer to its citizens. Also, it is an extra layer of government, so it may impact on how countries allocate their remaining functions between tiers.

Countries which are in the euro-zone, or which may join it, need to adopt the Maastricht criteria. These include constraints on government budgets which may require closer co-ordination between central governments and sub-national governments than existed previously.

EU enlargement from 15 members to 25 will inevitably lead to some changes in the EU, and these may have effects on sub-national government. Also, arrangements for sub-national governments in the new members may be influenced by practices in the existing members, and vice versa.

The allocation of functions between national and sub-national governments

In each group of countries -- EU Member countries and applicant countries -- the most common categories of sub-national government expenditure are education, health, social security and welfare, housing and community amenities, recreation, cultural and religious affairs, and transport and communication. But the relative importance of these items varies widely between countries.

Total government spending in relation to GDP is around 40% in the applicant countries and 45% in the existing members. But the applicants decentralise much less of this spending: their sub-national government spending is 7% of GDP compared with 16% in the existing EU members. This may be partly because the applicants are economies in transition.

The structure and size of sub-national governments

About half of the applicant countries and half of the existing member countries have a regional tier of government. In almost every case, regional governments have evolved since 1970. In some applicants, regional governments have evolved from regional divisions of the central government. Similar divisions exist in most of the other applicants, and some of these may in future evolve into regional governments.

The lowest – or municipality – tier of local government often comprises very small authorities. In some cases, over half of these authorities have fewer than 1000 people. It may be hard to decentralise some activities to these authorities. But these authorities need not hinder the process of decentralisation if there is also a higher tier of larger local authorities, or if there is a tier of regional authorities, or if municipalities somehow organise joint provision of some services.

Main sources of sub-national government revenue

Just as the total level of sub-national expenditure in relation to GDP is lower in the applicant countries than in the existing members, so is the total level of sub-national revenues. The average figures are 8% for the applicants and 16% for the existing members. Sub-national revenues also account for a smaller proportion of total government revenues in the applicant countries – 19% as opposed to 27 %.

The relative importance of taxes, non-tax revenues and grants varies greatly between countries, both among the applicants and the existing EU members.

Sub-national authorities need some tax powers in order to reduce the level of central control over them, to give their voters an idea of the cost of sub-national services, to allow them to alter their spending levels in accordance with local wishes, and to deter them from blaming poor services on inadequate levels of grants. However, grants will be needed to help poor and needy areas. Also, the central government will not wish to decentralise too much tax power for fear of hindering its ability to achieve its macroeconomic goals.

Thus governments in countries with much decentralised expenditure may wish to finance large proportions of that expenditure through grants. Certainly the sub-national authorities in these countries tend to receive relatively low proportions of their revenues in taxes, and relatively higher proportions in grants.

In both applicant and existing member countries, sub-national taxes have tended to rise in relation to total sub-national spending and in relation to GDP.

Some issues facing both groups of countries

The most common sub-national taxes are taxes on incomes – which are used by 15 of the 18 countries covered - and taxes on property – which are used in 17 countries. However, the average yield of taxes on income is much higher: taxes on income averaged 2.89% of GDP in the applicant countries and 4.53% in the existing members, compared with 0.60% and 1.13% respectively for taxes on property. The preference for income taxes probably arises because property tax payments relate only loosely to ability-to-pay. A number of countries also have sub-national taxes on goods and services, but typically their yields are modest in relation to GDP. For the existing EU members, the yields of all types of sub-national taxes have risen in relation to GDP since 1980. The largest rise has occurred with income taxes.

The sub-national governments in the ten applicant countries have much less autonomy over their tax revenues than applies in the existing EU members for which data are available. Indeed, this is by far the biggest measurable difference between sub-national governments in the two groups.

Grants form the second largest source of sub-national revenues. On average, the applicant countries use general grants for about one-third of their grants and specific grants for two-thirds. Most of the specific grants depend on the recipient's own expenditure on the supported service. Most of the general grants are based on formulae that take no account of the recipient's tax efforts.

In almost all the applicant countries, sub-national authorities are given some freedom to determine their non-tax revenues, such as fees.

On average, 'own' taxes in the applicant countries, that is taxes whose bases and/or rates they control, account for only 7.3% of their revenues. The figure is zero in Bulgaria, Latvia and Lithuania.

Sub-national governments in the applicant countries are often allowed to borrow with relative freedom, but the freedom is constrained by little or no freedom to raise taxes to service any loans they make. Few of the applicant countries have institutionalised arrangements for bailouts. Given the little freedom to set taxes which sub-national governments have in these countries, the central governments have fairly firm control of sub-national budgets, whether or not there is a formal system of budget co-operation.

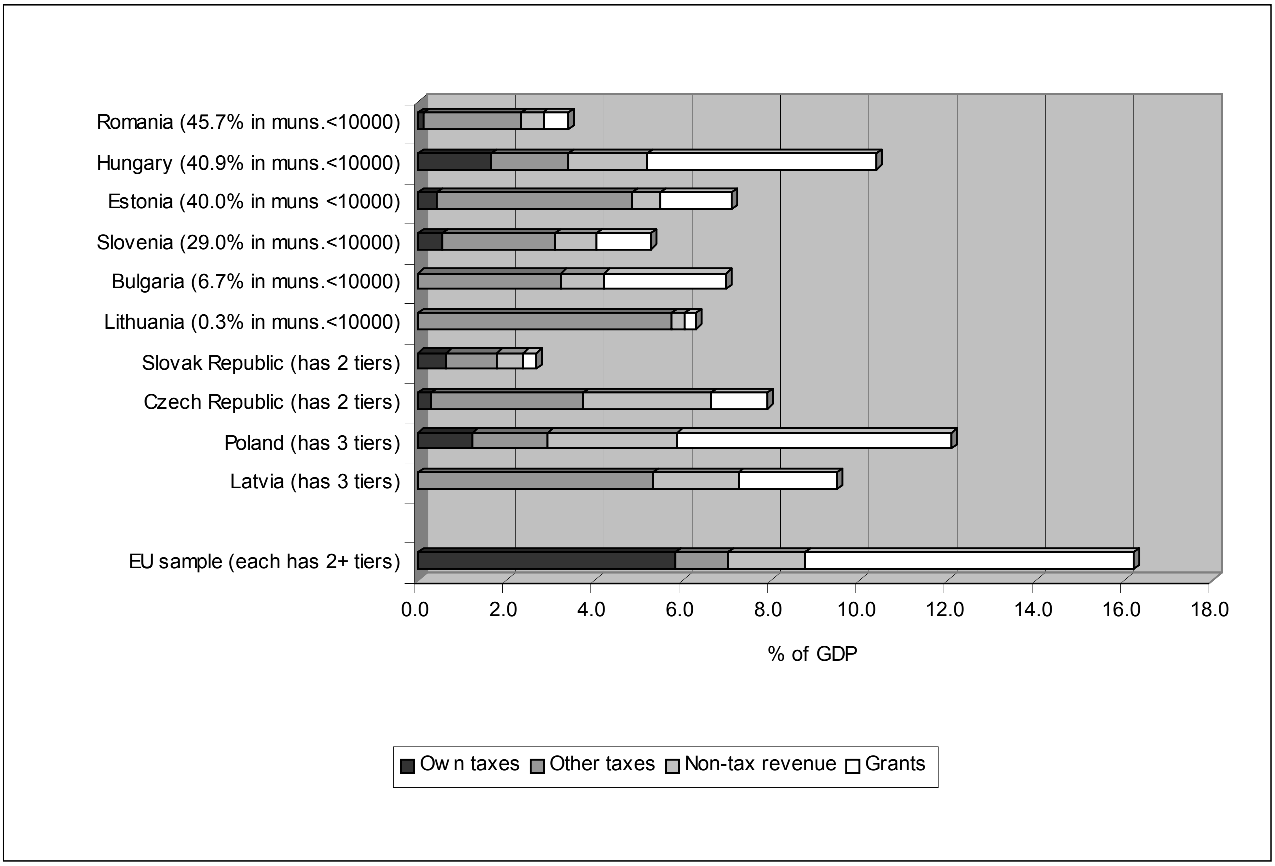
Conclusions

It is not easy to sum up the practices of the different applicant countries, but Figure 1.1 attempts to give a simple overview. Each applicant country has one bar on the chart, and there is a further bar for the mean for the sample of existing EU member countries. The applicant countries are arranged so that those with the highest percentages of people living in small authorities are at the top. Thus, in Romania, 45.7% of the population live in municipalities with fewer than 10,000 people, while the figure for Lithuania is 0.3%, so Lithuania is some way further down the chart. After Lithuania there come countries with two or more tiers of sub-national government (including regions) where it would be hoped that any problems of small sizes in the lowest tier of municipalities could be avoided by using higher tiers where necessary. In short, the position of the countries gives some indication of the potential for decentralisation in terms of size.

However, actual decentralisation in terms of expenditure as a percentage of GDP is shown by the length of the bars. It will be seen that the EU sample has more decentralised expenditure than the applicants have. Indeed, the lowest two levels of expenditure in the sample were 10.0% in France and 10.5% in the United Kingdom, and even these exceed all the applicants except Hungary and Poland. Nevertheless, Poland, Hungary and Latvia all have substantial levels of devolved spending. The levels are more modest elsewhere, especially in Romania and the Slovak Republic. It is worth noting that the level is high in

Hungary despite a potential problem with very small authorities, and it is low in the Slovak Republic where this problem can essentially be avoided because there are two tiers.

Figure 1.1: The percentage of GDP accounted for by sub-national expenditures, and the importance of different revenue sources, c.1999



Key: Muns. = Municipalities.

Sources: Tables 1.2, 1.5, 1.8 and 1.14.

Figure 1.1 adds a third aspect of decentralisation by giving information about sub-national government revenue sources. The black parts of each bar show the amount of spending financed by 'own taxes' whose rates or bases are under sub-national control. It can be seen that the situation here for the applicant countries is far less decentralised than in the EU sample. As with total spending, Hungary and Poland are the most decentralised in this respect which is perhaps surprising in Hungary, given its small municipalities. In contrast, there are no 'own taxes' in Bulgaria, Lithuania or Latvia.

The dark grey parts of the bars show other revenues from taxes, chiefly shared taxes, while the light grey areas show non-tax revenues. The combined revenues from these two sources are typically more important in the applicant countries than in the EU sample. Their modest role in the EU, combined with high spending in the EU, leads to a high degree of grants in the EU, as shown by the white parts of the bars.

It should be added in conclusion that no figures could fully capture the true degree of decentralisation. A country may have large authorities that spend large sums and rely substantially on 'own taxes' for their revenues. Yet their freedom could still be constrained by numerous pieces of legislation and directives about how they must provide their services. Admittedly, the converse of this does not apply: for small areas with little spending and few 'own taxes' cannot be seen as having much power, no matter how free they may be from the constraints of legislation or directives.

The preparation of the report

The project was led by Mr. Leif Jensen of the OECD Centre for Tax Policy and Administration (CTPA). Ms Dagmar Balve-Hauff and Mr Luca Gandullia from the CTPA have contributed to the report. Professor David King, Stirling University, Scotland has assisted in the final completion of the report, including the drafting of Chapter 1.

The country surveys, as presented in Chapter 2, were prepared in co-operation with the Ministry of Finance in the ten applicant countries. Contact persons for the surveys are brought in an Annex to the report. The results of the country surveys were presented to the FDI Steering Committee, at its Annual Meetings in 2001 and 2002.

The information about a sample of eight existing EU member countries that is given in Chapter 3 is not based on a new survey, but is instead based on information published elsewhere.

The present draft version of the report (13 September 2002) will be edited and redrafted, following the discussions at the Danish conference in Copenhagen 11-12 October 2002. *The present version is not for quotation.* Suggested changes and comments should be forwarded to Mr Leif Jensen, OECD, CTPA, 2 rue André-Pascal, 75775 Paris Cedex 16, France; fax 00 33 1 45 24 18 84 or e-mail: leif.jensen@oecd.org

CHAPTER 1

OVERVIEW ON FISCAL DECENTRALISATION IN SELECTED EUROPEAN COUNTRIES

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1.1 Introduction

1.1.1 Background and aims

There may be many levels of government operating in a country, but they can be divided into three groups:

1. any supranational authorities exercising taxation and expenditure functions within the country;
2. the central, federal or national government;
3. all sub-national governments, including those at a cantonal, provincial, regional or state level, and also those at a local or municipal level.

The EU currently has 15 existing members who adopt different approaches to sub-national government. Currently ten further countries have applied to join the EU, and they also adopt different approaches. These applicant countries are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Section 1.2 shows that there is a relationship between the EU and sub-national government, and it suggests that the enlargement of the EU may affect sub-national governments in both the existing members and the applicant countries. Because of this, it seems valuable to give an overview of the systems of sub-national government in the applicant countries, and to relate these practices to those that currently occur in the EU, and that is the main aim of this chapter. However, before presenting this overview, it is helpful to discuss the rationale for multi-level government, and this is done in section 1.3.

The remaining four sections of the chapter paper explore four key aspects of multi-level government. Thus section 1.4 looks at the allocation of functions between tiers, 1.5 looks at the size and structure of sub-national government, 1.6 looks at the main sources of finance, and 1.7 looks at other issues in finance.

1.1.2 Data

For its information on the ten applicant countries, this chapter relies heavily on the detailed information that is given in Chapter 2. That chapter is based on two very detailed questionnaire surveys which were conducted by the OECD, and it forms a crucial and valuable new resource. Some of this information has already been published by the OECD (2002).

For its information on the existing member states, the present chapter relies in large part on the information about a sample of eight existing EU member countries that is given in Chapter 3. This information is not based on a new survey, but is instead based on information published elsewhere; consequently, it does not present new data, and its does not always give data that is comparable to that found in Chapter 3.

1.1.3 The sample of EU members used for comparison with the applicants

The reason for using eight EU members out of the present 15 is to give some idea of the range of current practices. In choosing the sample of eight, it seemed appropriate to omit the two largest federations in the EU, Austria and Germany, because none of the ten applicant countries is a federation. It also seemed appropriate to omit Luxembourg whose population is much smaller than that of any of the applicant countries. Of the 12 remaining existing EU members, the following were chosen as giving a representative scope: Belgium, Denmark, France, Italy, the Netherlands, Spain, Sweden and the United Kingdom.

1.1.4 Qualifications about comparisons between the two groups of countries

In many aspects of sub-national government, the analysis of this chapter suggests that the differences between individual applicants and between individual members in the sample of existing members are greater than the differences between the two groups as a whole. But in other aspects, there are some clear differences between the two groups. However, any judgements based on these differences should be made with extreme caution. For it should be appreciated that other results might arise if the applicants were not also countries in transition, or if the sample of existing members was changed. And, above all, it should be appreciated that there may be lessons in both directions, that is from applicants to existing members as well as the other way round.

1.2 Sub-national government and the EU

1.2.1 Current approaches to sub-national government within the EU

The 15 existing EU members adopt different approaches to sub-national government. These approaches can perhaps be divided into four groups, although the allocation of countries between groups (ii) to (iv) could inevitably be debated.

i) In some cases, notably Austria, Germany and also Belgium, there is a federal approach, where a state level of government has constitutionally guaranteed powers and a level of sovereignty.
ii) In other cases, notably Denmark, Finland and Sweden, there is a traditional of relatively strong sub-national government with substantial functions that are performed with a high degree of autonomy.
iii) In other cases, notably Greece, Ireland and Portugal, there is a tradition of relatively weak sub-national government, with limited sub-national functions that are performed with limited autonomy.
iv) In the remaining cases, France, Italy, Luxembourg, Netherlands, Spain and the United Kingdom, there is a tradition of sub-national government where the functions performed by sub-national authorities and/or the level of autonomy which they have are intermediate between those found in groups (ii) and (iii).

The different approaches can be explained in terms of different historical perspectives and different needs. However, because needs are relevant, and because needs change, so the arrangements in each country tend to evolve over time. Moreover, there has in recent years been a growing literature on the arrangements in individual countries and on comparisons between them, and the resulting exchange of ideas produced by this literature has itself played a part in the evolution that can be observed in several countries.

1.2.2 The impact of the EU on sub-national government

The EU is a supra-national body which, at first sight, might seem unrelated to sub-national government. Nevertheless, there are both pro-active and reactive reasons why the EU may impact on the patterns of sub-national government which EU members adopt. On the pro-active side, the EU has a direct interest in sub-national government for three reasons.

i) The EU depends on sub-national governments to carry out many of its functions. For instance, in recent years the EU has assumed responsibilities in fields such as health, education, transport and the environment. These are often the concern of sub-national governments.
ii) Sub-national authorities have to spend additional resources to implement EU policy decisions.
iii) One of the EU's goals is to become more democratic and closer to its citizens and it can achieve this if there is a closer relationship with sub-central governments.

These factors all imply the formal participation of sub-national governments in EU decision processes. Partly because of this, the issue of decentralisation within the EU, and also the need to strengthen the principles of proximity, subsidiarity and transparency, were put on the EU enlargement agenda at the Ronneby Conference during the Swedish EU Presidency and at the Segovia Seminar during the Spanish EU Presidency.

Aside from any direct EU interest in sub-national governments, the structure or organisation of sub-national government may by affected when member countries react to developments in the EU. There are several reasons why such reactions may occur.

i) The EU is an extra level of government which may inevitably lead member countries to re-examine the allocation of their remaining government powers and functions between national and sub-national governments.
ii) There is a possibility that some central governments might perceive EU membership as leading to a loss in national government powers, so they might be tempted to preserve their overall influence by strengthening their powers or control over sub-national authorities.
iii) The EU members form a club where the interplay of ideas is increased, so that there may be greater pressures to learn from each other.

1.2.3 EMU and sub-national government

A further reason why the EU impacts on sub-national government applies particularly in those countries which use the euro, but it also applies to some extent in the remaining countries which may use it later. In these countries, the task of macroeconomic stabilisation tends to be attributed to the EU, and this then has to balance the need for macroeconomic stability against the need for microeconomic efficiency in the allocation of resources which is handled partly by sub-national governments. A particular problem has been ensuring that sub-national governments never face a 'soft-budget constraint', that is a situation where they suspect that the central government will bail them out if they embark on opportunistic behaviour which carries a risk of financial difficulty.

Thus, in pre-euro times, all EU members had to address the issue of how to balance sub-national financial discretion with the need for macroeconomic stability. Various alternative models were used. These included: sole or primary reliance on market forces; co-operation between levels of government; rules-based controls for sub-national governments; and administrative controls over sub-national governments. Each of these has had some impact on the procedures adopted by EMU. Perhaps most importantly, each member seeks to maintain the economic and fiscal convergence criteria, and in some cases such as Austria, Belgium, Denmark, Italy and Spain, procedures have been adopted for stabilisation agreements with sub-national governments, that is for closer co-ordination of national and sub-national budgets.

1.2.4 The impact of EU enlargement on sub-national government

Ten countries from Eastern Europe have applied for EU membership: This proposed enlargement has the potential for a large impact on sub-national government in both applicant and existing member countries. For the applicants, the impacts will be those which have just been outlined as affecting existing members. For the existing members, the large increase in size from 15 to 25 members means that the EU is liable to undergo some changes in its nature, and that in turn will lead to some changes in its effects on, and in its interest in, sub-national government in existing members.

One particular point to recall is that one catalyst for change in sub-national government in EU member countries has been the interchange of information about their various practices. Enlargement means that the existing members will offer insights for new members, and that new members will offer insights for the existing members. This last point is of special importance because all ten applicants are countries in transition. During their periods of transition, each of these countries has undertaken major reforms in its system of sub-national government. Because these countries have, typically, looked afresh at sub-national government, there is a sense in which they may well have fresh ideas that will influence existing members.

1.3 The rationale for sub-national government

A country which wanted a simple system of government might well prefer to vest all government powers and activities in the national government rather than spread them between the centre and one or more levels of sub-national authorities. Yet every OECD country and every one of the ten applicants has at least one tier or sub-national authorities, and many countries have more than one such tier. What arguments can be given for – and against – having one or more tiers of sub-national government?

1.3.1 Key arguments from the theory of fiscal federalism

The traditional theory of fiscal federalism highlights two key advantages that sub-national governments have with regard to the provision of government services. First, sub-national governments can provide their services differently from one another, in accordance with variations in preferences between different parts of the nation. Arguably, this advantage is stronger when sub-national elections about sub-national service levels also involve decisions about the sub-national taxes that are needed to pay for them. Secondly, decentralised provision may lead to more experiment and innovation in service provision. This is partly because there will be more service managers to have ideas, and partly because it is easier to have sub-national experiments than central ones.

If these advantages were the only arguments, then there would be a case for decentralising the provision of all government services. However, the theory of fiscal federalism also points to two possible disadvantages with decentralisation. So to see whether decentralisation is appropriate in the case of any particular government service, the arguments for decentralisation in facilitating local choice and experiments must be balanced against the two possible disadvantages.

One of these disadvantages is the possibility that some services may be subject to economies of scale which would be lost through sub-national provision. This argument has lost some of its force in recent years because there has been more interest in sub-national authorities purchasing services from private producers who might themselves be large enough to be able to enjoy the relevant economies of scale. However, this possibility must be qualified because a sub-national government which purchases services from a private producer may have less control over the service than it would have if it produced it itself.

The other disadvantage is that a sub-national authority might provide a local service with external 'spillover' effects on residents elsewhere. A providing authority might ignore these externalities when deciding on its provision, and so it might ignore any benefits or costs which its services impose on non-residents. In contrast, if there is central provision, then the central government can allow for the effects of government services on everyone.

1.3.2 Further arguments concerning multi-level government

Three more arguments for decentralisation may be mentioned here. First, by having more than one tier of government, voters have more than one set of elections to participate in, and this may improve the signalling mechanism between voters and representatives. However, this argument is much weakened if the taxes levied by the different tiers vary greatly from their expenditure levels, because voters may be misled over the cost of their respective services.

Secondly, having more than one level of elected representative means that the representatives in any one tier are not responsible for all government activities. This allows the representatives to specialise in a range of activities, and that in turn may help them to exercise those functions more effectively. An interesting aspect of this argument has been recent research showing that the macroeconomic policies of decentralised countries may be better than that of centralised countries (see, e.g., King and Ma, 2000). Macroeconomic policies are always handled by central politicians, and it is possible that the central politicians in decentralised countries do better because they have fewer other activities to distract them.

Thirdly, there are cases where decentralisation may lead to higher quality public services. Suppose, for instance, that health services are a public responsibility. A proposal to raise national taxes for a better national service may be rejected if many voters suspect that, while they would certainly have to pay higher taxes, they might not see better services in their own area. But a proposal for higher sub-national taxes for better sub-national services may be accepted because most voters might feel that there was a good chance of seeing sub-national improvements in response to the higher sub-national taxes.

To set against these extra arguments for sub-national government, two further arguments against decentralisation will also be mentioned. First, there is perhaps an inherent tendency for sub-national authorities to have conflicts with the centre. One potential source of conflict is that the national government may feel that sub-national aspirations for taxes and public spending exceed what the country can afford. It is possible, though, that sub-national electorates might counter by arguing that they should be able to spend as much as they choose in sub-national taxes for the provision of sub-national services.

Secondly, some areas are poorer than others, and some have higher spending needs, and the central government may wish to constrain the extent to which service levels can vary between areas as a result. One way of constraining these variations is by paying grants to poor and needy areas. However, devising suitable grants is tricky, and the national government might instead prefer to ease the problem by reducing the number of sub-national services.

1.3.3 The new institutional economics

Mention should also be made of the so-called 'strong new institutional economics'. This argues that all the arguments given so far have taken as their premise the view that the government is certain to undertake some activities, such as providing health, education, defence and so on, and the arguments have sought to consider which of these activities are most suited for sub-national governments. But why do governments undertake these activities at all? It is because markets may not work very satisfactorily for these items. However, governments may not work wholly satisfactorily either. For instance, they may lack the information needed to secure the best outcomes. Also, they may receive weak signals about voter preferences through the ballot box. And they may be confounded by opportunistic budget-maximising bureaucrats.

This new approach leads to the suggestion that governments should often work in partnership with the private sector, rather than as a substitute for it. This insight helps to explain the growing interest in public-private partnerships, in the use of private finance for assets used for public services, and in the purchasing of government services off the private sector. In turn, this approach gives a somewhat reduced role for all levels of government. And it argues that the extent to which local authorities should get involved depends, in addition to all the factors noted above, on their administrative capacity.

1.3.4 Regional and local identities

The key arguments from the theory of fiscal federalism, and the other arguments noted above, may well help explain some of the decentralisation that is observed in practice. For instance, arguments about economies of scale are an important factor in explaining why defence is never decentralised and, indeed, why it is often entrusted to, or shared with, supranational bodies. Again, arguments about spillovers may explain why major roads are often handled centrally. In contrast, the absence of economies of scale or spillovers in the case of parks and minor roads may explain why they are often entrusted to sub-national governments. However, there are probably few countries where the allocation of functions has been established following an analysis based on the arguments involved in the theory. Instead, most EU countries have an allocation that has evolved over time rather than being decided de novo on the basis of theory.

One interesting type of evolution has occurred in those EU countries that have responded to desires by different parts of a nation with strong individual identities for regional assemblies that allow a measure of self-determination. Examples of this include the introduction of 'strong' regional assemblies in parts of Spain, for instance in the Basque region and in Catalonia, the introduction of federalism in Belgium, and the introduction of regional assemblies in the United Kingdom for Scotland and Wales. Similar forces may also have encouraged the evolution of regional assemblies in Italy, and they may in time lead to some similar institutions in France for Brittany and Corsica.

While the introduction of regional authorities may sometimes have been seen as merely a response to regional pressure, the authorities have often proved in practice to be attractive in their own right. Thus Spain is currently strengthening the 'weak' regions to become as strong as the 'strong' regions, and the United Kingdom government is interested in the possibility of introducing regional assemblies in England that will be loosely comparable to those in Scotland and Wales.

Despite this growing interest in sub-national government at the regional level, most sub-national government takes place at the local level. Here, although identities may often be weaker than at the regional level, they may be strong enough to encourage local democracy and local transparency.

1.4 The allocation of functions between national and sub-national governments

This section attempts to compare the allocation of functions to sub-national governments in the ten applicant countries with the sample of existing members. The section is based on figures in Chapters 2 and 3.

1.4.1 The distribution of sub-national spending across different functions

The most straightforward comparison is given in Table 1.1, which reproduces some figures in Chapters 2 and 3 for all ten applicant countries and for the five existing members in the sample for which they are available. These figures show the percentage of sub-national expenditure accounted for by the 14 sub-headings for government expenditure that are used in the OECD's *National Accounts*. As well as giving figures for each of the countries covered, Table 1.1 also gives mean figures for the two groups of countries.

Table 1.1 **Sub-national government spending by function as a percentage of total sub-national government spending in the applicant countries and existing members, c.1999**

	1 General public services	**2 Defence**	**3 Public order &safety**	**4 Education**	**5 Health**	**6 Social security & welfare**	**7 Housing & community amenities**	**8 Recreational, cultural & religions affairs**	**9 Fuel & energy**	**10 Agriculture, forestry, fishing & hunting**	**11 Mining, manufacturing & construction (except fuel and energy)**	**12 Transportation & communication**	**13 Other economic affairs**	**14 Other functions**	***Total***
Bulgaria *(2000)*	8.0	0.8	0.0	33.4	22.0	16.8	9.0	3.0	0.0	0.5	0.0	4.7	1.2	0.5	***100.0***
Czech Republic *(1999)*	13.5	0.1	2.5	10.0	1.1	9.3	31.7	6.8	0.0	0.6	0.2	17.7	0.6	5.7	***100.0***
Estonia *(1999)*	13.5	0.0	0.3	40.8	1.2	12.5	10.4	9.0	1.0	0.1	0.0	5.5	1.7	3.8	***100.0***
Hungary *(1999)*	14.3	0.1	1.2	32.6	18.6	16.1	8.6	4.6	0.0	0.7	0.1	1.2	1.0	0.8	***100.0***
Latvia *(1999)*	13.0	0.0	1.6	49.5	1.1	8.7	10.4	5.6	0.1	0.1	0.0	4.5	0.2	5.1	***100.0***
Lithuania *(1999)*	4.6	0.0	0.8	56.3	0.5	16.1	7.9	4.9	3.1	0.0	0.0	3.4	0.0	2.2	***100.0***
Poland *(1999)*	8.8	0.0	5.1	33.9	2.5	10.9	22.8	5.1	0.0	2.2	0.6	7.1	0.3	0.6	***100.0***
Romania *(2000)*	15.6	0.0	2.0	7.9	0.2	13.4	23.8	7.7	0.0	0.7	0.0	23.3	0.8	4.6	***100.0***
Slovak Republic *(2000)*	22.8	0.0	2.8	0.2	0.6	1.8	38.1	8.6	0.0	3.4	0.2	13.0	3.9	4.4	***100.0***
Slovenia *(2000)*	14.3	0.3	1.9	24.1	1.7	3.9	23.7	10.0	0.0	2.5	0.0	11.3	6.0	0.3	***100.0***
Mean	***12.8***	***0.1***	***1.8***	***28.9***	***5.0***	***11.0***	***18.6***	***6.5***	***0.4***	***1.1***	***0.1***	***9.2***	***1.6***	***2.9***	***100.0***
Denmark *(2001)*	4.0	0.0	0.3	13.4	16.5	56.7	0.8	2.8	0.0	0.0	0.0	0.0	5.0	0.0	***100.0***
France *(1993)*	10.7	0.0	2.3	19.7	2.3	17.7	24.1	7.7	4.2	0.0	0.0	3.6	0.0	7.9	***100.0***
Netherlands *(1997)*	9.4	0.0	3.4	17.9	2.6	22.6	20.0	5.8	0.5	0.0	0.5	6.7	0.0	10.6	***100.0***
Spain *(1997)*	6.9	0.0	4.2	18.3	20.5	5.1	10.7	5.6	0.1	3.5	1.0	7.2	2.7	14.2	***100.0***
United Kingdom *(1998)*	4.0	0.0	12.3	28.7	0.0	32.5	5.4	3.1	0.0	0.1	0.0	4.9	1.0	8.0	***100.0***
Mean	***7.0***	***0.0***	***4.5***	***19.6***	***8.4***	***26.9***	***12.2***	***5.0***	***1.0***	***0.7***	***0.3***	***4.5***	***1.7***	***8.1***	***100.0***

Note: For data reasons, three countries in the EU sample had to be omitted in this table – these were Belgium, Italy and Sweden.

Sources: Chapter 2 (Tables 2.6a and 2.6b) and Chapter 3 (Table 3.7).

Looking at the means, the table shows some clear similarities between the two groups. In particular, in each group there is negligible sub-national expenditure on categories (2) defence, (9) fuel and energy, (10) agriculture, forestry, fishing and hunting, (11) mining, manufacturing and construction, and (13) other economic affairs. The case of defence was noted in section *1.3.4*, which argued that economies of scale are likely to point to central or supranational provision. For the other categories, which are all part of industrial policies, the argument for central provision is related to the fact that almost all macroeconomic policies tend to be centralised. This in turn is partly because it is hard to find instruments which sub-national governments could use to operate macroeconomics policies - for instance they could not use monetary policy, exchange rate policy and tariffs – and it is partly because any macroeconomic actions by one area would have spillover effects on others. Indeed, it is largely for similar reasons that macroeconomic policies within the EU are being co-ordinated far more than used to be the case.

Among the other expenditure categories, it is hard to make much of differences in the broad headings of (1) general public services and (14) other functions. Elsewhere, the mean spending percentages seem much higher in the EU countries for (3) public order and safety, (5) health, and (6) social security and welfare. But these high EU means chiefly reflect anomalies in individual countries. In the case of law and order, police services in the UK are, most unusually, a local authority activity. In the case of health and social security, there is an exceptional degree of decentralised activity in Denmark. Police services are usually quite centralised, perhaps out of spillover and economies of scale considerations, and the United Kingdom government has attempted over many years to get some share of responsibility, even if spending is ultimately handled locally. Social security is typically centralised on the grounds that there are problems with decentralised redistribution. The problem is that it is hard for any one area to pursue a more redistributive policy than the least redistributive area, for fear of attracting poor people from that area and driving rich people to it. Indeed, it is for this reason that Danish local authorities actually operate social security on an agency basis for the central government, for they follow central policy guidelines and are reimbursed for their expenditures.

The three remaining categories of expenditure are (4) education, (7) housing and community amenities, and (8) recreational, cultural and religious affairs. These are common local authority activities because they have limited spillover effects and offer little economies of scale arguments to point to central provision. In each case, the mean spending percentages are lower in EU member countries than in the applicant countries. However, to explore the relative degree of sub-national spending on these categories in the two groups of countries, it is helpful to refer to Table 1.2.

Table 1.2 **Sub-national government spending by function as a percentage of GDP in the applicant countries and existing members, c.1999**

	1 General public services	**2 Defence**	**3 Public order &safety**	**4 Education**	**5 Health**	**6 Social security & welfare**	**7 Housing & community amenities**	**8 Recreational, cultural & religions affairs**	**9 Fuel & energy**	**10 Agriculture, forestry, fishing & hunting**	**11 Mining, manufacturing & construction (except fuel and energy)**	**12 Transportation & communication**	**13 Other economic affairs**	**14 Other functions**	***Total***	**Total current government expenditure as % of GDP**
Bulgaria *(2000)*	0.6	0.1	0.0	2.3	1.5	1.2	0.6	0.2	0.0	0.0	0.0	0.3	0.1	0.0	***7.0***	40.0
Czech Republic *(1999)*	1.1	0.0	0.2	0.8	0.1	0.7	2.5	0.5	0.0	0.0	0.0	1.4	0.0	0.5	***7.9***	43.0
Estonia *(1999)*	1.0	0.0	0.0	2.9	0.1	0.9	0.7	0.6	0.1	0.0	0.0	0.4	0.1	0.3	***7.1***	36.2
Hungary *(1999)*	1.5	0.0	0.1	3.4	1.9	1.7	0.9	0.5	0.0	0.1	0.0	0.1	0.1	0.2	***10.4***	44.0
Latvia *(1999)*	1.2	0.0	0.2	4.7	0.1	0.8	1.0	0.5	0.0	0.0	0.0	0.4	0.0	0.5	***9.5***	41.4
Lithuania *(1999)*	0.3	0.0	0.1	3.5	0.0	1.0	0.5	0.3	0.2	0.0	0.0	0.2	0.0	0.1	***6.3***	32.1
Poland *(1999)*	1.1	0.0	0.6	4.1	0.3	1.3	2.8	0.6	0.0	0.3	0.1	0.9	0.0	0.1	***12.1***	43.6
Romania *(2000)*	0.5	0.0	0.1	0.3	0.0	0.5	0.8	0.3	0.0	0.0	0.0	0.8	0.0	0.2	***3.4***	33.5
Slovak Republic *(2000)*	0.6	0.0	0.1	0.0	0.0	0.0	1.0	0.2	0.0	0.1	0.0	0.4	0.1	0.1	***2.7***	41.8
Slovenia *(2000)*	0.8	0.0	0.1	1.3	0.1	0.2	1.3	0.5	0.0	0.1	0.0	0.6	0.3	0.0	***5.3***	44.1
Mean	***0.9***	***0.0***	***0.1***	***2.3***	***0.4***	***0.8***	***1.2***	***0.4***	***0.0***	***0.1***	***0.0***	***0.5***	***0.1***	***0.2***	*7.2*	***40.0***
Denmark *(2001)*	1.2	0.0	0.1	4.1	5.0	17.3	0.2	0.9	0.0	0.0	0.0	0.0	1.5	0.0	***30.5***	53.2
France *(1993)*	1.1	0.0	0.2	2.0	0.2	1.8	2.4	0.8	0.4	0.0	0.0	0.4	0.0	0.8	***10.0***	46.2
Netherlands *(1997)*	1.3	0.0	0.5	2.4	0.3	3.0	2.7	0.8	0.1	0.0	0.1	0.9	0.0	1.4	***13.3***	45.9
Spain *(1997)*	1.1	0.0	0.7	3.0	3.4	0.8	1.8	0.9	0.0	0.6	0.2	1.2	0.4	2.4	***16.6***	41.2
United Kingdom *(1998)*	0.4	0.0	1.3	3.0	0.0	3.4	0.6	0.3	0.0	0.0	0.0	0.5	0.1	0.8	***10.5***	36.9
Mean	***1.0***	***0.0***	***0.6***	***2.9***	***1.8***	***5.3***	***1.5***	***0.7***	***0.1***	***0.1***	***0.1***	***0.6***	***0.4***	***1.1***	***16.2***	***44.7***

Note: For data reasons, three countries in the EU sample had to be omitted in this table – these were Belgium, Italy and Sweden.

Sources: Table 1.1, Chapter 2 (Tables 2.6a and 2.6b) and Chapter 3 (Table 3.7).

1.4.2 Sub-national spending by function as a percentage of GDP

Like Table 1.1, Table 1.2 concerns the allocation of sub-national spending across different categories. However, it shows the spending on each function as a percentage of GDP. So, while the figures for each country in Table 1.1 summed to 100%, the totals in Table 1.2 vary.

Although Table 1.1 showed that sub-national spending on (4) education, (7) housing and community amenities, and (8) recreational, cultural and religious affairs accounts for a higher share of sub-national spending in the applicant countries, Table 1.2 shows that sub-national spending on these items accounts for very similar shares of GDP. Thus sub-national spending on education accounts for 2.3% of GDP in the applicant countries and for a comparable 2.9% in the six existing members. Likewise sub-national spending on housing and community amenities accounts for 1.2% of GDP in the applicant countries and for a comparable 1.5% in the existing members. And sub-national spending on recreational, cultural and religious affairs accounts for 0.4 of GDP in the applicant countries compared with 0.7% in the existing members. It will be noticed that it each case, the figure for new members is actually a little lower than the figure for existing members.

In Table 1.2, the figures for spending on each category inevitably vary between countries. But perhaps the most striking variations occur with education and health. Sub-national authorities seem to play an important part in education provision in almost every country. The main exceptions are the Slovak Republic, where the figures point to negligible sub-national involvement, and the Czech Republic and Romania where they point to relatively little sub-national involvement. However, figures can be misleading. For example, in the case of the Czech Republic, local authorities are responsible for providing schooling, but the national government pays teachers' salaries and buys a proportion of textbooks, thus reducing local expenditure. In contrast, sub-national authorities rarely play a major part in health provision. The main exceptions are Bulgaria, Hungary, Denmark and Spain.

Among the ten applicant countries, Table 1.2 also shows some quite wide variations in spending on housing and amenity services. The highest figures, of 2.5% and 2.8% of GDP, are to be found in the Czech Republic and Poland. It is suggested in Chapter 2 that this is because these two countries seem largely to have maintained the former state-dominated structure of housing provision. While this may well be so, it is notable that there are comparable figures of 2.4% and 2.7% in France and the Netherlands.

If the figures for total sub-national public spending are examined, then it will be seen that sub-national spending accounts for an average of 7.2% of GDP in the applicant countries. This is much lower than the average of 16.2% for the existing members. About a third of this gap can be attributed to the facts noted above, namely that there is an exceptional degree of decentralised expenditures for public order and safety in the United Kingdom, and for health and for social security and welfare in Denmark.

It might be assumed that the remaining two-thirds of the gap must be attributable to the applicant countries having a lower desire to decentralise government spending. This idea receives some support from the final column in Table 1.2, which shows total government spending – national as well as sub-national – as a percentage of GDP in each country. Here, the mean figure of 40.0% for the ten applicant countries is quite close to the mean of 44.7% for the five existing EU members, so it is clear that a lower proportion of the applicants' total public expenditure is decentralised. However, before concluding that this reflects less desire for decentralisation, it should be remembered that the applicant countries are all economies in transition, at different stages of development from the existing members, with a different pattern of public spending as a whole, and with different priorities.

1.5 The structure and size of sub-national governments

Many countries have more than one tier of sub-national authorities. Often, the upper tier is called a regional tier. This section looks in turn at regional bodies and local authorities.

1.4.1 Regional bodies

The questionnaire to the applicant countries defined regional bodies as 'governmental units exercising a competence independently of central government in a part of a country's territory that encompasses a number of localities'. Although this classification derives from that given by the IMF (e.g. 1986, p.86) it is a slightly loose definition, for it does not indicate clearly when the highest tier of sub-national governments should be termed a regional tier and when it should be termed an upper tier of local authorities. It is certainly possible that a tier of so-called regional authorities in one country might be smaller than a so-called highest tier of local authorities in another, and indeed this does happen. For example, the 28 regions in Latvia having a mean population of under 100,000, whereas the local authorities in Scotland (United Kingdom) have a mean population of over 150,000. In its own *Revenue Statistics*, the OECD bypasses these difficulties by restricting the term regional government to states in federal countries.

However, in this chapter, and in Chapters 2 and 3, the term is widened on the basis of the IMF definition. And although in principle this is a slightly loose term, in practice countries seem to have little difficulty deciding whether their highest level of sub-national authorities should be called regional bodies or not.

Some information about regional government is given in Table 1.3. Essentially, there are three possible responses to the question of whether a country has a regional level. Aside from the obvious 'yes' and 'no' responses, there is the possibility that there might be some structure of regions which exists as part of the central government to administer some activities on a regional basis. Although technically these sorts of bodies are not sub-national governments, they are worth mentioning, not least because sometimes they might evolve into genuine sub-national governments.

Table 1.3 **Regional government in the applicant countries and existing members, 2000**

	Does regional government exist?	**Notes about reforms to regions**
Bulgaria	*Only as part of central government*	
Czech Republic	Yes	*The regions were part of central government until 2001.*
Estonia	*Only as part of central government*	
Hungary	No	
Latvia	Yes	
Lithuania	*Only as part of central government*	
Poland	Yes	
Romania	*Only as part of central government*	
Slovak Republic	Yes	*The regions were part of central government until 2002.*
Slovenia	*Only as part of central government*	*The constitution is being amended to allow for regions.*
Belgium	Yes	*Regions strengthened in 1993 when Belgium became a federation, and strengthened again in 2001.*
Denmark	No	*But there are two levels of local government.*
France	Yes	*Regions have been created in recent years by converting consultative bodies into elected ones.*
Italy	Yes	*Regions were created under the 1948 constitution but not formally established until 1970.*
Netherlands	No	*But there are two levels of local government.*
Spain	Yes	*17 regions, or autonomous communities (ACs), were established in 1978. Steps are being taken to give the 10 ACs with 'common competences' the same powers as the remaining 7 ACs that have 'high' levels of responsibility. This chiefly means extending their powers to include health and education.*
Sweden	No	*There are four pilot programmes for regions which would take over some national government powers.*
United Kingdom	No in England; yes in Scotland, Wales and N. Ireland	*The 3 regional parliaments were established in 1999; there is discussion about introducing regions in England, which is the present government's long-term aim.*

Sources: Chapters 2 and 3, including executive summaries.

The first column in Table 1.3 shows that there is a genuine regional level in four of the ten applicant countries: the Czech Republic, Latvia, Poland and the Slovak Republic. There is likewise a regional tier in four of the eight existing EU members in the sample: Belgium, France, Italy and Spain. In addition, the United Kingdom has a partial regional level with regional assemblies in Northern Ireland, Scotland and Wales, but not in England. Another five of the applicant countries have a regional level that forms part of the central government, so that among them it is only Hungary which has no regional level at all.

The final column in Table 1.3 shows that the state of regional government is far from static. Thus the regions in the Czech Republic and the Slovak Republic were part of the central government until very recently, and there are plans to convert the regional arms of the Slovenian national government into a genuine level of regional government.

It is not only in the applicant countries that regional government is in a state of flux. The five existing EU member countries with regional governments have all established them since 1970. Moreover, Spain is strengthening its regional authorities, Sweden is considering having them, and the United Kingdom is considering having them in England as well as in the other parts of the country.

Why is there this interest in regional government? Perhaps the growing ease and use of transport has widened people's ideas about their communities. And perhaps the growing complexity of some sub-national services points to economies of scale from large-scale production. These factors would explain the creation of regions that have taken functions away from local authorities. Yet, in practice, most regions have taken functions away from their national governments. So it seems more likely that regionalisation is a response to a growing desire by electorates for closer control of government activities, and particularly for control over activities which are not suited to small local authorities.

1.5.2 Municipality size

In many countries, the lowest tier of local authorities with significant powers comprises authorities called municipalities, or something equivalent to this. These authorities are often very small. Table 1.4 gives information on the distribution of municipality size in the ten applicant countries. The table shows that some countries are dominated by small areas: for example, in the Czech Republic 79.6% of authorities have populations below 1,000, with another 10.4% having populations below 2,000, leaving only 10.0% with populations in excess of 2,000. In contrast, other countries have much larger authorities. For example, 8.4% of Lithuania's authorities have populations above 100,000 with another 25.0% having populations above 50,000, leaving only two-thirds smaller than that.

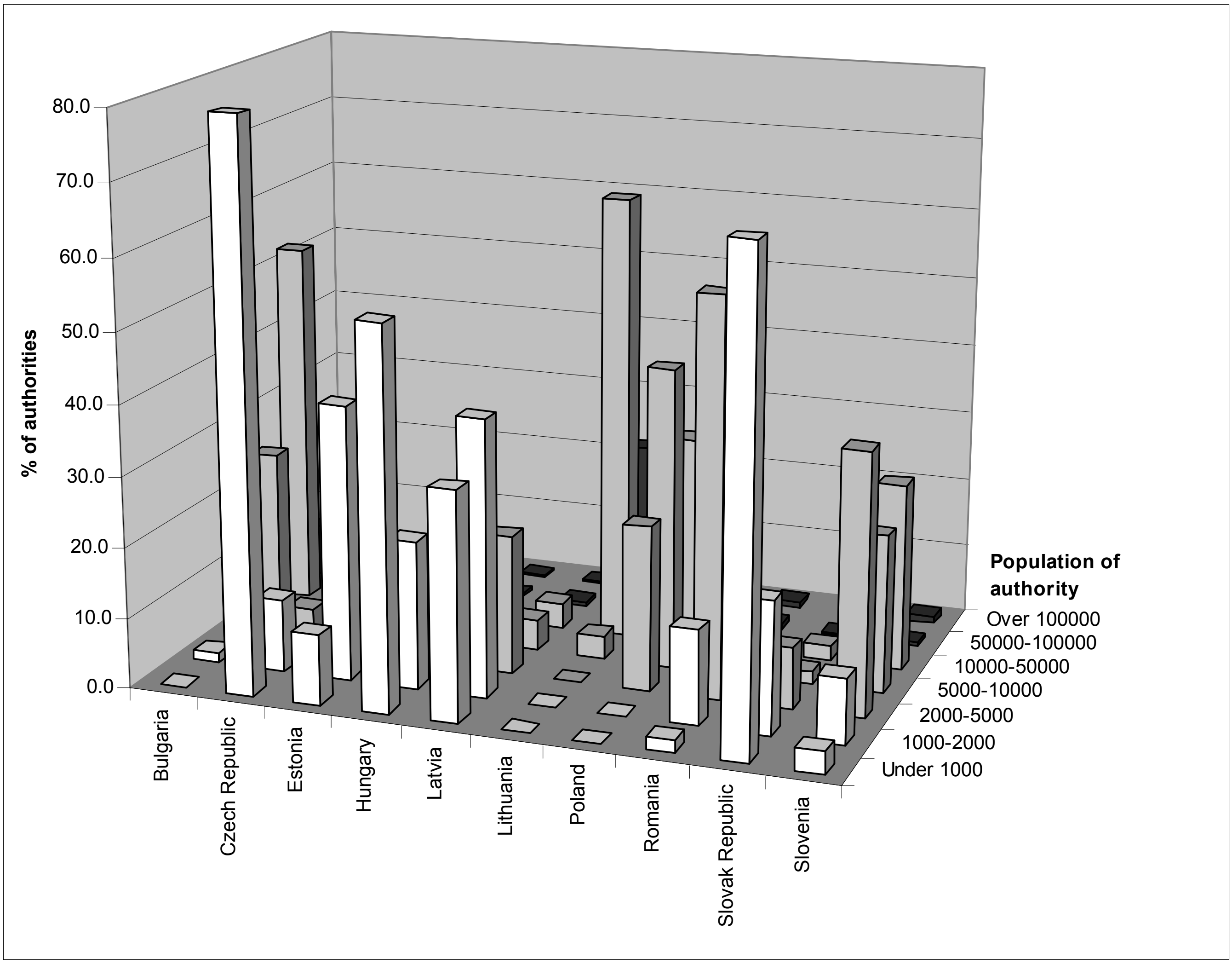
Table 1.4 Percentage of municipalities in various size ranges for the applicant countries, 2000

	Under 1000	1000 to 2000	2000 to 5000	5000 to 10000	10000 to 50000	50000 to 100000	Over 100000	*Total*
Bulgaria	0.0	1.5	9.2	24.4	52.3	7.6	5.0	***100.0***
Czech Republic *(1999)*	79.6	10.4	5.8	2.1	1.8	0.2	0.1	***100.0***
Estonia *(1999)*	10.0	39.0	36.0	9.0	4.0	1.9	0.1	***100.0***
Hungary	53.7	21.0	16.3	4.5	3.8	0.4	0.3	***100.0***
Latvia	32.3	39.1	19.7	4.4	3.6	0.5	0.4	***100.0***
Lithuania	0.0	0.0	0.0	3.3	63.3	25.0	8.4	***100.0***
Poland	0.0	0.0	23.4	42.6	30.0	2.2	1.8	***100.0***
Romania	1.8	13.5	56.1	20.9	6.1	0.8	0.8	***100.0***
Slovak Republic	68.4	18.6	8.7	1.8	2.1	0.3	0.1	***100.0***
Slovenia	3.1	9.4	37.0	22.4	26.5	0.6	1.0	***100.0***

Sources: Chapter 2 (Tables 2.7a and 2.7b); it is assumed that no Polish authorities have fewer than 2000 people, and that no Lithuanian ones have fewer than 5000.

Figure 1.2 reproduces the information of Table 1.4 in bar chart form. Countries with tall white bars, notably the Czech Republic, Estonia, Hungary, Latvia and the Slovak Republic have many small authorities. Countries with tall grey bars, notably Bulgaria, Lithuania, Poland, Romania and Slovenia, have larger authorities. It will be seen that, aside from Lithuania, no country has black bars of any height, indicating that there are very few municipalities with populations in excess of 50000.

Figure 1.2 **Distribution of municipalities by size range for the applicant countries, 2000**



Source: Table 1.4

Chapter 3 (Table 3.2) gives some data for municipality size in the existing EU member countries. Unfortunately, the data is not as detailed as that in Table 1.4, so a close comparison is not possible. However, it is clear that several of these EU countries also have very small municipalities. For instance, the percentage of municipalities with fewer than 5,000 citizens is 97.7% in France, which is comparable to the Czech and Slovak Republics, and there are also high figures of 92.4% in Spain and 87.2% in Italy.

In one respect, though, Table 1.4 and Figure 1.2 give a slightly misleading picture. A country may have many tiny authorities, but, because few people live in them, their total population may also be tiny. So it is also interesting to consider what percentage of each country's population live in small municipalities. Table 1.5 gives this information. In the Czech republic, for instance, it shows that only 16.8% of the population live in authorities with fewer than 1,000 people, even though Table 1.4 showed that 79.6% of municipalities are this small. In contrast, Table 1.5 shows that 40.0% of Lithuanians live in municipalities with over 100,000 people, even though Table 1.4 shows that only 8.4% of municipalities are this large.

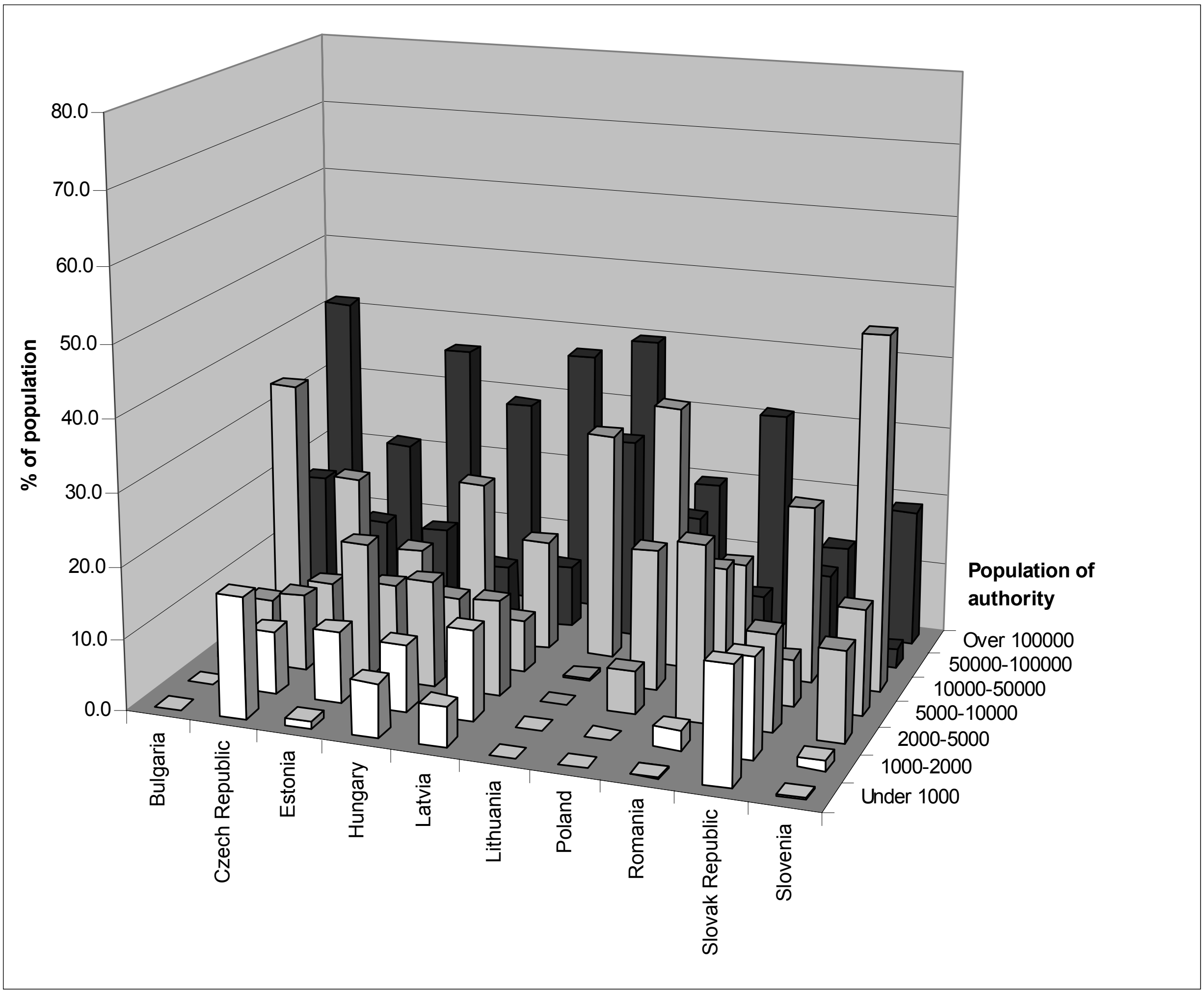
Table 1.5 **Percentage of population in various municipality size ranges for the applicant countries, 2000**

	Under 1000	1000 to 2000	2000 to 5000	5000 to 10000	10000 to 50000	50000 to 100000	Over 100000	*Total*
Bulgaria	0.0	0.1	1.0	5.6	34.1	17.7	41.5	***100.0***
Czech Republic *(1999)*	16.8	8.8	10.6	9.1	21.5	12.2	21.0	***100.0***
Estonia *(1999)*	1.0	10.0	19.0	10.0	12.0	12.0	36.0	***100.0***
Hungary	7.5	9.2	14.8	9.4	22.7	7.5	28.9	***100.0***
Latvia	5.6	12.6	13.3	7.3	15.4	8.7	37.1	***100.0***
Lithuania	0.0	0.0	0.0	0.3	31.7	28.0	40.0	***100.0***
Poland	0.0	0.0	5.9	19.5	36.5	18.1	20.0	***100.0***
Romania	0.2	2.8	24.6	18.1	15.5	7.8	31.0	***100.0***
Slovak Republic	16.3	13.9	13.7	6.7	24.6	12.0	12.8	***100.0***
Slovenia	0.2	1.4	12.6	14.8	49.3	2.5	19.2	***100.0***

Source: Chapter 2 (Tables 2.7a and 2.7b), it is assumed that no Polish authorities have fewer than 2000 people, that no Lithuanian ones have fewer than 5000, and that 20% of Poles live in areas with over 100000 people.

The tendency for people to live in large areas is reflected in Figure 1.3 which repeats the information of Table 1.5 as a bar chart. There are far more tall black and grey bars here than there were in Figure 1.2. Indeed, the size of the black bars shows that the number of people living in large areas is substantial, even though Figure 1.2 showed that there are very few areas of that size. Nevertheless, there are still some sizeable white bars, notably in the Czech Republic, Estonia, Hungary, Latvia and the Slovak Republic.

Figure 1.3 **Distribution of population by size of municipality for the applicant countries, 2000**



Source: Table 1.5

If the small municipalities in these five countries threatened to cause difficulties with decentralising some activities, then one solution would be for municipalities to provide services jointly by forming some sort of association. Another solution would be to have a second tier of sub-national authorities. There are two possible ways in which this could be done.

One possibility would be to have a layer of regional governments, and Table 1.3 has already shown that three of these five countries, the Czech Republic, Latvia and the Slovak Republic do have regional governments. So too, of course, do the three existing EU members with small municipalities, namely France, Italy and Spain. The other possibility is to have an additional higher tier of local authorities. To explore this, Table 1.6 shows how many tiers of local authorities there are in each applicant country. Of the five countries with small municipalities, only Latvia has a second tier, and, as just noted, it also has regional governments. Thus small municipality size seems most likely to present a problem in Estonia and Hungary.

Table 1.6 **Tiers of local authorities in the applicant and member countries, 2000**

	Number of tiers	Notes about reforms to local authorities
Bulgaria	One	
Czech Republic	One	
Estonia	One	*There has been a single tier since 1974.*
Hungary	One	*There are now about twice as many authorities as there were in 1990.*
Latvia	Two	*Seven big cities have single-tier authorities which also operate regional functions.*
Lithuania	One	
Poland	Two	
Romania	One	
Slovak Republic	One	
Slovenia	One	*The number of authorities was increased in 1995 and 1999.*
Belgium	Two	*Recent mergers have led to fewer authorities of larger size. In the lower tier, authorities occasionally form associations to provide particular services.*
Denmark	Two	*Mergers in 1970 led to fewer authorities of larger size.*
France	Two	*In the lower tier, authorities often form associations to provide particular services.*
Italy	Two	*In the lower tier, authorities occasionally form associations to provide particular services.*
Netherlands	Two	*In the lower tier, the government is pursuing amalgamations.*
Spain	Two	
Sweden	Two	*Recent mergers have led to fewer authorities of larger size. Also, authorities in different tiers often work together.*
United Kingdom	Two in parts of England; one elsewhere.	*Reforms in the 1970s created 2 tiers of large authorities everywhere. The 1990s reforms abolished some upper tier authorities, and made some of the other authorities smaller.*

Sources: Chapters 2 and 3, including executive summaries.

Table 1.6 also shows some details about recent reforms to local authorities. In the majority of cases, any recent reforms have been designed to create larger authorities. There are two exceptions. Among the applicant countries the exception is Hungary, where the number of municipalities has doubled in little over a decade. The executive summary in Chapter 2 notes that this process of excessive fragmentation is not yet at an end. Among the existing EU members the exception is the United Kingdom. There, a tendency towards smaller local authorities can be explained partly by the introduction of a new regional level in Northern Ireland, Scotland and Wales, and partly by a widespread feeling that the drive to create large authorities in the 1970s had itself been excessive. A further reason is that local authorities now contract out some services to private suppliers, and this process has reduced the importance attached to local authorities needing to be large enough to exploit all possible economies of scale in production.

1.6 The three main sources of sub-national revenue

This section gives an overview of the three main sources of sub-national revenue, while the following section considers some current issues in sub-national revenue. For statistical purposes, both the IMF and the OECD regard the sources of sub-national revenues as falling into three groups. These are defined as follows:

i) ***Taxes***, which include revenue from social security contributions as well as from taxes on income, payrolls, consumption, wealth and property, and any other taxes.
ii) ***Grants***, which include any non-repayable payments received from other levels of government.
iii) ***Non-tax revenues***, which includes any other sources of non-repayable income, including surpluses of trading enterprises, property income, administrative fees and charges, fines and forfeits, and contributions from both employees and other levels of government to employee pension and welfare funds.

Note that receipts from loans are not included in the figures.

1.6.1 The total level of sub-national revenues

Table 1.7 gives two columns for figures that concern the overall level of receipts by sub-national governments from the three sources noted above. The first column shows the level of sub-national receipts as a percentage of total government revenues. It will be seen that the mean figure for the ten countries in transition is 19.5% whereas the mean figure for the eight existing EU members is 26.4%. One simple way of comparing the degree of decentralisation of revenues is to consider how often sub-national revenue accounts for over 25% of total government revenues. This applies, but only just, in three of the ten applicant countries – with Poland on 28.8%, Hungary on 26.7% and Latvia on 26.0% - whereas it applies comfortably in three of the eight existing members – with Denmark on 43.8%, Belgium on 33.2% and Sweden on 30.6%.

Table 1.7 **Overall revenue and expenditure levels in the applicant and member countries, c.1999**

	Total sub-national revenues (as a % of total government revenue)	**Total sub-national revenues (as a % of GDP)**	**Total sub-national expenditures (as a % of GDP)**
Bulgaria *(2000)*	16.9	7.3	7.0
Czech Republic *(1999)*	20.8	8.6	7.9
Estonia *(1999)*	22.1	7.8	7.1
Hungary *(1999)*	26.7	11.1	10.4
Latvia *(1999)*	26.0	10.8	9.5
Lithuania *(1999)*	22.8	7.3	6.3
Poland *(1999)*	28.8	12.0	12.1
Romania *(2000)*	12.9	4.4	3.4
Slovak Republic *(2000)*	5.6	2.4	2.7
Slovenia *(2000)*	12.4	5.3	5.3
Mean	***19.5***	***7.6***	***7.2***
Belgium *(1998)*	33.2	16.6	n.a.
Denmark *(revenue 1999; expenditure 2001)*	43.8	30.7	30.5
France *(revenue 1997; expenditure 1993)*	18.7	10.0	10.0
Italy *(1999)*	22.1	12.0	n.a.
Netherlands *(1997)*	23.2	13.0	13.3
Spain *(1997)*	18.2	15.7	16.6
Sweden *(1999)*	30.6	21.1	n.a.
United Kingdom *(1998)*	21.4	9.9	10.5
Mean	***26.4***	***16.1***	***16.2***

Sources: Table 1.2, Chapter 2 (Tables 2.1a and 2.1b) and Chapter 3 (Table 3.4). Note that the Bulgarian figure for total sub-national revenues (as a % of GDP) was derived from their reply to the questionnaire.

The high degree of decentralisation in Hungary is the more notable given that, as discussed above, it has very small municipalities with no upper tier and no regional governments. Estonia and Romania also have just one level of small authorities, and there is much less decentralisation in these countries, particularly in Romania. The least decentralisation is to be found in the Slovak Republic. Possibly the new regional authorities, set up in 2001, will in time lead to more decentralisation.

The view that there is greater decentralisation in the existing EU countries than is the applicant countries is strengthened by the figures in the second column of Table 1.7 which show total revenues as a percentage of GDP. It will be seen that the mean figure for the ten applicant countries is 7.6% whereas the mean figure for the eight existing EU members is 16.1%. Not surprisingly, these figures are similar to those for total sub-central spending as a percentage of GDP. These are reproduced from Table 1.2 into the final column of Table 1.7.

1.6.2 The composition of sub-national government revenues

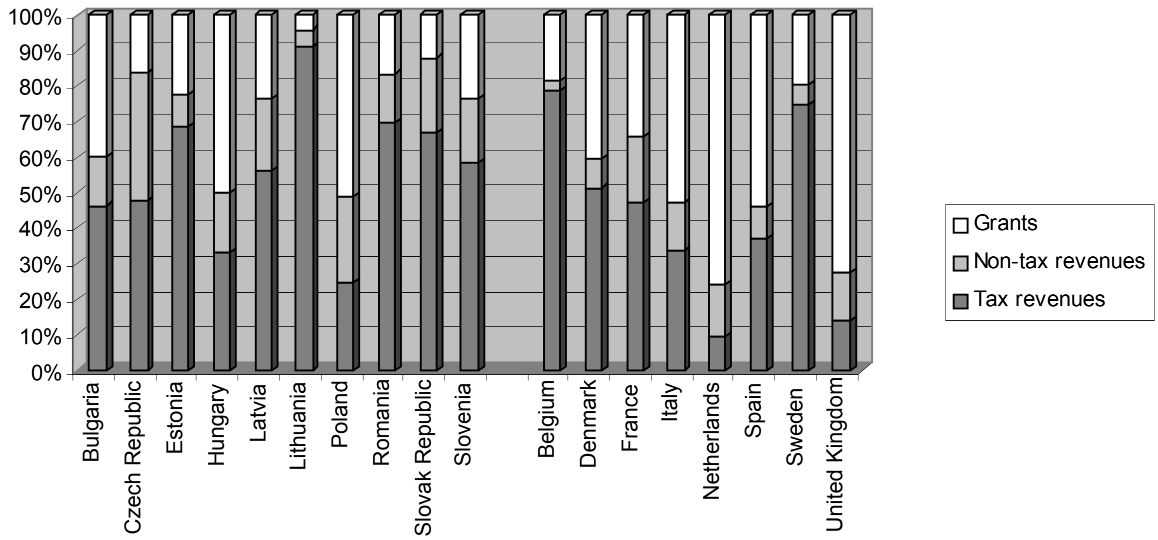
Table 1.8 shows the percentages of sub-national tax revenues that accrue in each country from taxes, non-tax revenues and grants. The information is also shown in graphical form in Figure 1.4. The main conclusion from the data is the diversity of arrangements. For example, among the ten applicant countries, the percentage of revenues accounted for by taxes ranges from 33.0% in Hungary to 91.0% in Lithuania, while the percentage accounted for by grants ranges from 4.1% in Lithuania to 50.0% in Hungary. However, the diversity is just as great among the eight existing EU members, with taxes ranging from 9.6% in the Netherlands to 78.5% in Belgium, and grants ranging from 18.4% in Belgium to 76.0% in the Netherlands.

Table 1.8 **Percentage shares of the three main sources of revenue for sub-national governments in the applicant and member countries, c.1999**

	Tax revenues (% of total revenue)	Non-tax revenues (% of total revenue)	Grants (% of total revenue)
Bulgaria *(2000)*	46.3	13.8	39.9
Czech Republic *(1999)*	47.7	36.3	16.0
Estonia *(1999)*	68.4	9.1	22.5
Hungary *(1999)*	33.0	17.0	50.0
Latvia *(1999)*	56.0	20.4	23.6
Lithuania *(1999)*	91.0	4.8	4.1
Poland *(1999)*	24.5	24.2	51.3
Romania *(2000)*	69.7	13.8	16.5
Slovak Republic *(2000)*	67.1	20.9	12.0
Slovenia *(2000)*	58.5	18.1	23.3
Mean	***56.2***	***17.8***	***25.9***
Belgium *(1998)*	78.5	3.1	18.4
Denmark *(1999)*	51.4	8.2	40.4
France *(1997)*	47.0	19.0	34.0
Italy *(1999)*	33.8	13.5	52.6
Netherlands *(1997)*	9.6	14.4	76.0
Spain *(1997)*	37.1	8.9	54.0
Sweden *(1999)*	75.0	5.5	19.5
United Kingdom *(1998)*	14.0	13.3	72.6
Mean	***43.3***	***10.7***	***45.9***

Sources: Chapter 2 (Tables 2.1a and 2.1b) and Chapter 3 (Table 3.4).

Figure 1.4 **Distribution of the three main sources of revenue for sub-national governments in the applicant and member countries, 1998**



Source: Table 1.8.

1.6.3 Sub-national tax powers

Some of the diversity between individual countries can undoubtedly be related to the separate ways in which their arrangements have evolved. But the diversity can also be partly explained by the tricky balances that must be struck when devising a system of finance for sub-national governments. This balance requires chiefly a consideration of the arguments for and against substantial tax power for sub-national authorities.

There are four major arguments for allowing sub-national authorities the opportunity to rely substantially on taxes rather than grants.

i) If sub-national authorities rely chiefly on grants, then they will rely on revenues from the central government. The central government will have raised the sums required from its own taxes, and it is responsible to its own taxpayers for how those sums are spent. So the government is likely to feel the need and the right to interfere with how the recipients spend their grants. In turn, this will make it harder for sub-national authorities to spend their revenues in accordance with local wishes.

ii) If sub-national authorities rely chiefly on grants, then their taxes will give electors a misleading perception of the tax cost of their services. In other words, if high sub-national spending is accompanied by low sub-national taxation, then electors may regard sub-national services as 'cheap', and so they may vote for excessive service levels.

iii) If sub-national authorities rely chiefly on grants, then they will find it hard to alter their spending levels in accordance with local wishes. Actually, even if they rely substantially on taxes, they will still be unable to alter their spending levels unless they can alter some of their tax rates or tax bases. They need to be able to alter the rates or bases on a substantial part of their tax revenue, as otherwise they may suffer from the 'gearing' problem that is mentioned in the executive report for the United Kingdom in Chapter 3. There, local taxes raise very little revenue, so a typical authority which wishes to raise its spending by 20-25% may need to more than double its tax rates.

iv) If sub-national authorities rely chiefly on grants, then they may become less careful in attempting to secure value for money for their voters. This is because they can always try to allege that any shortcomings in their services are the result of inadequate grants. Thus they can attempt to make the central government accountable for their own poor performance.

Taken together, these points seem to suggest a case for reducing grants to a minimum and for allowing sub-national authorities to rely on taxation as far as possible. However, there are two arguments for not pushing too far in this direction.

i) Sub-national authorities vary in the amounts of taxable resources that are available to them, and they also vary in their needs to spend. Consequently, governments typically try to help poor and needy areas with grants. The more the areas vary, the more grants will be needed, and hence the greater the total level of grants will become. (In theory, positive grants to poor and needy areas can be financed by negative grants to other areas, so that a substantial degree of equalisation is possible with a negligible total level of grants; but in political terms negative grants can prove unpopular, so this option is rarely used.)

ii) Central governments have the responsibility of managing the macroeconomic performance of their countries. To do this, they need instruments, and the key fiscal policy instruments of total tax and public spending levels have traditionally been important. If a central government decentralised too large a proportion of the country's taxes, then it would weaken its ability to use fiscal policy.

1.6.4 Relating tax powers to spending levels

The two arguments that have just been noted against having excessive reliance on sub-national taxes have the most force in countries where sub-national authorities have the highest expenditures. If their spending is low, then there need only be small variations in their tax rates to offset differences in resources and needs. And if their spending is low, then the total level of taxation needed to finance it will be small, and will not significantly reduce the central government's ability to operate fiscal policy.

Thus it seems worth considering whether there is any tendency for countries with high degrees of sub-national expenditure to entrust their sub-national authorities with relatively low levels of sub-national taxation. To explore this, Table 1.9 considers the 15 countries where figures for sub-national expenditures as a percentage of GDP are available: the three countries that had to be omitted from Table 1.8 were Belgium, Italy and Sweden. The table arranges these 15 countries in descending order of sub-national expenditures as a percentage of GDP, as shown in the first column. It divides the countries into two groups: the seven countries where sub-national spending accounts for 10% or more of GDP – which run from Denmark to France - and the eight where it accounts for less – which run from Latvia to the Slovak Republic. Decentralised expenditure averages 14.8% of GDP in the first group and 6.2% in the second.

Table 1.9 **Percentage shares of the three main sources of revenue for sub-national governments, countries arranged in order of decentralised expenditures, c.1999**

	Total sub-national expenditures (% of GDP)	Tax revenues (% of total revenue)	Non-tax revenues (% of total revenue)	Grants (% of total revenue)
Denmark *(expenditure 2001; revenue 1999)*	30.5	51.4	8.2	40.4
Spain *(1997)*	16.6	37.1	8.9	54.0
Netherlands *(1997)*	13.3	9.6	14.4	76.0
Poland *(1999)*	12.1	24.5	24.2	51.3
United Kingdom *(1998)*	10.5	14.0	13.3	72.6
Hungary *(1999)*	10.4	33.0	17.0	50.0
France *(1997)*	10.0	47.0	19.0	34.0
Mean	***14.8***	***30.9***	***15.0***	***54.0***
Latvia *(1999)*	9.5	56.0	20.4	23.6
Czech Republic *(1999)*	7.9	47.7	36.3	16.0
Estonia *(1999)*	7.1	68.4	9.1	22.5
Bulgaria *(2000)*	7.0	46.3	13.8	39.9
Lithuania *(1999)*	6.3	91.0	4.8	4.1
Slovenia *(2000)*	5.3	58.5	18.1	23.3
Romania *(2000)*	3.4	69.7	13.8	16.5
Slovak Republic *(2000)*	2.7	67.1	20.9	12.0
Mean	***6.2***	***63.1***	***17.2***	***19.7***

Sources: Chapter 2 (Tables 2.1a, 2.1b, 2.6a and 2.6b) and Chapter 3 (Tables 3.4 and 3.7).

Table 1.9 continues by giving the percentage shares in each country of the three main sources of revenue, and it gives separate means for each of these three sources for each group of countries. As suggested above, taxes do turn out to account for a much lower share in the more decentralised countries, averaging 30.9% there compared with 63.1% in the less decentralised countries. Likewise, grants turn out to account for a much higher share in the more decentralised countries, averaging 54.0% there compared with 19.7% in the less decentralised. Interestingly, there is little difference in the figures for non-tax revenues, which are 15.0% and 17.2% respectively for the two groups.

1.6.5 Fluctuations in the yields of sub-national taxes

It is perhaps partly because there is a balance of arguments about the appropriate yields for sub-national taxes that these yields tend to fluctuate over time. Table 1.10 considers whether there have been any widespread trends in recent years. The first column gives the 1998 yields of sub-national taxes as a percentage of total sub-national revenues. The adjacent column considers whether there have been any upward or downward moves in recent years. For the applicant countries, the changes can only be made for the subsequent one or two years, and it will be seen that there were six upward moves and four downward moves. Large changes might not be expected over a period of just one or two years, but in fact there were some substantial leaps. For instance the figure rose 74.1% to 91.0% over one year in Lithuania, and from 51.7% to 69.7% over two years in Romania, and the figure fell from 55.6% to 47.7% over one year in the Czech Republic, and it fell from 36.4% to 24.5% over one year in Poland.

Table 1.10 **Some recent changes to sub-national tax levels in applicant and member countries**

	Sub-national taxes as a % of sub-national revenue, 1998	Some recent changes in sub-central taxes as a % of total sub-national revenue	Sub-national taxes as a % of GDP, 1998	Some recent changes in sub-national taxes as a % of GDP
Bulgaria	52.3	***Down*** *to 46.3 in 2000*	4.0	***Down*** *to 3% in 2000*
Czech Republic	55.6	***Down*** *to 47.7 in 1999*	4.0	***Up*** *to 4.1 in 1999*
Estonia	67.7	***Up*** *to 68.4 in 1999*	5.2	***Up*** *to 5.4 in 1999*
Hungary	30.6	***Up*** *to 33.0 in 1999*	3.5	***Up*** *to 3.7 in 1999*
Latvia	54.0	***Up*** *to 56.0 in 1999*	5.6	***Up*** *to 6.0 in 1999*
Lithuania	74.1	***Up*** *to 91.0 in 1999*	6.2	***Up*** *to 6.6 in 1999*
Poland	36.4	***Down*** *to 24.5 in 1999*	3.4	***Down*** *to 2.9 in 1999*
Romania	51.7	***Up*** *to 69.7 in 2000*	2.0	***Up*** *to 3.1 in 2000*
Slovak Republic	67.3	***Down*** *to 67.1 in 2000*	1.5	***Down*** *to 1.4 in 2000*
Slovenia	57.8	***Up*** *to 58.5 in 2000*	3.0	***Up*** *to 3.1 in 2000*
Belgium	78.5	***Up*** *from 26.0 in 1980*	13.0	***Up*** *from 1.8 in 1980*
Denmark	51.2	***Up*** *from 38.7 in 1980*	15.8	***Up*** *from 13.3 in 1980*
France	47.0[a]	***Up*** *from 40.9 in 1980*	4.7	***Up*** *from 2.9 in 1980*
Italy	30.0	***Up*** *from 22.9 in 1996*	5.0	***Up*** *from 2.9 in 1996*
Netherlands	9.6[a]	***Up*** *from 5.3 in 1980*	1.3	***Up*** *from 0.8 in 1980*
Spain	37.1[a]	***Down*** *from 52.4 in 1980*	5.8	***Up*** *from 1.1 in 1980*
Sweden	74.5	***Up*** *from 57.0 in 1980*	15.8	***Up*** *from 15.2 in 1980*
United Kingdom	14.0	***Down*** *from 29.6 in 1980*	1.4	***Down*** *from 3.7 in 1980*

a: 1997.
Sources: Chapter 2 (Tables 2.1a and 2.1b), Chapter 3 (Table 3.4) and OECD *Revenue Statistics 1965-2000*, Table 200.

For the OECD member countries, it is possible to trace changes over a long period by comparing the 1998 figures with a much earlier year, and 1980 was selected for this purpose (although 1996 was used for Italy). Over this long period, the figure rose in six countries and fell in only two. There was also a remarkable leap in Belgium where the figure rose from 26.0% to 78.5%.

Thus the first two columns of the Table 1.10 suggest that there has been some trend for sub-national taxes to rise as a percentage of sub-national revenues. However, Table 1.10 also considers another aspect of sub-national taxes, which is their importance in relation to GDP. The penultimate column of Table 1.10 shows the 1998 figures for this share. The 1998 figures range from 1.3% in the Netherlands to 15.8% in Denmark; all the figures for the applicant countries fall between these two extremes.

The final column concerns recent changes in these figures. For the applicant countries, this column compares 1998 with a slightly later year. For the existing member countries, it compares 1998 with 1980 (or 1996 in the case of Italy). It will be seen that sub-national taxes rose as a percentage of GDP in 14 of the 18 countries. There were some big leaps among the existing members, most notably perhaps rises from 1.8% to 13.0% in Belgium, and from 1.1% to 5.8% in Spain. The only significant fall was one from 3.7% to 1.4% in the United Kingdom.

1.7 Some current issues in sub-national revenue

This section explores some issues and trends in sub-national revenues. It begins with a further look at sub-national taxation, and explores two questions:

i) Which are the most common sub-national taxes?
ii) How much autonomy do sub-national governments have over their taxes?

The section then considers three further questions about the current sources of revenue for sub-national governments. These questions are:

i) What types of grants are used?
ii) What can be said about non-tax revenues?
iii) What can be said about the freedom of sub-national governments to choose how to spend their revenues?

Finally, the section takes a look at the procedures and rules for borrowing, bailouts and budget co-ordination.

1.7.1 The choice of sub-national taxes

A variety of taxes are used by sub-national authorities. The pattern of taxes in use is indicated by Table 1.11. This shows the percentage contribution to each country's total sub-national tax revenue that is accounted for by the six main groups of taxes used in OECD classifications. It will be seen that no country uses social security contributions, and that only Bulgaria makes more than a very tiny use of taxes on payrolls. In fact, Bulgaria's payroll tax is its largest sub-national tax.

Table 1.11 **The composition by type of tax of sub-national tax revenues in applicant and member countries, 1999**

	1000 Taxes on incomes, profits and capital gains	**2000 Social security contri-butions**	**3000 Taxes on payroll and workforce**	**4000 Taxes on property**	**5000 Taxes on goods and services**	**6000 Other taxes**	**Total taxes**
Bulgaria *(2000)*	28.3	0.0	60.6	10.3	0.0	0.8	***100.0***
Czech Republic	89.4	0.0	0.0	5.6	4.9	0.1	***100.0***
Estonia	90.7	0.0	0.0	8.6	0.7	0.0	***100.0***
Hungary	45.0	0.0	0.3	13.9	0.0	40.8	***100.0***
Latvia	77.4	0.0	0.0	21.0	1.6	0.0	***100.0***
Lithuania	91.3	0.0	0.0	8.7	0.0	0.0	***100.0***
Poland	56.7	0.0	0.0	39.6	3.6	0.1	***100.0***
Romania *(2000)*	77.8	0.0	0.0	16.5	2.4	3.3	***100.0***
Slovak Republic *(2000)*	59.9	0.0	0.0	28.2	11.8	0.1	***100.0***
Slovenia *(2000)*	72.2	0.0	0.0	20.2	7.6	0.0	***100.0***
Mean	***68.9***	***0.0***	***6.1***	***17.3***	***3.3***	***4.5***	***100.0***
Belgium: state	55.2	0.0	0.0	6.2	38.6	0.0	***100.0***
local	84.2	0.3	0.0	0.0	15.5	0.0	***100.0***
Denmark	93.3	0.0	0.0	6.6	0.1	0.0	***100.0***
France	0.0	0.0	4.4	51.6	10.5	33.5	***100.0***
Italy	7.7	0.0	0.0	21.7	26.0	44.6	***100.0***
Netherlands	0.0	0.0	0.0	62.5	37.5	0.0	***100.0***
Spain	26.4	0.0	0.0	35.5	35.1	3.0	***100.0***
Sweden	100.0	0.0	0.0	0.0	0.0	0.0	***100.0***
United Kingdom	0.0	0.0	0.0	99.7	0.0	0.3	***100.0***
Mean[a]	***37.1***	***0.0***	***0.6***	***35.1***	***17.0***	***10.2***	***100.0***

a: this mean gives each Belgian tier half weight so that Belgium as a whole is weighted equally with other countries.
Sources: Chapter 2 (Tables 2.2a and 2.2b) and Chapter 3 (Table 3.5). Note that the Bulgarian figure for taxes on property, and the Romanian figures for taxes on incomes and profits and for 'other' taxes, were derived from their replies to the questionnaires.

Taxes on goods and services are much more common, occurring in 13 of the 18 countries, the exceptions being Bulgaria, Hungary, Lithuania, Sweden and the United Kingdom. These taxes receive limited support for sub-national use in the literature on fiscal federalism. This is partly because, with these taxes, a small area can export some of its burden on to non-residents who enter the area to make purchases; and it is partly because an area which raises its tax rates in an effort to raise extra revenue may actually drive shoppers elsewhere. So it is perhaps not surprising to find that few of the 13 countries with sub-national taxes on goods and services make much use of them. They account for over 10% of sub-national tax revenues in only six countries: the Slovak Republic, Belgium, France, Italy, the Netherlands and Spain.

In most of these six countries, total sub-national tax revenues in relation to GDP are relatively low. So, typically, sub-national taxes on goods and services have modest yields in relation to GDP. This is brought out by Table 1.12 which shows the yields of the various taxes as percentages of GDP. Thus, on this table, the yields in each country have similar totals to those given in Table 1.10, rather than totals of 100.0% as in Table 1.11; the totals differ slightly from Table 1.10 because they relate to 1999 rather than 1998. Table 1.12 shows that sub-national taxes on goods and services exceed 1% of GDP only in the cases of the Belgian states, Italy and Spain. In Spain, the taxes are shared taxes with their rates centrally controlled.

Table 1.12 **Types of sub-national tax as percentages of GDP in applicant and member countries, 1999**

	1000 Taxes on incomes, profits and capital gains	**2000 Social security contri-butions**	**3000 Taxes on payroll and workforce**	**4000 Taxes on property**	**5000 Taxes on goods and services**	**6000 Other taxes**	***Total taxes***
Bulgaria *(2000)*	0.85	0.00	1.82	0.31	0.00	0.02	***3.00***
Czech Republic	3.67	0.00	0.00	0.23	0.20	0.00	***4.10***
Estonia	4.90	0.00	0.00	0.46	0.04	0.00	***5.40***
Hungary	1.67	0.00	0.01	0.51	0.00	1.51	***3.70***
Latvia	4.64	0.00	0.00	1.26	0.10	0.00	***6.00***
Lithuania	6.03	0.00	0.00	0.57	0.00	0.00	***6.60***
Poland	1.64	0.00	0.00	1.15	0.10	0.00	***2.90***
Romania *(2000)*	2.41	0.00	0.00	0.51	0.07	0.10	***3.10***
Slovak Republic *(2000)*	0.84	0.00	0.00	0.39	0.17	0.00	***1.40***
Slovenia *(2000)*	2.24	0.00	0.00	0.63	0.24	0.00	***3.10***
Mean	***2.89***	***0.00***	***0.18***	***0.60***	***0.09***	***0.16***	**3.93**
Belgium: state	5.91	0.00	0.00	0.66	4.13	0.00	***10.70***
local	1.68	0.01	0.00	0.00	0.31	0.00	***2.00***
Denmark	14.74	0.00	0.00	1.04	0.02	0.00	***15.80***
France	0.00	0.00	0.20	2.37	0.48	1.54	***4.60***
Italy	0.31	0.00	0.00	0.87	1.04	1.78	***4.00***
Netherlands	0.00	0.00	0.00	0.81	0.49	0.00	***1.30***
Spain	1.56	0.00	0.00	2.09	2.07	0.18	***5.90***
Sweden	15.80	0.00	0.00	0.00	0.00	0.00	***15.80***
United Kingdom	0.00	0.00	0.00	1.50	0.00	0.00	***1.50***
Mean[a]	***4.53***	***0.00***	***0.03***	***1.13***	***0.79***	***0.44***	**6.91**

a: This mean gives each Belgian tier half weight so that Belgium as a whole is weighted equally with other countries.

Sources: Chapter 2 (Tables 2.1a, 2.1b, 2.2a and 2.2b) and Chapter 3 (Tables 3.4 and 3.5). 1999 total tax yields for Belgium and UK from OECD *Revenue Statistics 1965-2000*, Tables 135 and 137.

Tables 1.11 and 1.12 show that the two main sub-national taxes, both in terms of contributions to sub-national tax revenues and in relation to GDP, are income taxes and taxes on property. Taxes on property have some key advantages as sub-national taxes. Most notably, the tax base cannot migrate in response to tax rate changes, there is no ambiguity about which authority is entitled to the tax on any given property, and the tax base is relatively stable and predictable. Their main limitation is that the burdens on individual taxpayers are not related very closely to ability to pay, and this seems to limit the maximum yield that countries feel able to extract from them. In contrast, the burdens of income taxes are well related to ability to pay, and these taxes seem almost essential if a country wants its sub-national taxes as a whole to raise substantial revenues in relation to GDP. Indeed, local income taxes in Sweden have a yield of 15.80% of GDP, with Denmark close behind on 14.74%, whereas the highest yields for any other taxes are the total of 4.44% for state plus local taxes on goods and services in Belgium.

Tables 1.11 and 1.12 note that three countries have ‘other taxes’ with significant yields. These are Hungary, France and Italy. The Hungarian tax is called a business tax, the French tax is the ‘taxe professionnelle’, and the Italian tax is the Regional Tax on Productive Activities (IRAP) which was introduced in 1998. In each case, the tax concerned is a form of business tax where the base is some mixture of two or more of the following: payrolls, property and profits. So these taxes should not be seen as having some very different base from those covered by the other five main groups between them.

The final table on the choice of sub-national taxes is Table 1.13. This considers changes in the choice of taxes in the eight EU member countries since 1975. The figures show the shares of the main taxes as percentages of GDP. Comparable data are not available for the applicant countries, and in any case early data there would concern the years before transition. The table shows that the total share of GDP accounted for by sub-national taxes rose over the 24 years between 1975 and 1999 from 4.4% to 7.5%. However, the share of property taxes and ‘other’ taxes rose very little. Rather, the rise was accounted for chiefly by rises in taxes on income, which rose in all five countries that had them, and by taxes on goods and services, which rose in all four countries which had them.

Table 1.13 **Recent changes to the composition and yields of sub-national taxes as a percentage of GDP in sample of OECD member countries**

	1000 Taxes on Incomes, profits and capital gains			**4000 Taxes on property**			**5000 Taxes on goods and services**			**6000 Other Taxes**			***Total taxes***		
	1975	***1985***	***1999***	***1975***	***1985***	***1999***	***1975***	***1985***	***1999***	***1975***	***1985***	***1999***	***1975***	***1985***	***1999***
Belgium[a]	1.4	1.9	7.6	0.0	0.0	0.7	0.4	0.3	4.4	0.0	0.1	0.0	***1.8***	***2.3***	***12.7***
Denmark	10.6	12.6	14.7	1.6	0.9	1.0	0.0	0.0	0.0	0.0	0.0	0.1	***12.2***	***13.5***	***15.8***
France	0.0	0.0	0.0	1.3	1.8	2.4	0.2	0.5	0.5	1.3	1.5	1.7	***2.8***	***3.8***	***4.6***
Italy	0.2	0.5	0.3	0.0	0.0	0.9	0.0	0.1	0.8	0.0	0.2	0.1	***0.2***	***0.8***	***2.1***
Netherlands	0.1	0.0	0.0	0.3	0.8	0.8	0.1	0.2	0.5	0.0	0.0	0.0	***0.5***	***1.0***	***1.3***
Spain	0.5	0.8	1.6	0.1	0.5	2.1	0.3	1.7	2.1	0.0	0.1	0.2	***0.9***	***3.1***	***6.0***
Sweden	12.6	14.7	15.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	***12.6***	***14.7***	***15.8***
United Kingdom	0.0	0.0	0.0	3.9	3.9	1.5	0.0	0.0	0.0	0.0	0.0	0.0	***3.9***	***3.9***	***1.5***
Mean[a]	***3.2***	***3.8***	***5.0***	***0.9***	***1.0***	***1.2***	***0.1***	***0.4***	***1.0***	***0.2***	***0.2***	***0.3***	*4.4*	*5.4*	*7.5*

a: state plus local taxes.

Sources: OECD Revenue Statistics 1965-2000, Tables 135 and 137.

1.7.2 *Autonomy over sub-national taxes*

The Committee on Fiscal Affairs, Working Party 2 on Tax Policy and Tax Statistics (OECD 1999) has devised a framework for showing the degree of autonomy that sub-national governments (SNG) have over their taxes, and for showing how far their autonomy is reduced by the central government (CG). Essentially, each country's sub-national tax revenues are divided up to show the percentages of the total yield falling into each of the five groups shown below as *(a)*, *(b)*, *(c)*, *(d)* and *(e)*. One of these groups, (d), concerns situations where the revenues of a particular tax are shared, or split, between the CG and the SNG; this arrangement is sub-divided into four sub-groups, *(d1)*, *(d2)*, *(d3)* and *(d4)*, which reflect the varying degrees of influence that the SNG may have over their share.

(a) SNG tax where SNG set both the tax rate and the tax base.
(b) SNG tax where SNG set the tax rate only.
(c) SNG tax where SNG set the tax base only.
(d1) Tax-sharing where the split between the CG and SNG is set by SNG.
(d2) Tax-sharing where the split between the CG and SNG can be changed only if SNG agree.
(d3) Tax-sharing where the split between the CG and SNG is set in legislation and may be changed unilaterally by the CG.
(d4) Tax-sharing where the split between the CG and SNG is set annually by the CG as part of the budget.
(e) SNG tax where the CG sets both the tax rate and the tax base.

The questionnaire sent to the ten applicant countries noted that in cases *(a)* to *(c)* the sub-national government has total or significant control over its taxes. In the remaining cases *(d-e)*, its tax autonomy is very limited or non-existent; this autonomy is most restricted in cases *(d3-e)*.

The situation in the applicant countries, and in the six existing EU countries for which the OECD source has data, is shown in Table 1.14. The two existing EU members that had to be excluded were France and Italy. The table does not facilitate an exact comparison because the applicant countries are each taken as a whole, whereas the existing members are each taken tier by tier. Nevertheless, the table suggests shows that in terms of the point made in the questionnaire, existing member countries enjoy far more autonomy, for a total of 82.9% of their tax revenues fall into groups *(a)* to *(c)* compared with a total of only 17.0% in the applicant countries.

Table 1.14 **Tax roles of sub-national governments (SNG) and central governments (CG) in applicant and member countries, various years**

	Level	Sub-national government taxes as % of total tax revenue	SNG sets tax rate and base	SNG sets tax rate only	SNG sets tax base only	Revenue sharing where the CG:SNG revenue split…				CG sets both rate and tax base of SNG tax	*Total*
						…is set by SNG	…can be changed only if SNG agree	…is set in legislation and may be changed unilaterally by CG	…is set annually by CG as part of the budget		
			(a)	*(b)*	*(c)*	*(d1)*	*(d2)*	*(d3)*	*(d4)*	*(e)*	
Bulgaria *(2000)*	Local	*10.0*	-	-	-	-	-	39.0	61.0	-	***100.0***
Czech Republic *(1999)*	Local	*11.1*	2.7	5.6	-	-	-	91.7	-	-	***100.0***
Estonia *(1999)*	Local	*16.2*	-	9.2	-	-	-	90.8	-	-	***100.0***
Hungary *(1999)*	Local	*10.4*	49.2	-	-	-	-	-	50.8		***100.0***
Latvia *(1999)*	Local	*17.1*	-	-	-	-	-	-	-	100.0	***100.0***
Lithuania *(1999)*	Local	*22.0*	-	-	-	-	-	-	-	100.0	***100.0***
Poland *(1999)*	Local	*8.3*	-	41.9	0.6	-	-	57.6	-	-	***100.0***
Romania *(2000)*	Local	*10.5*	-	6.0	0.6	-	-	-	75.0	18.4	***100.0***
Slovak Republic *(2000)*	Local	*4.0*	7.0	28.2	-	-	-	-	64.8	-	***100.0***
Slovenia *(2000)*	Local	*7.9*	16.7	0.6	0.4	-	-	82.3	-	-	***100.0***
Mean (by country)	-	***11.8***	***7.6***	***9.2***	***0.2***	***0.0***	***0.0***	***36.1***	***25.2***	***21.8***	***100.0***
Belgium *(1995)*	Local	*6.0*	13.0	84.0	-	-	-	2.0	1.0	-	***100.0***
	Communities	*13.0*	-	3.0	-	-	97.0	-	-	-	***100.0***
	Regional	*10.0*	8.0	92.0	-	-	-	-	-	-	***100.0***
Denmark *(1995)*	Municipalities	*22.0*	-	96.0	-	-	-	4.0	-	-	***100.0***
	Counties	*9.0*	-	93.0	-	-	-	-	-	7.0	***100.0***
Netherlands *(1995)*	Municipalities	*1.0*	-	100.0	-	-	-	-	-	-	***100.0***
	Polder boards	*1.0*	-	100.0	-	-	-	-	-	-	***100.0***
Spain *(1995)*	Local	*9.0*	33.0	51.0	-	-	16.0	-	-	-	***100.0***
	Regions	*5.0*	15.0	7.0	-	-	78.0	-	-	-	***100.0***
Sweden *(1995)*	Municipalities	*22.0*	4.0	96.0	-	-	-	-	-	-	***100.0***
	Counties	*11.0*	-	100.0	-	-	-	-	-	-	***100.0***
United Kingdom *(1995)*	Local	*4.0*	-	100.0	-	-	-	-	-	-	***100.0***
Mean (by tier)	-	***9.4***	***6.1***	***76.8***	***0.0***	***0.0***	***15.9***	***0.5***	***0.1***	***0.6***	***100.0***

Note: For data reasons, two countries in the EU sample had to be omitted in this table – these were France and Italy.
Sources: Chapter 2 (Tables 2.3a and 2.3b) and Chapter 3 (Table 3.6).

Table 1.15 **Specific and general grants in applicant countries, c.1999**

	Specific grants[a]				**General grants**				**Grants as a % of total sub-national revenue**
	Conditional based on standard costs	**Conditional based on actual costs**	**Uncon-ditional**	**Specific grants as a % of total grants**	**Objective criteria excluding tax effort**	**Objective criteria including tax effort**	**Discre-tionary**	**General grants as a % of total grants**	
Bulgaria *(2000)*	9.1	-	-	***9.1***	65.0	-	25.9	***90.9***	39.9
Czech Republic *(1999)*	16.0	37.2	46.8	***100.0***	-	-	-	***-***	16.0
Estonia *(1999)*	40.2	-	-	***40.2***	-	59.8	-	***59.8***	22.5
Hungary *(1999)*	94.2	0.6	1.8	***96.6***	-	0.6	2.8	***3.4***	50.0
Latvia *(1999)*	90.0	-	-	***90.0***	10.0	-	-	***10.0***	23.6
Lithuania *(1999)*	12.7	32.5	-	***45.2***	54.7	-	-	***54.7***	4.1
Poland *(1999)*	14.3	25.1	-	***39.4***	60.6	-	-	***60.6***	51.3
Romania *(2000)*	-	100.0	-	***100.0***	-	-	-	***-***	16.5
Slovak Republic *(2000)*	-	-	100.0	***100.0***	-	-	-	***-***	11.9
Slovenia *(2000)*	18.7	18.2		***36.9***	63.1	-	-	***63.1***	23.3
Mean	***29.5***	***21.4***	***14.9***	***65.7***	***25.3***	***6.0***	***2.9***	***34.3***	***25.9***

a: current grants only.
Source: Chapter 2 (Tables 2.4a and 2.4b).

1.7.3 Grants

It was shown in Table 1.8 that sub-national governments in the applicant countries received on average 56.2% of their revenue from taxes, 25.9% from grants, and 17.8% from non-tax revenues. Thus grants are the second largest source. Table 1.15 gives some information about the types of grant used.

The most important distinction between types of grants is that between general grants and specific grants. The questionnaire sent to the applicant countries defined general grants as those which can be used as if they were the receiving sub-national government's own tax revenues, with their use limited only by a possible distinction between current and capital uses. Any other type of grant is termed a specific grant, which must be spent by the recipient on some particular activity. Recipients will prefer general grants, because these can effectively be regarded as equivalent to their own revenue, but Table 1.15 shows that general grants account for only 34.3% of total grant payments, with the more restrictive specific grants accounting for the remaining 65.7%. Thus nearly two-thirds of grants are specific grants. Indeed, the Czech Republic, Romania and the Slovak Republic rely wholly on specific grants, whilst Hungary and Latvia rely almost entirely on them. In contrast, Bulgaria relies almost wholly on general grants, and general grants are more important than specific grants in Estonia, Lithuania, Poland and Slovenia.

The questionnaire sent to applicant countries asked them to sub-divided their specific grants. One division is between those which are conditional on the recipient's expenditure on the supported activity and those which are not. Conditional grants are typically straight percentage grants. Most countries prefer conditional grants, but none of the Slovak Republic's specific grants are conditional, and nor are 46.8% of the Czech Republic's specific grants. There are circumstances in which the effect of an unconditional specific grant is effectively the same as a general grant (see for instance, King, 1984, p.91). This arises if the amount of grant paid for the service is less than the amount which the recipient would have spent on the service in the absence of the grant. Thus it is likely to occur in countries where the specific grants are low. In turn, it seems likely to apply in both the Czech and Slovak Republics, because Table 1.8 showed that their grants account respectively for only 16.0% and 12.0% of total sub-national revenues. Thus the apparent restriction on freedom in these two countries of relying wholly on specific grants rather overstates the true restriction on freedom.

Within the category of conditional specific grants, a further sub-division was mentioned in the questionnaire. This sub-division depends on whether the grant meets a percentage of the cost that would be incurred if the recipient provided the activity at a standard cost, or whether it meets a percentage of the actual cost. The example given in the questionnaire was that of a 50% grant for a kindergarten chair. If the conditional grant were based on a standard cost of, say, 100 euros, then the recipient would receive 50 euros per chair irrespective of the price it actually paid for each chair. If the grant were based on actual costs, then the recipient would receive 50% of its actual spending. Using standard costs will discourage extravagance, but it will also encourage low quality purchases as all savings accrue to the recipient authority. Given this tricky balance, it is perhaps not surprising that there is a good mix of the two types, with standard cost grants accounting for 29.5% of all grants, and actual cost grants accounting for 21.4%.

General grants can also be subdivided. One division made in the questionnaire is between those which are distributed according to some objective criteria or formula, and those which are allocated at the total discretion of the central government. Almost all general grants are formula based. The only notably exception arises in Bulgaria where discretionary general grants account for 25.9% of total grants. The only other exception is in Hungary, but there they account for only 2.8%.

The objective criteria grants were themselves divided into two groups, according to whether or not the formula takes account of the recipients' own efforts to raise taxes. The relative merits of these two possibilities have been frequently discussed (e.g. by Musgrave, 1959). If an authority is given a bigger grant when it spends more, then the grant may be seen as discouraging low service levels or, equivalently, as encouraging high levels. Thus countries will be tempted to include tax effort if they wish to raise sub-national government service levels, and not otherwise. In fact, the only applicant country to pay any significant amount of general grants that are effort related is Estonia.

1.7.4 Non-tax revenues

As noted at the start of section 1.6, non-tax revenues are defined to include any other sources of non-repayable income, including surpluses of trading enterprises, property income, administrative fees and charges, fines and forfeits, and contributions from both employees and other levels of government to employee pension and welfare funds. And, as noted in Table 1.8, they account for less income than taxes or grants in the applicant countries.

The questionnaire did not elicit much precise comparable data for non-tax revenues in these countries. However, Table 1.16 gives the contribution to total revenues and also gives a few notes. The notes most cover the degree of control by the central government over fees and charges. The degree of control varies considerably, with little or no control in Estonia, Latvia and Poland, and tight controls in Hungary.

Table 1.16 **Some notes about non-tax revenues in applicant countries, 1999**

	% of total revenue	**Notes**
Bulgaria *(2000)*	13.8	*Over 50% accounted for by fees which municipalities may vary within set limits.*
Czech Republic	36.3	*Includes fees which municipalities may vary within set limits.*
Estonia	9.1	*There are no regulations.*
Hungary	17.0	*Fees and charges are regulated by the central government.*
Latvia	20.4	*No controls and a relatively high yield, much of it from various licence duties.*
Lithuania	4.8	*Very small and effectively regarded there as discretionary taxes.*
Poland	24.2	*No clear limits from central government.*
Romania *(2000)*	13.8	*Relatively small; many fees are for services to horticulture and agriculture. Municipalities may impose and vary fees within set limits.*
Slovak Republic *(2000)*	20.9	*Includes fees which municipalities may impose and vary within set limits.*
Slovenia *(2000)*	18.1	*Rental incomes are an important source.*
Mean	***17.8***	

Source: Chapter 2 (including executive summaries and Tables 2.1a and 2.1b).

1.7.5 Free revenues and tied revenues

Chapter 2 gives an overall summary of sub-national government revenue sources which is reproduced in Table 1.17. The aim is to give some feel for the independence of sub-national revenues, but any conclusions here must be interpreted with care. For instance, an authority might in principle receive all its revenue from its own taxes and so appear to be free to allocate the revenue as it pleases; yet in reality it might be largely inhibited by numerous rules and regulations about the sorts of services it must supply.

Table 1.17 **Own revenues, other free revenues and tied revenues as percentages of current revenues for sub-national governments in applicant countries, 1999**

	Own revenue			**Other free revenues**			**Tied revenues**	***Total***
	Own taxes categories (a)-(c)	**Non-tax revenue**	**Total**	**General grants**	**Tax-sharing and centrally set taxes categories (d) – (e)**	**Total**	**Specific grants**	
Bulgaria *(2000)*	0.0	13.8	13.8	32.6	46.3	78.9	7.3	***100.0***
Czech Republic*)*	3.9	36.3	40.2	0.0	43.8	43.8	16.0	***100.0***
Estonia	6.3	9.1	15.4	13.4	62.1	75.5	9.1	***100.0***
Hungary	16.3	17.0	33.3	1.7	16.8	18.5	48.2	***100.0***
Latvia	0.0	20.4	20.4	2.4	56.0	58.4	21.2	***100.0***
Lithuania	0.0	4.8	4.8	2.3	91.0	93.3	1.9	***100.0***
Poland	10.6	24.6	35.2	30.5	14.4	44.9	19.9	***100.0***
Romania *(2000)*	4.6	13.8	18.4	0.0	65.1	65.1	16.5	***100.0***
Slovak Republic *(2000)*	21.1	18.7	39.8	0.0	38.8	38.8	21.4	***100.0***
Slovenia *(2000)*	10.4	18.1	28.5	14.7	48.2	62.9	8.6	***100.0***
Mean	***7.3***	***17.7***	***25.0***	***9.8***	***48.3***	***58.0***	***17.0***	***100.0***

Source: Chapter 2 (Tables 2.5a and 2.5b).

Table 1.17 shows the percentage of total sub-national government revenue that accrues from various sources. On average, ‘own taxes’, where the base and/or rate are locally set, account for just 7.3%. The highest figure is 21.1% in the Slovak Republic. The minimum figure is zero, which applies in Bulgaria, Latvia and Lithuania. On average, non-tax revenues raises account for a further 17.7% of total revenues. So the average total for ‘own revenues’, which includes own taxes and non-tax revenues, is 25.0%. This ranges from 4.8% in Lithuania to 40.2% in the Czech Republic.

Sub-national governments have as much freedom over the allocation of their revenues from general grants as they do with their own revenues. They also have similar freedom with their receipts from tax-sharing arrangements and from any sub-national taxes whose rates and bases are both centrally determined. Between them, these extra sources account for an average of 58.0% of sub-national revenues. So, allowing for these as well as the average 25% from own revenues, gives an average total for ‘free’ revenues of 83%. The remaining 17% of revenues is tied and comes in the form of specific grants.

Looking at the total for tied revenues, it can be seen that this is highest in Hungary, at 48.2%, and it is over 20% in Latvia and the Slovak Republic as well. So these seem to be countries which constrain sub-national freedom the most. In contrast, low figures for tied revenues in Lithuania, Bulgaria, Slovenia and Estonia suggest a situation of sub-national autonomy.

However, conclusions about autonomy should take into account the scale of sub-national revenues as well as the percentage accounted for by tied revenues. To do this, Table 1.18 repeats Table 1.17 except that it gives each revenue source as a percentage of GDP. So the totals in each country are not the 100.0% that they were in Table 1.17, but are instead the percentages of GDP accounted for by sub-national revenues as a whole. The final column shows free sub-national revenues – that is all sources except specific grants – as a percentage of GDP. It will be seen that, on this table, Latvia appears one of the freer countries; this is because the fact that free revenues there account for a small proportion of sub-national revenues is more than offset by the fact that these revenues are high in relation to GDP. Likewise, the final column shows that Slovenia appears one of the least free countries; this is because the fact that free revenues there account for a low proportion of sub-national revenues is more than offset by the fact that these revenues are low in relation to GDP.

Table 1.18 **Own revenues, other free revenues and tied revenues as percentages of GDP for sub-national governments in applicant countries, 1999**

	Own revenue			**Other free revenues**			**Tied revenues**	***Total***	**Free revenues as a % of GDP**
	Own taxes categories (a)-(c)	**Non-tax revenue**	**Total**	**General grants**	**Tax-sharing and centrally set taxes categories (d) – (e)**	**Total**	**Specific grants**		
Bulgaria *(2000)*	0.00	1.38	1.38	3.26	4.63	7.89	0.73	***10.00***	9.27
Czech Republic*)*	0.34	3.12	3.46	0.00	3.77	3.77	1.38	***8.60***	7.22
Estonia*)*	0.49	0.71	1.20	1.05	4.84	5.89	0.71	***7.80***	7.09
Hungary*)*	1.81	1.89	3.70	0.19	1.86	2.05	5.35	***11.10***	5.75
Latvia	0.00	2.20	2.20	0.26	6.05	6.31	2.29	***10.80***	8.51
Lithuania	0.00	0.35	0.35	0.17	6.64	6.81	0.14	***7.30***	7.16
Poland	1.27	2.95	4.22	3.66	1.73	5.39	2.39	***12.00***	9.61
Romania *(2000)*	0.20	0.61	0.81	0.00	2.86	2.86	0.73	***4.40***	3.67
Slovak Republic *(2000)*	0.51	0.45	0.96	0.00	0.93	0.93	0.51	***2.40***	1.89
Slovenia *(2000)*	0.55	0.96	1.51	0.78	2.55	3.33	0.46	***5.30***	4.84
Mean	***0.52***	***1.46***	***1.98***	***0.94***	***3.59***	***4.52***	***1.47***	*7.97*	***6.50***

Sources: Chapter 2 (Tables 2.1a, 2.1b, 2.5a and 2.5b).

Finally, it should be noted that all the comments in the preceding two paragraphs about tied revenues should be qualified by repeating the point explained in section *1.7.3*. This is that specific grants do not always tie recipients more than general grants

1.7.6 Borrowing, bailouts and budget co-ordination

To complete the picture on sub-national finance in the applicant countries, Table 1.19 gives some information for them about borrowing, bailouts and budget co-operation between levels of government. In each case there is a range of policies.

On borrowing, there are some countries where there is little or no control over sub-national government borrowing. These countries include the Czech Republic, Romania and the Slovak Republic. It should be observed, though, that in the first two of these, there is very little scope for raising extra sub-national taxes. Consequently, almost any expenditure that is financed in the current year by loans will effectively have to be offset by lower expenditure in future when the loans have to be serviced. At the other extreme, some countries permit borrowing only with special permission. Examples include Latvia and Lithuania. In between, borrowing is permitted within set limits which are quite tight in some cases.

This variety is matched by what can be found in the eight EU member countries surveyed in Chapter 2. For example, there is wide freedom in Belgium, France and Sweden, and fairly tight controls in Denmark, Italy, Spain and the United Kingdom.

On bailouts, Table 1.19 shows that some countries, such as Hungary and Latvia, have established standard procedures. Some other countries permit discretionary help; examples include Bulgaria, Poland and Romania. Elsewhere, there is little sign of any specific mechanism.

On budget co-ordination, Table 1.19 shows that several countries allow sub-national governments to set their own budgets, but typically these countries actually allow sub-national authorities little control over their tax rates. Examples include Bulgaria, the Czech Republic, Estonia and Slovakia; of these, Slovakia has the most generous proportion of sub-national tax rates under sub-national control. In some other countries, the total level of sub-national spending is determined jointly by the central government and the sub-national governments. These include Latvia and Lithuania. But any slight influence which individual sub-national authorities get here must be set against the fact that in neither country can they set any of their tax rates. In two further countries, Romania and Slovenia, sub-national governments must have their budgets approved by the central government; this suggests that any freedom which they appear to receive from their small tax-rate setting powers may be smaller than it seems. Finally, there are two countries, Hungary and Poland, where sub-national governments are allowed to set their rates on a wide range of taxes with only their support from the central governments being centrally determined.

Table 1.19 **Findings about borrowing, bailouts and budget co-operation in applicant countries**

	Notes on borrowing	Notes on bailout	Notes on budget co-operation
Bulgaria	*SNGs may borrow but only within fairly tight limits.*	*SNGs may be supported at CG discretion.*	*SNGs set their own budgets but there are no taxes whose rates they can alter.*
Czech Republic	*No controls. SNGs may borrow at will.*	*No rules; by law CG is not responsible for SNG debt.*	*SNG set budgets independently, but SNGs set the rate on only 8.3% of their taxes.*
Estonia	*SNGs are required to have balanced budgets.*	*There are no standard regulations so far.*	*SNG set budgets independently, but SNGs set the rate on only 9.2% of their taxes.*
Hungary	*SNGs may borrow subject to limits related to current revenue.*	*There is a procedure, even though, by law CG is not responsible for SNG debt.*	*Parliament fixes the SNG revenues from shared taxes annually, but SNGs set the rate on 49.2% of their taxes.*
Latvia	*Needs permission from a board made up of representatives of the government, state bank and local authority representatives.*	*There is a special stabilisation fund.*	*Joint CG and SNG negotiation over total SNG spending.*
Lithuania	*Needs Ministry of Finance permission.*	*No specific framework is noted.*	*Joint CG and SNG negotiation over total SNG spending.*
Poland	*SNGs may borrow subject to limits related to current revenue.*	*SNGs may be given individually negotiated loans by the CG.*	*The CG fixes SNG revenues from CG sources, but SNGs set the rate on 41.9% of their taxes.*
Romania	*Borrowing is permitted with no explicit limits.*	*SNGs in trouble may have interest-free loans, but only up to 5% of their annual revenues.*	*SNG budgets must be approved by the CG. Note that SNGs control the tax rates of only 6.6% of their taxes.*
Slovak Republic	*No controls. SNGs may borrow at will, but some rules from 2002.*	*There is no framework for assistance.*	*SNG set budgets independently, but SNGs set the rate on only 35.2% of their taxes.*
Slovenia	*SNGs may borrow but only with permission and within tight limits.*	*There is provision only to help SNGs which ran into difficulties before 1995.*	*SNG budgets must be approved by the CG. Note that SNGs control the tax rates of only 17.3% of their taxes.*

Key: SNG = sub-national governments and CG = central governments.
Source: Chapter 2.

CHAPTER 2
FISCAL DECENTRALISATION IN EU APPLICANT COUNTRIES - THE FISCAL DESIGN SURVEYS

TABLE OF CONTENTS

1. INTRODUCTION - BACKGROUND

1.1 Introduction

Chapter 2 summarises the overall results and comparative findings of the OECD Fiscal Design surveys which were carried out between April 2000 and April 2002 in ten countries in Central and Eastern Europe. Organised into two separate rounds of survey activities, in 2000-2001 the first surveys were carried out in the three Baltic states: Estonia, Latvia and Lithuania and in the three OECD countries: Czech Republic, Hungary and Poland. The detailed results are reported in the "Fiscal Design Surveys across Levels of Government, OECD Tax Policy Series no 7, 2001. The second round of surveys took place during November 2001 - April 2002, in Bulgaria, the Slovak Republic, Slovenia and Romania. The surveys were written on the basis of responses to a questionnaire and follow the structure outlined therein. This note summarises the detailed results of the four latest surveys, together with overall summary tables for the initial six surveys. Executive summaries of all ten country reports, are brought in a separate set of Background documentation for the conference in Copenhagen.

The overall framework within which these surveys were carried out, was the **Fiscal Decentralisation Initiative (FDI),** a joint initiative of the OECD, the World Bank, USAID, the Council of Europe, The Open Society Institute, UNDP and OECD Member countries. This initiative is intended to assist transition economies in Central and Eastern Europe in carrying out intergovernmental reforms (for further information see http://www.oecd.org/daf/ctpa/tpa).

2. FISCAL DESIGN SURVEYS -- FRAMEWORK

2.1 Main purposes of the surveys

Economies in Central and South Eastern Europe (CEE) are carrying out a number of activities to complete local and regional government reform initiatives aimed at a decentralised political-administrative structure. And yet there is an increasing need for a share perspective on policy and administrative issues. No internationally consolidated data on the fiscal autonomy in CEE countries of transition is available at the moment to look to for policy guidelines and to guide them through the reform processes.

The experiences of other economies -- in Central Eastern Europe as well as Western countries -- are invaluable sources of information as those countries address fiscal reforms and align themselves with their EU neighbours systems.

2.2 Main policy issues on fiscal design across levels of government

The surveys address these issues by providing comparative data on the following issues:

- The design of fiscal systems: which functions of expenditure and revenue sources are devolved or decentralised.
- The match between locally managed expenditures and the corresponding revenues; the level of vertical imbalance in the context of local accountability and the fulfilment of national financial policies.
- The institutional arrangements for ensuring fiscal discipline and budgetary constraints.
- The design of intergovernmental fiscal relations -- the need for stable, transparent and formula-based procedures and relations.
- The profile of sub-national revenues -- the composition of the revenue base.
- The profile of sub-national expenditures -- local vs. national public services. National standard setting vs. sub-national discretion in the provision of public services.

There is obviously no single or standard solution to these issues. The actual design of local finance and intergovernmental fiscal relations varies from country to country, reflecting actual decision-making processes and distributions of political power. The country's physical and political geography, and historical and cultural traditions are strong structural determinants of the actual design of sub-national governments' responsibilities and competencies.

2.3 The structure of the questionnaire

In the questionnaire these issues on fiscal design are addressed by two themes:

A. Basic government finance statistics for the sub-national levels of government, covering comparative figures on sub-national government revenue, including grants and expenditure. The figures are based on existing international definitions and classifications, developed by the OECD and other international organisations.

This information is reported in chapter 3 in the country reports and is summarised in chapter 3 in this note.

B. Country-specific analysis and evaluation of sub-national government finance reforms in relation to ensuring the balance between local autonomy in financial decision-making and national targets and constraints on fiscal policy matters.

Information on these issues is reported in chapter 4 in the country reports and summarised in chapter 4 in this note.

3. SUB-NATIONAL GOVERNMENT FINANCE. COMPARATIVE FINDINGS

3.1 Introduction

This chapter presents the, main findings on the level and composition of sub-national expenditure and revenue. It covers specifically:

Profiles of sub-national revenues

Profiles of the tax and revenue autonomy of sub-national governments

Profiles of sub-national expenditure

The summary tables are based on the statistics as reported in the country surveys. The definitions of sub-national finance data were generally based on the System of National Accounts (SNA 93). The operational IMF classifications were preferred when setting up the classifications on expenditure, non-tax revenue and grants, whilst the OECD definitions and classifications provided a better base for tax revenue. Furthermore, as some of the countries in the surveys only report data to the IMF and not to the OECD, it was considered necessary, for practical reasons, to draw on both sets of classifications. The relevant classifications are defined in the following publications: the IMF, A Manual on Government Finance Statistics 1986 (GFS) and the OECD, Revenue Statistics 1965-98.

As far as **tax revenue** is concerned, the IMF definitions and classifications are consistent with those of the OECD, cf. Revenue Statistics, Part II, VII. In relation to **expenditure, non-tax revenue** and **grants,** the general classifications of the OECD National Accounts and the IMF Government Finance Statistics are identical, although the actual reported data may differ due to differences in the accounting bases of the two systems (accrual versus cash base)

In the questionnaire, the countries were asked to report the figures in two main tiers of government: regional and local. The countries were requested to base their reporting on the GFS definitions on levels of government.

The four countries have identified one tier of sub-national government: local (municipal) government for the reporting period of 1998 to 2000. All countries have got an intermediate regional level between the central government and the municipalities which is treated as part of the central government since these "regions" do not have self-government functions as defined by GFS criteria.

Hence, for comparative reasons, in this note the fiscal data presented for the local level are compatible with the sub-national data presented in the earlier summary report on the six survey countries from FDI surveys 2000.

3.2 Profiles on sub-national revenues

Table 2.1 summarises the revenue profiles of the countries with the latest four surveys reported in Table 2.1a while the six countries from last years survey are shown in Table 2.1b.

Table 2.1a **Profile of sub-national revenues: Composition by revenue source. Share of national government revenue and GDP, 1998-2000**

Country / Year	**Composition of sub-national revenues (%)**									**Share of total sub-national revenues in consolidated national government revenue**			**Share of total sub-national revenues in GDP (tax revenue)**		
	tax revenues			**non-tax revenues**			**grants**								
	1998	**1999**	**2000**	**1998**	**1999**	**2000**	**1998**	**1999**	**2000**	**1998**	**1999**	**2000**	**1998**	**1999**	**2000**
Bulgaria	52.3	47.2	46.3	10.3	13.3	13.8	37.4	39.4	39.9	18.4	18.6	16.9	7.6 (4.0)	7.9 (3.7)	7.3 (3.4)
Romania	51.7	70.2	69.7	13.4	14.9	13.8	34.9	14.9	16.5	11.9	11.7	12.9	3.9 (2.0)	4.4 (3.0)	4.4 (3.1)
Slovak Republic	67.3	69.0	67.1	23.8	21.4	20.9	9.0	9.7	12.0	5.7	5.0	5.6	2.5 (1.5)	2.3 (1.4)	2.4 (1.4)
Slovenia	57.8	59.9	58.5	20.5	17.5	18.1	21.6	22.5	23.3	11.9	11.9	12.4	5.1 (3.0)	5.2 (3.1)	5.3 (3.1)
OECD. Unweighted average. Unitary States(1)	51.3	n.a.	n.a.	16.9	n.a.	n.a.	31.9	n.a.	n.a.	12.9 (tax)	n.a.	n.a.	12.1 (5.0)	n.a.	n.a.

Note (1) Source: Revenue Statistics, 1965-2000, Paris 2001, p. 260.

Table 2.1b **Profile of sub-national revenues: Composition by revenue source. Share of national government revenue and GDP, 1997-99**

Country / Year	Composition of sub-national revenues (%)									Share of total sub-national revenues in consolidated national government revenue			Share of total sub-national revenues in GDP (tax revenue)		
	tax revenues			non-tax revenues			grants								
	1997	**1998**	**1999**	**1997**	**1998**	**1999**	**1997**	**1998**	**1999**	**1997**	**1998**	**1999**	**1997**	**1998**	**1999**
Czech Republic	54.9	55.6	47.7	26.4	26.8	36.3	18.7	17.5	16.0	18.0	18.3	20.8	7.15 (3.9)	7.2 (4.0)	8.6 (4.1)
Hungary	28.1	30.6	33.0	18.1	18.0	17.0	53.7	51.3	50.0	26.6	27.4	26.7	11.3 (3.2)	11.5 (3.5)	11.1 (3.7)
Poland	37.6	36.4	24.5	28.0	27.8	24.2	34.3	35.8	51.3	21.1	21.6	28.8	9.4 (3.5)	9.3 (3.4)	12.0 (2.9)
Estonia	64.6	67.7	68.4	12.9	9.3	9.1	22.5	23.0	22.5	20.0	21.0	22.1	7.8 (5.0)	7.7 (5.2)	7.8 (5.4)
Latvia	53.9	54.0	56.0	20.7	21.4	20.4	25.3	24.6	23.6	25.3	25.3	26.0	9.9 (5.3)	10.5 (5.6)	10.8 (6.0)
Lithuania	65.7	74.1	91.0	4.7	4.0	4.8	29.6	21.8	4.1	24.2	25.8	22.8	7.5 (4.9)	8.3 (6.2)	7.3 (6.6)
OECD. Unweighted average. Unitary states (1)	43.4	-	-	21.7	-	-	38.3	-	-	-	-	-	11.5 (5.0)	-	-

Note (1) Source: Revenue Statistics, 1965-1999, Paris 2000.

The share of sub-national revenue in GDP is generally used as an indicator of the size of sub-national government. In 1998– three countries are reporting revenue ratios centred around 2.5 - 5.1% of GDP. Compared with the unweighted average of OECD unitary states (1998) where 12.1 of GDP was attributed to local governments as revenue, this ratio appears rather small. The ratio is higher for Bulgaria (7.3%). The tax ratios out of GDP (between 1.5 and 3%) are equally below the OECD average of 5%. In Bulgaria, Romania, Slovenia and the Slovak Republic, these two ratios have more or less remained stable over the three reporting years. No trend indicating further decentralisation can be identified from the reported figures.

With regard to the share of sub-national revenues in overall government revenue, the countries into three groups. Sub-national governments receive the largest revenue share in Bulgaria (18.2% in 1998). In 2000, Romania and Slovenia are at 12.9% and 12.4% which is very close to the OECD average of 12.9% (1998), while, the Slovak Republic, has identified a share of 5.7 %, less than half of the OECD average ratio. There seems to have been a rather slow development for the period considered. In Romania the sub-national proportion of total government revenues has expanded by a little more than one percentage point. In Bulgaria, the local revenue proportion has decreased by 7%, while in the Slovak Republic it has remained more or less stable.

As one would expect, the composition of sub-national revenues varies a great deal between the four countries. In the latest reported year 2000, tax revenues make up more than half of local revenues in Romania (69.7%), the Slovak Republic (69.7%) and Slovenia (58.5%). The OECD average is 51.3% (for 1998). The second important sub-national revenue source are grants. In Bulgaria where taxes make up only 46.3% of all sub-national revenues, grants are biggest compared with the other countries (at nearly 40%). In the Slovak Republic and Slovenia, the rates are centred between 21 and 23%.

A major policy change seems to have happened in Romania, where taxes have significantly gained importance as a local revenue source. The tax share out of overall sub-national revenue rose by one third from 1998 to 2000. Grants have at the same time decreased by 52.7%. Non-tax revenues have remained at stable percentages.

On non-tax revenues, the Slovak Republic (21.1%) and Slovenia (20.5%) report shares above the OECD average of 16.9%, whilst Romania (13.4%) and Bulgaria (10.4%) levels below the OECD average.

The distribution of the country reporting with regard to the composition of local tax revenues by tax base is shown in Table 3.2.

With regard to year 2000, the tax on income, profits and capital gains is reported to be the most important sub-national tax source in Romania, the Slovak Republic and in Slovenia with 77,7%, 59.9% and 72.2% respectively, well above the OECD average of 40.8%. While in Bulgaria taxes on payroll and workforce make up 60.6% of all sub-national taxes. The taxes on property (category 4000) which are traditionally considered as an important local tax base, appear well below the OECD average of 32.5% especially in Romania and Bulgaria. For the Slovak Republic, the share is close to the average at 28.2%, whilst in Slovenia it is at 20.2%.

Table 2.2a **Classification of local taxes by tax base (in %), 2000**

	Bulgaria	**Romania**	**Slovak Republic**	**Slovenia**	**OECD unweighted average for unitary countries, 1998 (1)**
1000 Taxes on income, profits & capital gains	28.3	77.7	59.9	72.2	40.8
2000 Social security contributions	0	0	0	0	–
3000 Taxes on payroll and workforce	60.6	0	0	0	–
4000 Taxes on property	10.3	16.5	28.2	20.2	32.5
5000 Taxes on goods and services	0	2.4	11.8	7.6	16.3
6000 Other taxes	0.8	3.32	0.1	0	10.3
Total	100.0	100.0	100.0	100	

Note (1) *Source:* (OECD benchmarks): Revenue statistics, 1965-1999, Paris 2000, p. 206.

Table 2.2b **Classification of local taxes by tax base (in %), 1999**

	Czech Republic	**Hungary**	**Poland**	**Estonia**	**Latvia**	**Lithuania**	**OECD unweighted average for unitary countries, 1998 (1)**
1000 Taxes on income, profits & capital gains	89.4	45.0	56.7	90.7	77.4	91.3	40.8
2000 Social security contributions	-	-	-	-	-		-
3000 Taxes on payroll and workforce	-	0.3	-	-	-		-
4000 Taxes on property	5.6	13.9	39.6	8.6	21.0	8.7	32.5
5000 Taxes on goods and services	4.9	-	3.6	0.7	1.6		16.3
6000 Other taxes	0.1	40.8	0.1		-		10.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note (1) Source: (OECD benchmarks): Revenue statistics, 1965-1999, Paris 2000.

3.3 Profiles on tax and revenue autonomy of sub-national governments

As referred to in section 2, the issue on local discretion in financial decision-making is a central theme in the questionnaire for the survey. The country data on this issue are summarised under the following three headings:

Own tax revenue, Table 2.3

Classification of grants in relation to sub-national autonomy, Table 2.4

Overall presentation of own revenue sources, Table 2.5

3.3.1 Own tax revenue

In identifying own taxes of sub-national governments, the essential question concerns the separation of tax revenues across levels of government. The OECD has taken the initiative of developing a new system of classification regarding own taxes of sub-national government (SNG). Taxes of sub-national governments are, here, subdivided into categories of decreasing tax autonomy and then ranked by decreasing order of control that the SNG's can exercise over this revenue source:

(a) SNG sets tax rate and tax base
(b) SNG sets tax rate only
(c) SNG sets tax base only
(d.1) SNG determines revenue-split
(d.2) revenue-split can only be changed with consent of SNG
(d.3) revenue-split fixed in legislation, may unilaterally be changed by central government
(d.4) revenue-split determined annually by central government as part of the budget.
(e) central government sets rate and base of SNG tax.

In cases (a) – (c), the sub-national government has total or significant control over its taxes ("own taxes"). In the remaining cases, involving tax-sharing arrangements, its tax autonomy is very limited or non-existent.

For further information on the system of classification, please see OECD *Revenue Statistics 1965-98, Special Features* and "Taxing Powers of State and Local government" OECD *Tax Policy Studies*, *No 1*., 1999.

With reference to the results in this survey - Table 2.3 - when considering 'own taxes' -- categories a-c where local government has control over the tax base and/or tax rate – the Slovak Republic is reporting the largest share under this heading (35.2%). In Slovenia, local governments can set both tax rate and base for 16.7% of all local taxes. In Romania, the share of own taxes amounted to a modest share of 6.6%, while Bulgaria has no 'own' taxes at all.

The publication, Tax Policy Studies No. 7, reports the results of the fiscal design surveys carried out in Poland, the Czech Republic, Hungary and the three Baltic States, based on the same classifications as in this survey. It appears that, the profile of the Slovak Republic resembles the one of the Czech Republic. The Bulgarian profile where all taxes are set by the central government stands out as quite unique. Otherwise no distinct similarities can be identified across the countries.

Table 2.3a **Tax autonomy at the sub-national government level: degrees of control given as percentages out of all tax categories**

Category	**Sub-national government taxes as % of total tax revenue**	**a**	**b**	**c**	**d.1**	**d.2**	**d.3**	**d.4**	**e**
Bulgaria									
1998	12.0						41	59	
2000	10.0						39	61	
Romania									
1998	7.2		8.6	4.6				66.9	19.9
2000	10.5		6.0	0.6				75.0	18.4
Slovak Republic									
1998	4.1	7.4	28.2					64.4	
2000	4.0	7.0	28.2					64.8	
Slovenia									
1998	7.4						100		
2000	7.9	16.7	0.60	0.4			82.30		

Table 2.3b **Tax autonomy at the sub-national government level: degrees of control given as percentages out of all tax categories**

Category	Sub-national government taxes as % of total tax revenue	a	b	c	d.1	d.2	d.3	d.4	e
Czech Republic									
1997	10.8	2.2	6.0	-	-	-	91.8	-	-
1999	11.1	2.7	5.6	-	-	-	91.7	-	-
Hungary									
1997	8.9		43.5	-	-	-	-	-	56.0
1999	10.4		49.2	-	-	-	-	-	50.8
Poland									
1997	9.1	-	39.3	0.7	-	-	60.0	-	-
1999	8.3	-	41.9	0.6	-	-	57.6	-	-
Estonia									
1997	14.6	-	9.8	-	-	-	90.2	-	-
1999	16.2	-	9.2	-	-	-	90.8	-	-
Latvia									
1997	15.7	-	-	-	-	-	-	-	100
1999	17.1	-	-	-	-	-	-	-	100
Lithuania									100
1997	16.7	-	-	-	-	-	-	-	100
1999	22.0	-	-	-	-	-	-	-	100

3.3.2 The system of grants in relation to sub-national autonomy

In the questionnaire for the survey, the main distinction is set between general grants and specific grants. Within these categories, different arrangements can be identified relating to varying policy mandates and objectives from national government, and the specific form of grant distribution (degree of discretionality).

General-purpose grants are those which can be used as if they were the receiving sub-national government's own tax revenues. Within this category, **grants related to objective criteria** are those which are distributed according to some measure of taxable capacity and/or expenditure needs, whilst **grants also related to own tax effort** are those related to objective criteria *and* to an authority's own tax effort in such a way that an increase in the level of local taxation for a given authority results in an increase in the amount of grant for that same authority.

Under the heading, **Specific grants - c*onditional grants*** are those where the amount of the grant (seen as revenue for each authority) depends on the expenditure of that same authority. At ***standard cost*** means that the percentage refund only covers a certain standard cost or some similar amount. If local expenditure exceeds this amount, the grant is reduced or not given at all. At ***actual cost***, there is no limit as to standard or similar limits but this does not include 100 per cent grants. Sometimes, a 100 per cent grant is given because the local authority acts only as an administrative agent carrying out a precisely defined function on behalf of central government. ***Discretionary grants*, on the other hand, include grants which the central government may or may not distribute and which are distributed at the discretion of the government according to the particular circumstances of the authority in question. Normally, there are no general criteria for the distribution of such grants.

For further details on the classification, please see the Questionnaire for the surveys (which can be obtained from the OECD Secretariat).

The reporting of the countries in Table 2.4 can be 'grouped' into two types: for the Slovak Republic and Romania, 100% of the grants are reported as specific grants. In the Slovak Republic all the grants are given as unconditional grants. For the Czech Republic, the specific grants are distributed with approximately 50% as conditional grants and 50% as unconditional grants (see OECD *Tax Policy Studies No. 7*).

For Bulgaria and Slovenia, in 1998, more than 78% of the grants are classified as tied resources i.e. as specific grants, whilst the remaining part is distributed as general purpose grants. For Slovenia, in 2000, however, a larger part of the grants was 'generalised', leaving a proportion of 63% as specific grants.

Table 2.4a **Profile of grants to sub-national governments (in %)**

Country/ Year	Specific grants				General purpose grant				Total	Grants as proportion of total local revenue %
	Current				Objective criteria		Discretionary	Total		
	Conditional		Not conditional	Total	Without own tax effort	With own tax effort				
	Standard costs	Actual Costs								
Bulgaria										
1998	0				84.3		15.7		100	37.4
2000	9.1				65.0		25.9		100	39.9
Romania										
1998		100		100					100	34.9
2000		100		100					100	16.5
Slovak Republic										
1998			100	100					100	9.1
2000			100	100					100	11.9
Slovenia										
1998	19.1	2.7		21.8	78.2			78.2	100	21.6
2000	18.7	18.2			63.1			63.1	100	23.3

Table 2.4b **Profile of grants to sub-national governments (in %)**

Country/ Year	Specific grants				General purpose grant				Total	Grants as proportion of total local revenue
	Current				Objective criteria		Discretionary	Total		
	Conditional		Not conditional	Total	Without own tax effort	With own tax effort				
	Standard costs	Actual Costs								
Czech Republic										
1997	12.8	41.2	46.0	100					100	18.7
1999	16.0	37.2	46.8	100					100	16.0
Hungary										
1997	95.0	1.7	0.6	97.3		0.6	2.1	3.7	100	53.7
1999	94.2	0.6	1.8	96.6		0.6	2.8	3.4	100	50.0
Poland										
1997	12.5	24.4		36.9	63.1			63.1	100	34.3
1999	14.3	25.1		39.4	60.6			60.6	100	51.3
Estonia										
1997	35.6			35.6		64.4		64.4	100	22.5
1999	40.2			40.2		59.8		59.8	100	22.5
Latvia										
1997	87.2			87.2	12.7			12.7	100	25.3
1999	90.0			90.0	10.0			10.0	100	23.6
Lithuania										
1997	57.0	4.6		61.6	38.4			38.4	100	29.6
1999	12.7	32.5		45.2	54.7			54.7	100	4.1

3.3.3 Overall presentation of own revenue sources

The findings in Tables 2.3 and 2.4, together with other information on sub-national revenues (Table 2.1), are summarised in Table 2.5. The total sub-national revenue is classified into three categories “own revenues”, “other free revenues” and “tied revenues” – cf. Table 2.5.

There does not seem to be an overall pattern of 'revenue autonomy' across the countries. The profile of revenue sources across the sub-national revenue base differs to a large extent, just as the deciding power for setting the base and rate of taxation and the grant designs, is very unevenly distributed across the countries.

However, when referring to the findings in Table 2.5, there seems to be a few common features. In Bulgaria and Romania, own revenues make up a small proportion of total revenues. The proportion is between 13% and 18%, whilst in the Slovak Republic and Slovenia own resources make up 39.8% and 28,5%, respectively. In the Slovak Republic most revenues are raised under the category ‘own revenues’. The profile of own revenues, however, seems similar across the two groups of countries. Bulgaria and Romania, non-tax revenues make up 13.4% and 13.8% of own revenues, while there are no own taxes in Bulgaria and approximately 5% in Romania.

The major part of sub-national revenues in Bulgaria, Romania and Slovenia are classified in the next category, “other free revenues”, the majority of which have been raised under tax sharing arrangements set wholly by central government. In Romania and in the Slovak Republic, tax sharing revenues make up 100% of free revenues, whilst in Bulgaria and in Slovenia general grants make up 40.7% and 23.4% of free revenues.

Finally, when considering “tied revenues”, Bulgaria and Slovenia report between 7% and 9% of their revenues as specific grants, whilst Romania and the Slovak Republic, report between 16% and 21% of their revenues belong to the tied revenues category.

To summarise Table 2.5, from an overall perspective, there does not exist any parallel profiles across the countries. Parallel to the tables discussed earlier, the countries stand out as having a unique pattern of revenues. As an overall impression non-tax revenues seem to have played a more important role in three of the survey countries from the last survey round: Czech Republic, Poland and Latvia with 36.3%, 24.6% and 20.4% respectively.

Table 2.5a **Local government. Summary of profiles of current revenue, 1999**

% of total public expenditure	**% of financing**			
	Bulgaria	**Romania**	**Slovak Republic**	**Slovenia**
I Own revenues:	13.4	18.4	39.8	28.5
– own taxes, category a - c	(0)	(4.6)	(21.1)	(10.4)
– non-tax revenue	(13.4)	(13.8)	(18.7)	(18.1)
II Other free revenues:	79.6	65.1	38.8	62.9
– general grants	(32.4)	(0)	(0)	(14.7)
– tax sharing , category d – e	(47.2)	(65.1)	(38.8)	(48.2)
III Tied revenues	7.0	16.5	21.4	8.6
– specific grants	(7.0)	(16.5)	(21.4)	(8.6)
Total	100	100	100	100

Note 1: The proportion of non-tax revenue out of total revenue was extraordinarily high in 1999. For the figures on 1997-98, please refer to Table 3.1

Table 2.5b **Local government. Summary of profiles of current revenue, 1999**

	% of financing					
	Czech Republic 1)	**Hungary**	**Poland**	**Estonia**	**Latvia**	**Lithuania**
I Own revenues:	40.2	33.3	35.2	15.4	20.4	4.8
– own taxes, category a - c	(3.9)	(16.3)	(10.6)	(6.3)	(0.0)	(0)
– non-tax revenue	(36.3)	(17.0)	(24.6)	(9.1)	(20.4)	(4.8)
II Other free revenues:	43.8	18.5	44.9	75.5	58.4	93.3
– general grants	(-)	(1.7)	(30.5)	(13.4)	(2.4)	(2.3)
– tax sharing , category d – e	(43.8)	(16.8)	(14.4)	(62.1)	(56.0)	(91.0)
III Tied revenues	16.0	48.2	19.9	9.1	21.2	1.9
– specific grants	(16.0)	(48.2)	(19.9)	(9.1)	(21.2)	(1.9)
Total	100	100	100	100	100	100

Note 1: The proportion of non-tax revenue out of total revenue was extraordinarily high in 1999. For the figures on 1997-98, please refer to Table 3.1

3.4 Profiles on sub-national expenditure

In 2000, the levels of decentralised expenditures -- seen as the proportion of total government expenditure of which sub-national authorities dispose (see Table 2.6) – are centred around 2.7 (Slovak Republic) and 7.3% (Bulgaria). Compared with the previous survey, in 2000, these decentralisation indicators appear rather low. For instance, in 1999, the relevant quota are 10.4% in Hungary, 12.1% in Poland and 0,5% in Latvia.

The overall impression is that there are few similarities in the expenditure profile across the four countries. (Column A). Housing is the most important local expenditure task in Romania and the Slovak Republic, while the education sector receives most local resources in Bulgaria and in Slovenia. In Bulgaria, 82.1% of sub-national expenditures are spent on education, health, social security and housing tasks. One third of local expenditures are given to the education policy area. Bulgaria stands out as the country where the local governments assume by large the biggest responsibility for education policy expenditures (55%). A different concentration of tasks can be found in Romania: Here 76,1% of expenditures go into general public services, social security and welfare, housing and transportation. The largest local expenditure is housing (23.8%), followed by transportation and communication (23.3%). Only 0.2% of local expenditures are spent on health. Local governments pay only 13.9% of education expenses.

The social security sector is receiving the largest share of local funds in Bulgaria (15.5%), followed by Romania (13.4%), Slovenia (3.9%) and the Slovak Republic (1.8%).

In all four countries, the housing-sector is largely financed by the municipalities. The share of local expenses out of overall expenditure range from 64.1% (Bulgaria and Slovak Republic) to 96.4% (Romania). Although the housing sector receives only a minor part of the expenditure for most countries (apart from Poland and the Czech Republic), for all the other countries, the local proportion of the overall expenditure on housing is between 80% and 100%. Seen as a proportion out of the local budget, housing makes up 14% (Bulgaria) to 38.1% (Slovak Republic) of local expenditures across the four countries. The largest share of housing tasks in the Slovak Republic is parallel to the situation in the Czech Republic (see OECD *Tax Policy Studies No. 7*)

Table 2.6a **Current sub-national expenditures by function, as a percentage of sub-national government expenditure (A) and as a share of consolidated general government expenditure by expenditure issue (B) (2000)**

		Bulgaria		Romania		Slovak Republic		Slovenia	
		A	B	A	B	A	B	A	B
1	General public services	8.0	18.1	15.6	33.2	22.8	19.1	14.3	27.7
2	Defence	0.8	2.1	0	0	0.03	0.05	0.3	1.5
3	Public order & safety	0	0	2.0	3.2	2.8	0.2	1.9	5.9
4	Education	33.4	56.3	7.9	7.2	0.2	0.1	24.1	23.7
5	Health	22.0	45.3	0.2	0.2	0.6	0.2	1.7	1.6
6	Social Security & Welfare	16.8	8.2	13.4	4.9	1.8	0.5	3.9	1.1
7	Housing & community amenities	9.0	69.6	23.8	96.4	38.1	64.1	23.7	75.7
8	Recreational, cultural & religious affairs	3.0	27.2	7.7	49.7	8.6	26.7	10.0	45.8
9	Fuel & energy	0	0	0	0	0	0	0	0
10	Agriculture, forestry, fishing & hunting	0.5	4.9	0.7	2.2	3.4	4.9	2.5	13.8
11	Mining, manufacturing & construction, except fuel & energy	0	0	0	0	0.2	1.1	0	0
12	Transportation & communication	4.7	23.5	23.3	36.4	13.0	21.5	11.3	23.2
13	Other economic affairs	1.2	11.4	0.8	5.1	3.9	3.1	6.0	24.7
14	Other functions	0.5	0.9	4.6	3.1	4.4	4.3	0.3	0.9
15	Total	100		100		100		100	
	Total current government expenditure. Consolidated % of GDP	40.0		33.5		41.8		44.1	
	Total current sub-national government expenditure. % of GDP	7.0		3.4		2.7		5.3	

Note 1 GFS 2001.

Table 2.6b **Current sub-national expenditures by function, as a percentage of sub-national government expenditure (A) and as a share of consolidated general government expenditure by expenditure issue (B) (1999)**

		Czech Republic		Hungary		Poland		Estonia		Latvia		Lithuania	
		A	B	A	B	A	B	A	B	A	B	A	B
1	General public services	13.5	42.9	14.3	47.2	8.8	44.0	13.5	37.5	13.0	42.2	4.6	20.8
2	Defence	0.05	0.2	0.05	0.6	0.02	0.2	0.02	0.2	-	-	0	0
3	Public order & safety	2.5	9.8	1.2	7.6	5.1	32.6	0.3	0.9	1.6	6.3	0.8	2.6
4	Education	10.0	18.1	32.6	66.2	33.9	71.2	40.8	49.2	49.5	73.2	56.3	68.0
5	Health	1.1	1.3	18.6	43.8	2.5	7.0	1.2	1.5	1.1	2.6	0.5	0.7
6	Social Security & Welfare	9.3	5.1	16.1	11.1	10.9	6.8	12.5	7.5	8.7	4.9	16.1	8.7
7	Housing & community amenities	31.7	79.1	8.6	*	22.8	88.5	10.4	97.7	10.4	80.1	7.9	100
8	Recreational, cultural & religious affairs	6.8	54.6	4.6	46.5	5.1	74.4	9.0	40.6	5.6	47.1	4.9	36.2
9	Fuel & energy	0.04	1.8	-	-	-	-	1.0	100	0.06	50.0	3.1	94.3
10	Agriculture, forestry, fishing & hunting	0.6	5.1	0.7	5.2	2.2	32.5	0.07	0.6	0.1	0.6	0.01	0.02
11	Mining, manufacturing & construction, except fuel & energy	0.2	9.3	0.07	12.7	0.6	28.0	-	-	-	-	-	-
12	Transportation & communication	17.7	43.7	1.2	12.2	7.1	64.0	5.5	18.4	4.5	23.0	3.4	15.4
13	Other economic affairs	0.6	3.5	1.0	10.6	0.3	18.0	1.7	39.4	0.2	4.2	0.04	1.8
14	Other functions	5.7	42.9	0.8	1.0	0.6	2.3	3.8	26.8	5.1	39.0	2.2	6.2
15	Total	100	18.3	100	23.7	100	27.6	100	19.7	100	23.1	100	19.6
	Total current government expenditure. Consolidated % of GDP	43.0		44.0		43.6		36.2		41.4		32.1	
	Total current sub-national government expenditure. % of GDP	7.9		10.4		12.1		7.1		9.5		6.3	

B-column: current local expenditure as % of current government expenditure.
NOTE: (*) Social security contributions are included in the figures, but not consolidated. Data is therefore not compatible.
Note 1 Source: FDI 2000, Danish country report.

4. THE BALANCE BETWEEN NATIONAL FISCAL TARGETS AND SUB-NATIONAL FINANCIAL DISCRETION

4.1 Introduction

In addition to the overall government finance indicators on sub-national governments, as presented in Section 3 in this Chapter, the country surveys cover a number of matters with regards to the specific mode of sub-national financial decision-making, including the specific design of intergovernmental fiscal relations. This Chapter describes some of the main findings in the surveys on these issues.

The questions on the mode of financial decision-making are compiled under the overall heading of "Setting the balance between local discretion and autonomy in financial decision-making on the one hand, and macroeconomic control and fiscal discipline on the other". Setting the balance in the power distribution across levels of governments is, of course, at the focus of reform considerations in all countries - in OECD Member countries just as in countries in transition. Reforms are taking place in all the countries, although there are still some outstanding problems and gaps in efficiency.

In the questionnaire and, more specifically, as set out in the sections below, the following questions and issues were raised, in order to identify the country-specific 'balances' or designs:

Institutional framework on central-local relations

Taxation

Measures on overall fiscal co-ordination and policy coherency. What kinds of measures are there to ensure co-ordination between central and local tax policies? Are there any national restrictions on local autonomy: targets for each local government on total revenue from a specific source; targets for the range (min./max.) of the specific tax rate; exemptions from the tax bases set centrally; etc.?

– Are sub-national governments free to decide whether to impose taxes, or are taxes mandatory?
– Are they combined with minimum rates (cf. above)?

National measures for revenue-efficient local tax administration. Central assistance in general capacity-building of local tax administrations, including central systems in support of local administrations.

Central assistance in optimal exploitation of sub-national tax sources, e.g. national systems of valuation.

Non-tax revenue

What kind of overall measures are set up to restrict and control sub-national government revenue from non-tax sources? Are sub-national governments generally allowed to deficit finance with non-tax revenues?

Grants

What overall measures are set up to avoid national budgetary pressures from sub-national government? How are the annual overall amounts for grants determined e.g. automatically (as set out in substantial law); as a share of current revenue (identity of the revenue e.g. by base); or set as discretionary in the national budget law? How are the grants allocated – cf. the categories identified in the tables.

Have reforms taken place due to insufficiencies in the overall design of the system of intergovernmental relations, i.e. the lack of stable, reliable, transparent, well-documented and formula-based relations and procedures?

Borrowing

Procedures on the bailout of sub-national governments. To what extent can sub-national fiscal imbalances be passed back to the national government? Does central government set conditions for helping sub-national governments in deficit?

Expenditure

Is there clear assignment of expenditure responsibilities across levels of government? What is an appropriate size of unit for the cost-efficient operation of sub-national government services?

Macroeconomic control of local governments -- Budget co-operation (expenditure) between central and sub-national levels. Main characteristics of the instruments for the central control of expenditure Institutions and procedures for expenditure control. The decision-making processes. A summary of recent reforms of central-local relations. Background and objectives. Have there been reforms due to insufficiencies in the overall design of the systems of budget co-operation: the lack of stable, reliable, transparent, well-documented and formula-based relations and procedures?

Specific budget co-operation. Compensation when new activities are assigned to sub-national governments: according to which principles is the compensation calculated?

The replies to these questions are summarised in the following subsections, 4.2 - 4.3. Section 4.2 deals with the issues on sub-national government size and the expenditure assignments to sub-national governments. Section 4.3 summarises the situation of the framework on sub-national finance.

4.2 The framework of government size and expenditure assignments

4.2.1 Sub-national government size

Regarding the size of sub-national government, one interesting result of the survey is that the municipalities are on average less fragmented compared with what was found in five out of six countries in the surveys of 2000-1.

Among the four countries, only the Slovak Republic reports quite a fragmented government structure: 16.3% of population live in municipalities of less than 1000 inhabitants, which corresponds to 68.4% of municipalities. This means that most local expenditure responsibilities are carried out by a very large number of governments, most of which are of a small unit size.

Bulgaria, Romania and Slovenia have a more concentrated government structure. In Bulgaria, only 1.1% of the population live in municipalities with less than 5000 inhabitants which equals 10.7% of all municipalities. The largest part of the population live in municipalities with more than 50 000 inhabitants. Romania and Slovenia equally have a fairly balanced government structure. In Romania, more than half of the population, and in Slovenia, more than two thirds of the population, live in municipalities with more than 10 000 inhabitants (92.3% and 71.9% the municipalities respectively).

Cost-efficient operation of local services does require municipalities of a certain size. As an example, municipalities smaller than 6 000-8 000 inhabitants are traditionally considered too small to run their own schools and facilities in relation to primary education cost-efficiently.

Table 2.7a **The distribution of municipalities by size. 2000**

Proportion of municipalities (A), proportion of population (B)								
Number of Inhabitants	Bulgaria		Romania		Slovenia		Slovak Republic	
	A	B	A	B	A	B	A	B
- 999	0	0	1.8	0.2	3.1	0.2	68.4	16.3
– 1 999	1.5	0.1	15.3	3.0	12.5	1.6	87.0	30.2
– 4 999	10.7	1.1	71.4	27.6	49.5	14.2	95.7	43.9
– 9 999	35.1	6.7	92.3	45.7	71.9	29.0	97.5	50.6
– 49 999	87.4	40.8	98.4	61.2	98.4	78.3	99.6	75.2
– 99 999	95.0	58.5	99.2	69.0	99.0	80.8	99.9	87.2
>100 000	100	100	100	100	100	100	100	100

Table 2.7b **The distribution of municipalities by size. Various years**

Number of inhabitants	Proportion of municipalities (A), proportion of population (B)											
	Czech Republic (1999)		Hungary (2000)		Poland (2000)		Estonia (1999)		Latvia (2000)		Lithuania (2000)	
	A	B	A	B	A	B	A	B	A	B	A	B
- 999	79.6	16.8	53.7	7.5			10	1	32.3	5.6		
– 1 999	90.0	25.6	74.7	16.7	23.4	5.9	49	11	71.4	18.2		
– 4 999	95.8	36.2	91.0	31.5			85	30	91.1	31.5	3.3	0.3
– 9 999	97.9	45.3	95.5	40.9	66	25.4	94	40	95.5	38.8		
– 49 999	99.7	66.8	99.3	63.6	96	61.9	98	52	99.1	54.2	66.6	32
– 99 999	99.9	79.0	99.7	71.1	98.2		99	64	99.6	62.9	91.6	60
>100 000	100	100	100	100	100	100	100	100	100	100	100	100

4.2.2 The assignment of expenditure responsibilities across levels of government

All four countries report overlapping, shared or transferred tasks between the central and the local levels of government. Reform considerations on clarifying the division of expenditure assignments seem to be under way in some countries, e.g. in Bulgaria.

Bulgaria, for instance, has started a reform in 2002 with the objective of clarifying the division of expenditure assignments between the two levels of government. According to the Bulgarian country report, this is an important step towards "real" fiscal decentralisation of municipalities and a clear definition of the state's and municipalities' rights and responsibilities. The objective of this reform is, in the words of the Ministry of Finance: "to maximally cover the negative balance between the state expenditures assigned (health care, education, social benefits and assistance) and the revenues from shared taxes (tax for municipalities and personal income tax), and to make more transparent the definition of the relations between the municipalities and the central budget."

In **Romania**, according to the Romanian country report, there are decentralised services of central ministries who carry out their tasks on the local level. The activities of the local authorities can overlap with those of other decentralized public services. For example, according to the provisions of the *Law of local public administration*, local councils provide the necessary physical and financial conditions for the well functioning of the public institutions and services in education, health, culture, youth and sport, public order, fire protection, civil protection, for which, at the county level, there exist also decentralized services of ministries. However, no subordinate relations between these decentralized services of the ministries and the local public administration authorities are allowed, as such a subordination would break the legal and constitutional norms and the principle of local autonomy.

Slovenia: The *Local Government Act* merely lists the tasks of municipalities, while the specific allocation of tasks (in specific areas) between the local and national levels is determined by individual sectoral laws (for example: Organisation and Financing of Education Act, Nursery Schools Act, Primary School Act, Social Security Act, Health Care Activities Act, Exercise of the Public Interest in Culture Act, Sport Act, Commercial Public Services Act, Environmental Protection Act, Housing Act, Public Roads Act, Act on Protection Against Natural and Other Disasters, Fire Brigade Act). Laws governing these specific areas define, for the specific tasks, the competencies of the municipalities and the state. Pursuant to Article 24 of the *Local Government Act*, the state may with the prior consent of municipalities transfer by statute to municipalities the performance of individual tasks within the competence of the state (transferred tasks). The state also provides appropriate funds to municipalities for the performance of transferred tasks.

Assignment across the different functions

Expenditures for the operation of municipal bodies and municipal administration form one of the more important groups of expenditures in municipal budgets. Most tasks in the defence sector are within the competence of the state. Most tasks in the public order and safety sector are within the competence of the state. Both the state and municipalities perform tasks in the education sector. Both the state and municipalities perform tasks in the education sector. All tasks in the area of secondary and higher education are within the competence of the state. Municipalities are competent for arrangements in the area of pre-school and primary education, while financing of primary education is partly within the competence of the state (salaries with contributions and taxes and other personnel incomes, and material costs linked to the implementation of programmes). In the area of health care, the payment of all health care services is secured on the national level via the system of health insurance. Tasks in the area of secondary and tertiary health care are performed by the state. Municipalities have competence for tasks relating to primary health care. In the area of social insurance, tasks are performed in their entirety on the national level via the system of pensions and disability insurance. In the area of housing and community amenities, municipalities are competent for most matters. Pursuant to Article 4 of the *Act on the Exercise of the Public Interest in the Area of Culture*, funding is provided for the exercise of the public interest in the area of culture from the state budget and from the budgets of local communities in line with their programmes for the following purposes:

Slovak Republic: Pre-determined functions are carried out by municipalities within their own self-government responsibilities. Although the law allows municipalities to execute delegated (transferred) competencies on behalf of the state - the state would in such a case provide for financial and other material necessities for the municipality to ensure the execution of the task - this provision had not been applied until 2000 in the communal practice. As of 1st January, 2002 the competencies in the field of roads, water management, social assistance, birth registry, certification of documents and signatures, territorial planning and building rules, protection of nature, primary education, physical culture, health care, travel industry and regional development will gradually pass to the municipalities.

4.3 Evaluation of the sub-national finance framework

This section summarises the findings on the sub-national finance framework in the four countries. The findings are given, country by country, primarily by paraphrasing from the relevant sections of the country reports. The summaries have been prepared with direct reference to the structure of questions presented in Section 4.1, topics covered are tax revenues, non-tax revenues, grants, borrowing, bailout and budget co-operation. For a complete presentation of the country systems of finance framework, please refer to the full country reports.

4.3.1 Bulgaria

Tax revenues: The Constitution of the Republic of Bulgaria explicitly provides that the National Assembly has the prerogative of setting taxes. This means that “local parliaments” are deprived of the right to impose on their citizens additional tax burdens in cases of need for funds or when the economic situation changes. Hence, municipalities are deprived of a very important power regarding one of the most important sources of revenues, namely the tax on real property. Local taxes are collected by the tax administration authorities, which are under the subordination of the Ministry of Finance.

Non-tax revenues: Non-tax revenues make up about 20% of the overall municipalities’ own revenues, whilst fees constitute over 50% of non-tax revenues. According to the *Local Taxes and Fees Act*, a municipal council has the right to set the size of the fees within the limits provided by law. Municipal administrations collect fees with the exception of the household waste fee, while local taxes and household waste fees are collected by the tax administration authorities, which are under the subordination of the Ministry of Finance. The possibility for granting municipalities the right to set the size of local fees themselves is under consideration at the moment. Through changes and improvement of the methodology in 2000, the practice to redistribute non-tax revenues between the municipalities was stopped. A stop was also put on the transfers of non-tax revenues into the central budget in the form of unjustified contributions.

Grants. Since 1993, inter-governmental financial relations have been determined through the *Methodology of Determining Budget Relations between the Municipalities and the Central Budget*. The latter is in essence a complex of mathematical formulae and interdependencies consistent with the provisions of the Constitution of the Republic of Bulgaria, the Organic Budget Act and the Municipal Budgets Act. According to the *Organic Budget Act* (1996), the central government should allocate resources to the municipalities for financial support. Since 1996, resources have mostly been allocated in the form of general-purpose grants, but in concrete cases specific grants or subventions can be used as well. The Republic of Bulgaria's budget practice shows that since the adoption of the Organic Budget Act, no subventions have been remitted to local governments.

Borrowing. Borrowing on behalf of municipalities is a normal procedure for overcoming the acute shortage of budget resources. In Bulgaria, the Municipal Budgets Act (1998) and the Organic Budget Act (1996) regulate the use of borrowed money. Borrowed funds can be used 1) to finance the budget deficit set in the process of municipal budgets' preparation, which cannot exceed 10% of municipalities revenues (own revenues plus grants from the central budget), and 2) to overcome temporary shortages of budget resources within the budget year. The Municipal Budgets Act regulates the relationship of municipalities with banks and other financial institutions. By resolution of the municipal councils, municipalities can perform any transactions permitted by law with banks and other financial institutions. Bank loans borrowed by municipalities are secured by mortgage and/or pledge of municipal property. Municipalities' liabilities arisen, as a result of borrowing cannot be settled using state budget resources. Municipal councils are not allowed to take out bank loans, issue municipal bonds or issue temporary interest free loans from the municipal budgets within the six months before their term of office expires. There are no provisions in the current legislation that require the Ministry of Finance to approve municipalities' borrowings (in the form of loans or bonds issuing).

On bailout. Municipal budgets are independent and the state supports municipalities financially only to the extent it has assigned /delegated / them the respective expenditure liabilities – in the sense of conceded taxes and subsidies. The Ministry of Finance has other mechanisms for compensating the under-performance of municipalities' revenues. In case of temporary shortage of funds municipalities may be supported at government discretion. Art. 43 of the *Organic Budget Act* stipulates that from the state budget interest-free loans can be issued under terms and conditions set by the Minister of Finance, which are to be refunded by the end of the budget year. In cases of temporary cash shortages temporary interest free loans can be issued by the central budget.

General budget co-operation. One of the first principles on which the budget system was built at the beginning of the market reforms in Bulgaria, was the principle of the state budget unity. After the adoption in 1996 of the *Organic Budget Act*, the relations between the state budget and the municipalities budgets changed qualitatively. From a macroeconomic point of view the state budget is considered to be a consolidated pecuniary fund comprising all revenues and expenditures of the state. But the budgets of the municipalities are independent, thus not subject to approval by the National Assembly. The municipal budgets are prepared and adopted by municipal councils in compliance with the relevant provisions. The National Assembly only sets the amount of transfers (general-purpose and specific ones) from the Central Government to the municipalities and the contributions to the central budget.

4.3.2 Slovenia

Tax Revenues: Municipalities have very little tax autonomy. Except in few cases municipalities have no competence in determining the tax base, rate and exemptions. As a rule, the taxes are collected by the national tax administration. The only two taxes items for which municipalities may determine the tax base and tax rate are the compensation tax for the use of building land (which is an important source of revenue for municipalities) and certain municipal taxes The municipalities can also in part influence the tax base and rate for the property tax and the tourist tax.

Non-tax revenues: The more important sources here are: rental revenues, municipal contributions and, in individual municipalities, self-contributions. Most non-tax revenues belong in full to municipalities, while some are divided on a statutory basis between the state and municipalities (revenues from concession fees from special games of chance, administrative fees, compensation for degradation and usurpation of space). With regards to determining the basis for payment and the level of payment, the majority of non-tax revenues is within the competence of municipalities, with the exception of revenues from concession fees from special games of chance, administrative fees and compensation for the degradation and usurpation of space.

Grants: Municipalities are entitled to transfers funds from the state budget, in the form of a financial settlement for the financing of "appropriate" expenditure (for further information see country report) calculated pursuant to Article 20a of the *Municipal Financing Act*, and for the co-financing of individual measures and investments, where there exists on the national level a special interest for their development.

Borrowing. Municipalities may only borrow on the basis of prior consent of the Ministry of Finance under the conditions stipulated by the Municipal Financing Act. Municipalities may borrow by issuing securities and taking out loans. Municipalities may not borrow abroad, except pursuant to the law. Municipalities may take on long-term borrowing for investment confirmed by the municipal council. Loan contracts are concluded by the mayor on the basis of the adopted budget and with the prior consent of the Ministry of Finance. Municipalities may only borrow if the total level of existing indebtedness and the anticipated new indebtedness does not exceed 10% of the revenues generated by the municipality in the year prior to the year of borrowing, while the total payment of principal and interest in an individual year of payment may not exceed 5% of revenues generated.

On bailout: The Ministry of Finance is striving to establish suitable records on the level of indebtedness of municipalities and on guarantees issued. Municipalities are obliged to submit to the Ministry of Finance data on the state of their indebtedness and on the issuing of guarantees, but in practice this task is not carried out consistently, since not all municipalities report such data. Therefore the Ministry of Finance does not have access to precise data on the state of indebtedness of municipalities and on guarantees issued in past years. State assistance to municipalities in financial difficulty is only envisaged for municipalities that fell into financial difficulties (excessive indebtedness) before 1995 in accordance with the provisions of Article 51a of the Municipality Financing Act. The government guarantees additional funding to those municipalities if the liabilities arising from indebtedness before 1995 exceed the anticipated revenues by more than five per cent in a specific budgetary year. The additional funds provided amount to the difference between the matured liabilities from indebtedness before 1995 and five per cent of revenues for that budgetary year. The *Financing of Municipalities Act* regulated the indebtedness of municipalities in detail after 1998. This Act does not stipulate that the state will take over the liabilities of municipalities who fell into financial difficulties after 1995 or provide them with additional funds.

General budget co-operation: The same regulations apply for the composition, adoption and implementation of municipal budgets and the state budget: The Government must at the proposal of the Ministry of Finance determine by 30 September of the current year the amount of the financial settlement (general grants) for the following budget year. This must be communicated to the municipalities. The Government submits the draft state budget for the following budget year to the National Assembly by 30 September of the current year. Mayors submit proposed municipal budgets for the following budget year to the municipal council within 30 days of submission of the state budget to the National Assembly. The National Assembly or municipal council must adopt the budget within an interval enabling the entry into force of the budget by 1 January of the year for which the budget is adopted. Pursuant to the Public Finance Act, budget inspectors of the Ministry of Finance may supervise the use of transferred funds from the state budget. Such supervision also includes supervision of the lawfulness and purpose of funds transferred to municipalities from the state budget (special grants).

4.3.3 Slovak Republic

Tax revenues: The existing basis of the tax system was set up in the principal tax reform of 1992, which (effective from January 1, 1993) represented the initial step toward reconstruction of the tax system in the interests of its comparability with developed market economies. Municipalities are authorised to define the tax rates only in respect of local taxes, which are included in the taxes levied on goods and services. In the tax system presently in force, the powers of municipalities to specifically determine tax rates are limited to the *Real Estate Tax A*ct and to the *law on local charges*. These powers are further limited by the provision of the Real Estate Tax Act defining the basic tax rates that may be applied by the municipality with a certain amount of increase or decrease (the limits of such deviations are also prescribed by the law), depending on local conditions.

A similar solution is applied in the law on local charges, with the difference that the rates are defined as maximums which, in specified cases, may be additionally increased by the municipality up to a statutory limit value. According to the quoted tax laws, both the real estate tax and the local charges are under municipal administration and fully represent budgetary revenues of the administrator municipality. All other taxes collected on the SR territory are state taxes, managed in a specialised network of state tax offices operating under the jurisdiction and management of the Ministry of Finance of the Slovak Republic. The Ministry of Finance is currently considering the strengthening of local tax revenues. The Ministry will submit a relevant proposal, identifying new financial sources for local governments and analysing the options of additional improvements in the tax competencies of municipalities, for government debate in 2002.

Non-tax revenues: The central government has passed, in 1991 a law which identifies local fees: The municipality decides on the type of local charges applied within its territory, i.e. not all types of charges must be introduced. On the other hand, no local charges must be used which are not specified in the law. Municipalities are free to determine the charge rate but must respect any maximum limits of such rates and the possible ranges of increase, specified by the central government in the law.

Grants: In principle, budgetary limitations - i.e. definition of (i) available resources in the state budget for the corresponding fiscal year, and (ii) of priority expenditures - represent the only measure applied by the central government to prevent pressure on the state budget by municipalities. The legal framework of subsidies from the state budget is resolved in the *Budgetary Rules Act*. According to this Act, subsidies may be provided from the state budget to municipalities only to the extent specified in the State Budget Act, and used only for specific purposes or in predetermined areas of requirements. It follows from this that the global general- purpose subsidy system is not applied in Slovakia. Municipalities may use their allocated subsidies until the end of the fiscal year, and account for such use annually by methods prescribed by the Ministry of Finance. If the allocated subsidies remained not drawn, or were used contrary to the predetermined purpose, they must be returned to the state budget or the state fund.

Borrowing: Local governments in Slovakia may accept loans in any amounts from any sources, for purposes specified at their own discretion. Municipalities borrow mostly from commercial banks and from certain state funds. They may accept credits from domestic as well as from foreign banks; they are not subject to special terms and conditions, but have to borrow at "most favourable market rates". Loans extended by state funds offer more favourable conditions compared to market terms.

On bail out: Since there were no mechanisms or measures of the central government in force before 2001 regulating the acceptance of credits and loans by municipalities, they report a growing indebtedness. The government, in order to restrict the increasing sum of communal debt, adopted legal measures regulating the rate of indebtedness and debt service of municipalities and superior territorial units. These measures were reflected in the amended *Budgetary Rules Act*, effective from January 1, 2002. The Slovak Republic has no legal framework for a general system of assistance by the state to local governments in financial difficulties that are unable to repay debts**.**

General budget-co-operation: Financial management in the Slovak Republic is governed by the state budget, approved by Parliament. Municipalities and self-government regions construct and approve their budgets independently. There is no obligation that the local budgets get approved by the central government. Municipalities have no budgetary objectives, sector-dependent specifications or output goals prescribed within the central budget framework.

4.3.4 Romania

Tax Revenue and non-tax revenues. The *Law on local taxes and fees*, adopted by Parliament in 1994, has established the local taxes and fees that constitute revenues of the budgets of the administrative-territorial units. The law settles upper and lower limits for some local taxes, giving the local councils the possibility of deciding the tax levels, according to the principle of local autonomy. It also stipulates payment dates and penalties for delayed payment of local taxes and fees. The local taxes and fees may be increased or decreased, annually, up to 50%, by the local and county councils. The decision of modification must be taken by October 31st, every year, to be applied in the following year.

Non-tax revenues. Non-tax revenues of the local budgets include only those revenues directly collected by the local authorities or their institutions. Non-tax revenues of local councils are established by decisions of local public administration authorities, such as a) the level of fees for pest and disease control in the vegetal sector, and for the services rendered by the sanitary-veterinary circumscriptions and artificial insemination units; and b) the level of special taxes and fees levied for creating some public services in the interest of physical and legal entities.

Grants. In order to sustain some activities that passed under the responsibility of local authorities, the law foresees allocations from the state budget to the municipalties. These transfers are earmarked quotas and amounts from the income tax revenues, earmarked amounts from the value added tax revenues, as well as subsidies granted for financing certain activities. In 2000, the funds allocated from the state budget represented 68.8% of the total revenues of local budgets, from which 52.3% are rates and amounts earmarked from the income tax revenues and 16.5% subsidies.

Borrowing. According the *Law of local public finance*, the local and county councils and the General Council of the Municipality of Bucharest, may approve taking internal or external loan contracts on medium and long term, for public investments of local interest, as well as for refinancing of local public debt. The loans can be made by issuing bonds or by borrowing from commercial banks or other credit institutions.

On bailout. If during the budget execution there appears a temporary cash gap, due to disparities between local revenues and expenditure, these gaps may be covered by non-interest loans from the reserves of the general account of the state treasury. However, this is allowed only after the circulating funds from the annual excess of the local budget have been utilised. The total value of the loan that may be granted to local authorities from the reserves of the state treasury general account cannot override 5% of the total estimated revenues to be collected during the fiscal year in which the loan is contracted.

On budget co-operation. The *Law on local public finance* rules the relationships between the state and local budgets, the due dates for local budgets elaboration, approval and execution, and for financial reports regarding the budgetary execution. This law rules the methods for elaboration and execution of the state budget. It further sets the limits for the amounts allocated from some revenues of the state budget and the transfers with special destination, as well as the allocation criteria for the administrative-territorial units. After the state budget law is adopted, the Ministry of Public Finance informs the local authorities about the amounts earmarked from some revenues of the state budget, about the transfers with special destination, and about the methodology of finishing and approbation of budget drafts, comprising the main aspects of the state budget law regarding local budgets.

5. SOME COMPARATIVE FINDINGS ON THE FISCAL DESIGN STRUCTURE ACROSS THE TEN CEE COUNTRIES

This section highlights some findings of the decentralised fiscal design structure across the 10 participating countries. Table 2.8 shows a synopsis view on the structure of sub-national government across the ten countries.

Such comparison across the ten countries should be made with care, since each intergovernmental fiscal system is unique in its complexity and comprehensiveness. Further, the countries have provided information of differing degrees of detail across the various questions on decentralised systems of financial decision-making laid down in the questionnaire, findings cannot be compared one by one.

As mentioned earlier, the main purpose of the surveys has been to provide each country with updated information on the status quo of fiscal design in other countries in the region who have all one thing in common: They are all on their way from a highly centralized prereform system towards a more decentralised economy, requiring a more decentralised approach to public services.

Table 4.2 shows the proportion of municipalities with less than 10 000 inhabitants. We have mentioned earlier that as a rule-of-thumb municipalities with less than 6000 – 8000 inhabitants can hardly perform their duties, especially in the field of education, cost-efficiently. Seven out of 10 countries have reported that more than 70 % of their local governments fall into this category. The size fluctuates between two poles: Lithuania where only a small group of municipalities has less than 10 000 inhabitants (3.3 %), and the Czech Republic where almost all the municipalities belong to this group (97.9 %).

Among the survey countries covered in this report, Bulgaria has the most concentrated, and the Slovak Republic the most fragmented municipal government structure. 35.1 % (Bulgaria) and 97.9 % (Slovak Republic) of municipalities fall into the above-mentioned category.

One question is whether there is a correlation between the size pattern of municipalities and the level of decentralised supply of services. This seems not to be the case: The two poles, Lithuania and the Czech Republic have both reported expenditure shares between around 18-19 %. The smallest expenditure shares can be found in the Slovak Republic, where local governments spend only 6.7 % of all expenditures. The largest share could be found in Poland, where local governments spend 27.6 % of all expenditures. As an overall impression, countries with very fragmented sub-national government patterns do not seem to have a larger share of expenditure than those with a more concentrated profile.

The revenue profiles show the composition of sub-national resources into own revenues, other free revenues and tied revenues (sees for details about these categories section 3.3.3 and table 2.5). An interesting finding is that in the country with the most concentrated sub-national government structure, Lithuania, local governments have the least amount of tax autonomy: Own revenues constitute 4.8 % of local revenues, whilst other free revenues (grants and centrally set taxes) make up the largest local revenue source (93.3 %). On the opposite case, in the Czech Republic, the country with the largest amount of small government units, local governments dispose of the largest amount of own revenues (40.2 %).

As an overall impression, tax autonomy seems to be somewhat larger in the countries where the large majority of sub-national governments are of a "small" size. This correlation is however not necessarily accompanied by a large share of sub-nationally provided public services, as was demonstrated above.

Table 2.8 **Decentralisation profiles**

	Proportion of municipalities, less than 10 000 inhabitants, 2000	Share of sub-national expenditure out of overall government expenditure	Summary of revenue profiles		
			Own revenues	Other discretionary revenues	Tied revenues
Lithuania	3.3	19.6	4.8	93.3	1.9
Bulgaria	35.1	17.7	13.8	78.9	7.3
Poland	66	27.6	35.2	44.9	19.9
Slovenia	71.9	12.0	28.5	62.9	8.6
Romania	92.3	10.4	18.4	65.1	16.5
Estonia (1999)	94	19.7	15.4	75.5	9.1
Hungary	95.5	23.7	33.3	18.5	48.2
Latvia	95.5	23.1	20.4	58.4	21.2
Slovak Republic	95.7	6.7	39.8	38.8	21.4
Czech Republic (1999)	97.9	18.3	40.2	43.8	16.0

CHAPTER 3
FISCAL DECENTRALISATION IN SELECTED EU MEMBER COUNTRIES

TABLE OF CONTENTS

Introduction

In this chapter, main findings on the inter-governmental fiscal relations are presented for the eight selected EU member States: Belgium, Denmark, France, Italy, Netherlands, Spain, Sweden and the United Kingdom. This is seen as a representative grouping of EU States in terms of their policies towards decentralisation.

The country presentations are brought with a view of broadening the status and perspectives on fiscal design in the EU applicant countries, as discussed in Chapter 1 of this report.

The findings cover specifically the following dimensions:

Main feature of inter-governmental relations;

Assignment of responsibilities across levels of Government;

Sub-national finance framework

Profiles on sub-national revenues;

Profiles on sub-national expenditure;

3.1 Main feature of inter-governmental relations

3.1.1 The institutional framework

The institutional framework and the system of inter-governmental fiscal relations vary significantly in the eight selected EU member States, reflecting their varying historical and cultural backgrounds.

From the institutional point of view, four different groups of countries may be identified. Belgium is the only federal country among the selected countries. France, Italy and Spain are countries characterized by the presence of separate and responsible regional government. The absence of regional level of government, but a high level of decentralization characterizes Denmark, Netherlands and Sweden with some differences. Finally, in the United Kingdom the structure of inter-governmental fiscal relations is not easily comparable to the previous ones.

Belgium. Among the eight selected countries Belgium is the only federal country, with a complex structure of co-operative federalism, resulting from a series of recent reforms. Belgian system consists of one federal or central government and a composite level of decentralized government. As written in the Constitution “Belgium is a federal State made up of Communities and Regions”. So there is no hierarchy between the State and the regional and community governments. An upper level comprises three “communities” (Flemish, French and German-speaking) plus three regions (Flanders, Wallonia and Brussels Capital Region). The Regions are strictly geographically defined, while the Communities are in principle defined by culture and language. An intermediate level of government includes ten provinces. Finally a local tier comprises 589 municipalities. The Communities are directly represented in the federal parliament (senate), whose approval is required, especially in respect of constitutional amendments and special legislation of concern to the Communities.

France, Italy and Spain. In these countries separate regional governments exist, enjoying a varying degree of independence and responsibility. In two of them (Italy, especially after the 2001 Constitutional reform, and Spain) regional authorities exercise in some areas legislative powers comparable with those of regions or States in federal countries.

In **France**, the Constitution defines two tiers of "collectivites territoriales" below the central State and gives a pledge that local authorities shall "administer themselves freely through elected councils, under the conditions laid down by the law". But, in recent years, regional authorities, which had been merely consultative bodies, has been transformed into a third level of elective government. Metropolitan France has comprises 22 regions, 96 departments and 36.621 communes. Over the past 20 years France has moved from one of the most centralized system in Europe to embrace a process of devolution. Actually, the financial autonomy of French local authorities is extensive, effective, strongly supported by decentralization, and guaranteed by the political weight wielded by local elected representatives in the parliamentary deputation. This autonomy is considerable both from the standpoint of the mobilization of resources (taxes, transfers and borrowings) and the use to which resources are put. However, after a long period of decentralization in recent years a trend in the opposite direction has occurred, as the local authorities' tax autonomy has been reduced.

Italy is a unitary State with four levels of government: central, regional, provincial and municipal. Sub-national government comprises 20 regions, 100 provinces and about 8,100 municipalities. All are directly elected, multifunctional government bodies. Five regions are called "special statute" regions, as they have wider legislative and administrative powers. One of the special statute regions, Trentino-Alto Adige, has delegated almost all its legislative and administrative powers to the two component provinces (Trento and Bolzano), which can be considered to be regions in their own right. The remaining 15 regions are "ordinary statute" regions. While provinces and municipalities have a long tradition in Italy, ordinary regions are a relatively new entity. Even if they were created under the 1948 Constitution, the formal establishment took place only in 1970. In 2001 an important Constitutional reform took place in Italy. Following to the reform, State, Regions, Provinces and Municipalities are now "equi-ordinated". All administrative tasks have been attributed to municipalities and can be attributed to upper levels of government (i.e. provinces, regions and State) only according to the principle of subsidiarity. The new Italian Constitution changes the model of fiscal inter-governmental relations in a variety of aspects. More legislative powers are assigned to (ordinary) regional authorities. A number of responsibilities that previously were in the State exclusive or concurrent (with Regions) competence has been transferred to the exclusive regional competence.

In **Spain** the 1978 Constitution dramatically modified the previous situation by the introduction of new regional structures, the Autonomous Communities (ACs), based on common historical, cultural or economic characteristics. Under its Constitution, Spain is not a federation in the strict sense, but rather defines itself as a "state of autonomies". The national parliament comprises the chamber of representatives and the senate. The senate has 259 members, 51 of which are appointed by the legislative assemblies of the ACs. The Senate holds an absolute veto over constitutional amendments, but has only a suspensive veto over bills. In Spain there are three levels of devolved government: 17 regions (Autonomous Communities), 50 provinces and 8.078 municipalities. There are two categories of Autonomous Communities depending on the level of responsibility. The seven ACs with high level of responsibility have had recognition of the right to assume a larger powers range since the beginning of the autonomous process or later within a slower, constitutionally designed process. The remaining ten ACs have assumed only the "common" competencies, which are extensive but crucially omit health and education. But the Spanish Constitution is open, so steps are now under way to convert the ten ACs in "high" ACs.

Denmark, Netherlands and Sweden. A third group of countries (Denmark, Netherlands and Sweden) is characterized by the absence of "regional" level of government, comparable to those present in France, Italy and Spain.

Denmark is a unitary State whose Constitution establishes the principle that "the right of local authorities to govern independently under the supervision of the State must be laid down by law". This self-government principle means that local authorities are free to adopt their own local polities within a broad framework of national laws. As a consequence individual authorities have significant powers to decide their own polities and to adapt their public offer to the wishes of local population. There are two types of local government bodies in Denmark, with the municipality (275) as the local unit and the county council (14) as the intermediate unit. The general rule is that the counties are not superior to the municipalities. In general, the Danish system of local government is very comprehensive, both as to the share of the overall public tasks carried out by municipalities, and the right of municipalities and counties to impose taxes and to determine their own levels of taxation and service.

The **Netherlands** is known as a "decentralized unitary state" with three levels of government: central government, intermediate government – provinces- (12) and local government – municipalities – (548). According to the Dutch Constitution, national law establishes sub-national government's powers and responsibilities. These constitutional provisions are stipulated in the Municipal Act and in the Provincial Act. Central government plays a major part in policy implementation at the local level. A wide range of field agencies has been created in order to implement national policies. In last years there has been a tendency to convert some agencies into independent public boards. Intermediate and local authorities are entities directly elected by the citizens. There is a hierarchical relationship between the three tiers of government. In financial terms, municipalities are the most important level of local government.

Sweden is a unitary State whose Constitution establishes the principle of local self-government and the right of local authorities to levy taxes and determine tax rates. There are now two types of local government bodies in Sweden, with the municipality, kommun, as the local unit and the county council, landsting, as the intermediate unit. The number of municipalities (which cover the entire territory of Sweden) is 289. There are 21 county councils (including the municipality of Gotland). There are currently four pilot programs aimed at a new regional division of responsibility in Sweden. Under these programs, regions consisting of more than one county have taken over certain tasks from the State, including the responsibility for regional business development. County councils do not have hierarchical authority over municipalities. The essential difference between local and county government lies in the nature of tasks allocated to them. Each county has a county administrative board representing the national government at regional level and a county council. Every municipality and county has a decision-making body called municipal council and county council. Members of these bodies are directly elected by the people at general elections every four years.

The United Kingdom. Finally, the UK is a unitary State made up of the four constituent nations of England, Scotland, Wales and Northern Ireland. The structure of local government is very different among the four nations. In England the structure is complex. Generally while in urban areas there is one level of local government, in rural areas there are two levels (counties and districts). In the year 2000 a new Greater London Authority was created with elements of both a county and a regional authority. In Wales there is one level of 22 unitary authorities. Scotland has one level of 32 unitary authorities. Finally Northern Ireland is divided into 26 districts. Until 1999 in Scotland, Wales and Northern Ireland administrative departments of national government exercised most central responsibilities (such as health, agriculture and relations with local authorities). Recently in Scotland and Wales these powers have been transferred to the new Scottish Parliament and Welsh National Assembly. For Northern Ireland a new constitutional settlement based on power sharing between the main communities has taken place. Finally, in England new signs of regional government have begun to emerge. During the 1990s a lot of central government departments were consolidated into ten Government Offices for the regions and recently eight Regional Development Agencies were established. The long time Government's aim is to establish in England elected regional governments. In the UK local government has no general power. They may exercise only the powers expressly transferred to them by law. In England, Wales and Scotland education is the most important responsibility of local government. Police and personal social services are other important ones. Local finance is mostly derived as fiscal autonomy is very limited.

3.1.2 Sub-national structures of Government

The following Table summarises the variety of these sub-central structures of government in the selected EU member States.

Table 3.1 **Sub-national Government in selected EU member States**

Country	Regional Government	Intermediate level	Local Government	Sub-national expenditure as % of total public expenditure
Belgium	3 Regions 3 Communities	10 Provinces	589 Municipalities	23.18
Denmark		14 Counties	275 Municipalities	57.33
France	26 Regions	100 Departments	36.763 Municipalities	21.69
Italy	15 Ordinary Regions 5 Special Regions 2 autonomous provinces	100 Provinces	8.100 Municipalities	29.70
Netherlands		12 Provinces	548 Municipalities	28.97
Spain	17 Regions	50 Provinces	8.078 Municipalities	40.16
Sweden		21 Counties	289 Municipalities	38.54
United Kingdom	4 Nations 8 English Regions	34 Counties	263 Councils	28.36

Source: Country Reports

As mentioned above, separate regional governments are not present in all selected countries. In particular, they are absent in Denmark, the Netherlands and Sweden. In Sweden, however, in last years experiments in setting up new regional authorities have been made and the institution of a new regional level is still under discussion.

In the Belgium federal system, central government and regional governments share most of the power (including financial power) and responsibilities.

Separate regional governments also exist in those countries where the Constitution or the legislation envisages a varying degree of operating independence and responsibility to regional authorities.

In these countries the real degree of competence of regional authorities may vary significantly, with those in Italy and Spain exercising in some areas legislative powers comparable with the powers of regions in federal countries.

Local governments, with one or two levels, exist throughout all the eight selected countries. Generally, they exercise independent competence according to the “agency” model or to the “choice” model of local government or to a mix of the two ones. As known, in the first model local authorities are simply engaged in administrative activities transferred to them by the central or the regional government. In the “choice” model, on the contrary, local authorities have more powers in choosing different levels of local services and taxes, according to preferences of local citizens.

The last column of the Table summarises the economic size of sub-national government, in term of local expenditure as a percentage of total public spending. In economic term, the size of sub-national government is higher in Denmark and Spain, followed by Sweden, where local expenditure accounts for respectively 57%, 40% and 39% of general government spending. The other countries show comparable size, between 22% (France) and 30% (Italy).

With regard to the size of municipalities, one significant result from the eight selected countries’ survey is the problem of fragmented government.

Apart from the Netherlands, in the other seven countries most local responsibilities are carried out by a very large number of local governments, often with a small unit size.

As shown in the previous Table, selected member States differ in the numbers of local authorities. France has more local authorities (more than 36.000) than the rest of the States put together.

With regards to the size of municipalities, the following Table shows that particularly in France, Italy and Spain local authorities are of very small dimension. For instance, in France and in Spain about respectively 95% and 86% of local government units comprise no more than 5.000 inhabitants. Local authorities seem to be larger in average in the Netherlands, while in an intermediate position we find Belgium, Denmark and Sweden.

Table 3.2 **The distribution of municipalities by size (various years)**

<table>
<tr><th>Number of inhabitants</th><th>Belgium</th><th>Denmark</th><th>France</th><th>Italy</th><th>Netherlands</th><th>Spain</th><th>Sweden</th><th>United Kingdom</th></tr>
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<tr><td>-1000</td><td>0.2</td><td rowspan="2">5.82</td><td rowspan="2">95.20</td><td>24.00</td><td rowspan="2">4.40</td><td>60.00</td><td rowspan="2">4.00</td><td>n.a</td></tr>
<tr><td>-5000</td><td>17.31</td><td>72.70</td><td>86.00</td><td>n.a</td></tr>
<tr><td>-10000</td><td>46.35</td><td>49.09</td><td>97.70</td><td>87.20</td><td>25.20</td><td>92.40</td><td>23.00</td><td>n.a</td></tr>
<tr><td>-25000</td><td rowspan="2">95.41</td><td>84.00</td><td rowspan="2">99.70</td><td rowspan="2">98.40</td><td rowspan="2">89.50</td><td rowspan="2">98.40</td><td rowspan="2">86.00</td><td>n.a</td></tr>
<tr><td>-50000</td><td>93.82</td><td>n.a</td></tr>
<tr><td>-100000</td><td>98.64</td><td>98.55</td><td>99.9</td><td>99.60</td><td>95.50</td><td>99.10</td><td>97.00</td><td>n.a</td></tr>
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Source: Committee of the Regions (2001) and Country Reports.

In France, the 36 communes with 100.000 or more inhabitants account for 15% of the population; the 841 communes with 10 000 or more inhabitants account for 49.5% of the population. Symmetrically, the 35 710 communes with fewer than 10 000 inhabitants, of which – 28 183 have fewer than 1.000 inhabitants, account for 16% of the population. The average size of French communes is thus small, the lowest in the EU member countries, i.e. 1578 inhabitants.

The problem of fragmented government and the need to reach cost-efficient size in local government are on the policy agenda of almost all the selected countries.

In **Belgium** last years mergers between municipalities have led to greater economies of scale and to more efficient supply of local public services. Local authorities may also enter into cooperation agreements, setting up "inter-municipal associations" to tackle jointly issues of common interest. The most important structure is the *Joint municipal authority* that is set up and managed on the basis of voluntary rules adopted by the participants. The major policy areas are energy supplies and waste disposal. The regional government supervises these joint authorities.

In **Denmark**, structural reform that took place in 1970 laid the basis of the present Danish local government system. Before the reform Denmark was divided into 1391 municipalities and 25 counties. After the reform the number was reduced to the present 275 municipalities and 14 counties. Each municipality belongs to a county, except for the two authorities making up the capital city – Copenhagen and Frederiksberg – each of which has the dual functions of county and municipality.

In **France**, communal fragmentation makes necessary the voluntary grouping of basic authorities with a view to jointly managing amenities or elaborating economic development and urban planning projects on a more relevant scale than the communal level. Voluntary groups of communes take mainly an associative form. In an associative group, the communes (municipal councils) transfer to the group decision-making and executive power in respect of the jurisdictions transferred in exchange for a financial contribution and levy additional taxes to this end. The total number of groups has risen from 10.636 in 1972 to approximately 20.000 today. Since 1992, an alternative formula, the federative one, has become more popular for voluntary grouping. Under the federative formula local authorities apply a substitutive tax at a single rate to finance inter-communal public expenditure.

In **Italy**, though the atomization of Italy's municipalities gives rise to a lot of economic inefficiencies, there have been not many successful moves to merge or associate them. State and Regional authorities may, in certain cases, create or give incentives for the creation of associations of municipalities for the management of activities and services concerning adjacent areas. Consortia of municipalities may be formed between municipalities and provinces for the joint management of one or more services. Each consortia has its own legal personality and autonomy and its status is approved by the councils of directors of the associated authorities. Unions of municipalities may also be established between two or more municipalities with less than 5 000 inhabitants in the same province, in anticipation of their eventual merger, for the joint execution of a number of various functions or services. They are run on a system similar to that of the municipality. If no merger occurs within ten years, it is dissolved.

In the **Netherlands** central government is pursuing an active policy of amalgamation of local authorities. The number of municipalities has gradually been reduced. At present there are twelve provinces and 548 municipalities. About eighty polder boards are responsible for maintenance of the dykes, for managing surface water levels in the Low lands and for the treatment of waste water. The boundaries of the geographical area that is the responsibility of a particular polder board do not match those of provinces and the local government.

In **Sweden** the number of municipalities has markedly decreased in last four years. This process had a favorable impact on municipal finances and administration. Moreover, there is a growing need for municipalities and county councils to work together. The mechanism of co-operation is usually specified in a contract. More extensive co-operation may be regulated through a local government federation. In such a federation, one or more municipalities may work together with one or more county councils. The number of these federations is growing and totaled 60 last year.

3.2 The assignment of responsibilities across levels of Government

As shown in the previous Table 3.1, the expenditure share of sub-national governments in total government spending indicates the significant role played by regional and local authorities in providing public services in the 8 selected UE countries.

Using this common measure of fiscal decentralisation, two groups of countries seem to be identified, according to the last available data.

In the first group of countries characterised by low degree of decentralisation the sub-national expenditure as a share of total public spending is between 23 per cent and 30 per cent. In this group we find Belgium (23.18%), France (21.69%), Italy (29.70%), Netherlands (28.97%) and the United Kingdom (28.36%).

A second group of countries includes those with a higher level of fiscal decentralisation. In Spain, Denmark and Sweden sub-national expenditure accounts for respectively 40.16%, 57.33% and 37.15% of total public spending.

In all the selected countries the powers and responsibilities of sub-national authorities have increased over the past twenty years.

Large differences among selected countries in structure of sub-national government and in the role of the public sector itself make difficult to identify general models of responsibilities' assignment across levels of government.

Moreover, all the eight selected countries show overlapping and shared tasks and responsibilities between the different levels of government.

In general terms, countries with strong regional level assign to them the core welfare functions: education, health and other social services. This is particularly the case of Spain and Italy where regional authorities can legislate, sometimes jointly with central government, on social welfare, health and education. On the contrary, in France regions have a lot of responsibilities, like land use planning and development, regional planning, assistance to businesses, but have not significant powers on social matters.

Intermediate levels of government have generally more specialised responsibilities, which often reflect geographical factors. Examples of those responsibilities include transport, environmental protection and conservation, construction and maintenance works.

The same intermediate units of local government may however also assume responsibilities for core welfare services, especially in those countries where strong regional structures do not exist. For instance, in Denmark counties are responsible not only for public transport across municipal boundaries and regional physical planning, but also for hospitals, primary health care and secondary education. In Sweden county councils are mainly responsible for health care, while in the United Kingdom counties play an important role in supervising primary and secondary education sectors and have extensive responsibilities for social services.

In all selected countries allocation functions are attributed to local authorities, which as a consequence are responsible for the provision of local public goods and services. They typically include public lighting, road maintenance, water and sewage systems, refuse collection and disposal, cultural and leisure facilities and local physical planning. In addition to this set of tasks local authorities sometimes play a role also in welfare services. This is particularly the case of municipalities in Denmark, Italy and Sweden.

More specific information about the assignment of responsibilities across levels of government in the selected EU member States are given in the following.

Belgium. Belgian Constitution does not explicitly state the fields of competence of the federal parliament. As a consequence, within a specific policy area more authorities can have simultaneously responsibility. So it is difficult to summarize the allocation of competence between the various categories of regional and local authorities. Without being prejudicial to the competence of the Communities and Regions, the federal government retains powers over the conduct of defense, justice, finances, social security and parts of public health, employment and monetary policy. It also has responsibility over foreign relations, but shares it with regional and community governments.

The Communities are responsible for the following fields of jurisdiction: cultural matters; education; services offered to individuals; the use of languages in respect of administrative matters; intra-Community and international cooperation, including the conclusion of treaties in realms that fall exclusively under their jurisdiction. Services offered to individuals include, in particular, health policy and policy governing the disabled, but not social security, which falls under federal jurisdiction.

The Constitution does not specifically define the Regions' fields of jurisdiction, which are instead specified through special legislation that requires a two-thirds majority in both chambers of parliament. At present, Regions assume the following main fields of jurisdiction: economic policy, including assistance in respect of investment and employment; employment; foreign trade; agriculture; transportation; public works; the financing and supervising of subordinate powers; scientific policy pertaining to their fields of jurisdiction; energy; wastewater treatment and the protection and distribution of water; policy governing waste and environmental protection; monuments and sites; international relations from the standpoint of the Regions' fields of jurisdiction.

Provinces support education and cultural activities and are also responsible for supervising the municipal authorities. Municipalities' tasks concern local civic administration and civil order, road maintenance and urban development, education, health and social services.

Denmark. In Denmark, the system of local government is very comprehensive, both as to the share of the overall public tasks carried out by municipalities, and the right of municipalities and counties to impose taxes and to determine their own levels of taxation and service. The 1970 reform was based on the principles of devolution and subsidiarity. As a result, the distribution of responsibility between the State, the counties and the municipalities implies that most competence that directly concern local citizens has been progressively transferred to municipalities and counties. Today the responsibility for providing most public services lies with local authorities.

County tasks include public transport across municipal boundaries, hospitals, primary health care, secondary education and regional physical planning. They also decide some environmental issues.

Municipalities are responsible for a large number of public service tasks in the social, education, technical, environmental and cultural sectors. These include day care for children and services for the elderly such as special housing and old people's homes, meals-on-wheels, nurses and helpers in private homes. The municipalities administer various social benefits. They are also responsible for primary schools (7-16 years), cultural activities such as libraries and subsidies to sport clubs, as well as local roads, environmental protection, town planning, water supply, sewage, local industry and employment policy. They also administer the system of local income taxes.

Where functions are nation-wide in scope, and where the nature of the duty so requires, these stay with the State. These include foreign affairs, defence, police and overall communication.

France. In France, a number of compulsory competence is attributed to local authorities by law. Authorities are free to assume other ones.

The regions have been assigned jurisdiction over land use planning and development, regional planning, assistance to businesses, ongoing vocational training and apprenticeship, river ports and navigable waterways, fishing fleets and aquaculture, construction and the maintenance of high schools.

The departments are responsible for social action and health, maritime ports and aquaculture, non-urban school transportation, the maintenance and construction of colleges, and assistance in respect of rural amenities.

The communes are responsible for urban planning, general jurisdiction over local urban services, the construction and maintenance of nursery and primary schools, libraries, occupational health and general health services, sports facilities, urban public transport, and jurisdictions exercised on behalf of the State, e.g. civil status and voters' lists. All communal jurisdictions may be transferred to inter-communal groups (except for police powers). The groups manage a wide range of services that has continued to grow over the years.

Italy. In Italy, central government has among others the following exclusive responsibilities: defense, foreign policy, currency and financial markets, the determination of the essential levels of performances concerning civil and social rights to be warranted on the entire national territory. The new Constitution assigns to the concurrent legislative competence (State and Regions) matters as foreign trade, health care, education, co-ordination of public finances and tax system. Finally, all the matters not included in the list of the State exclusive responsibilities or in the list of the concurrent responsibilities are assigned to the regime of exclusive regional competence. Moreover, the new Constitution entitles individual regional authorities to submit proposals to Parliament in order to obtain more sphere of autonomy, but the Parliament is under no obligation to approve them. A new Constitutional law is going to be submitted to the Parliament for approval during this year. The draft proposal contains the provision for attributing exclusive legislative power to regions in matter such as health, education and local police.

Following the 1997 reform sometimes referred to as "administrative federalism", a large decentralization of functions occurred, with around 40% of the administrative functions transferred from the central Ministries to the Regions, Provinces and Municipalities.

The most important responsibility for the ordinary regions is health care. This accounts for well over half of their total expenditure. Other areas for which they can legislate include social welfare, the implementation of European Union agricultural structure policy, economic development, manpower training, housing, tourism and cultural activities, regional public transport and environmental protection. They also cover the operating deficits of regional and local transport systems and finance their capital expenditure. The regional role goes beyond financing lower levels of government and also includes planning, regulation and auditing. The regions also co-ordinate the capital programmes of the municipalities and provinces located in their territory.

Special statute regions have an even broader range of functions.

The provinces have a limited number of functions -- in particular the maintenance of designated provincial roads, school building and maintenance, social care in selected fields and pollution control.

The municipalities are the public body closest to the citizens and form the core of local government in Italy. They carry out "own functions" and those delegated by the State or regional authorities. Own functions include three categories of responsibilities: social, economic and territorial. Firstly, education, covering nursery schooling, school buildings for other age-group, social functions such police, care for elderly, general health care and public housing. Secondly, municipalities are responsible for economic development services such as tourism and trade fairs. Finally, they provide a number of territorial services such as road construction and maintenance, urban transport, refuse collection and disposal, provision of gas and electricity. The municipalities perform a wide range of functions, either directly or using contracted suppliers. Some services may be delivered by communally owned companies. The municipalities, like the regions, have important regulatory functions including land use zoning, environmental control and the issue of trading permits.

The regions delegate most responsibility for programme implementation to the municipalities, provinces, highland communities, local health authorities, etc. along with the necessary funds.

The period since 1970 has seen the transfer of numerous functions from the State to the regions: for example in the fields of agriculture, manpower training, health care, transport, environmental protection and economic development. This has been accompanied by a transfer of resources, personnel and facilities. Law 142, passed in 1990, set the stage for a reorganisation of the provinces and municipalities. This should lead to a major reallocation of functions between the different government levels. Law 142 also provides for the creation of nine metropolitan cities and also that the region should establish the functions of the provinces and municipalities, other than those guaranteed by national legislation. However, many of the directives provided by this law have not been implemented, and it is probable that it will be amended.

Netherlands. In the Netherlands, according to the Constitution national law establishes sub-national government's powers and responsibilities. These constitutional provisions are stipulated in the Municipal Act and in the Provincial Act. Central and sub-national governments are very much interdependent. Especially in recent years, less emphasis has been put on hierarchical relations and more attention paid to closer co-operation between the different levels of government on the basis of partnerships.

Central government plays a major part in policy implementation at the local level. A wide range of field agencies has been created in order to implement national policies. In last years there has been a tendency to convert some agencies into independent public boards. Central government is generally responsible for tasks concerning Dutch society as a whole. This implies a responsibility for the system of justice, defense, foreign affairs, tax collection, and infrastructure (in a wide sense). Central government also provides general guidelines for future development. The main function of the province is to translate central government plans to their territory. Municipal government is seen as the main provider of public services to the citizens.

Provincial governments overall play an intermediate role between central government and the municipalities. These intermediary tasks primarily relate to co-ordinate activities in areas such as traffic and public transport, welfare services, culture, spatial planning, public housing and environmental affairs. There is a limited number of executive tasks in areas such as (provincial) public works (including water management) and the environment. In general, provinces perform activities that require administrative capacity not available in the average municipality. Moreover, provinces play an important role in coordinating and supervising municipalities and in allocating financial resources among municipalities. Furthermore, provinces control the municipal budgets, as the budgets of provinces are controlled by the central government.

Municipal governments are active in a vast range of policy areas including welfare, public order, education, housing, public health care and social security. Direct public service delivery is concentrated in these local governments. However, this does not imply that all powers in these fields are in the hands of local governments.

Municipal tasks are carried on under a system of joint activities, whereby the central government lays down the legal framework for the municipalities activities through detailed regulations. Municipalities hold a certain degree of autonomy in some areas, such as construction and maintenance of roads, cultural and leisure activities. The principle of co-administration or co-governance is specified in the Provincial and Municipal Government Acts. This concept refers to the duty of sub-national governments to implement general regulations issued at a higher level of government.

Although in some policy-areas (for instance education and social security) strict guidelines are attached to the local implementation of co-administration tasks, the overall picture is somewhat more balanced. The implementation or execution of many (though not all) co-administration tasks is not a neutral nor technical operation. There is often ample discretionary power for local governments to adjust the execution of these tasks to their local needs. Co-administration also implies that municipalities and provinces have a responsibility for making regulations on certain topics without having detailed guidelines by central government on how to do so.

Spain. In Spain there are two categories of Autonomous Communities depending on the level of responsibility. The seven ACs with high level of responsibility have had recognition of the right to assume a larger powers range since the beginning of the autonomous process or later within a slower, constitutionally designed process. The remaining ten ACs have assumed only the "common" competencies, which are extensive but crucially omit health and education. But the Spanish Constitution is open, so steps are now under way to convert the ten ACs in "high" ACs. Common competencies are for instance agriculture, ports and airports, roads, environment, culture, tourism. In most cases the responsibilities are shared by central and regional governments. It's the case of major road and transportation, housing, social services and development policy. Moreover, Autonomous Communities share with central government the important role of supervising and financing local government.

At local level there are two institutions, provinces and municipalities. Other types of local entities (metropolitan areas, consortium, etc.) can be created to manage local public services in efficient ways.

Local authorities' responsibilities are regulated by law, not by the Constitution. Law establishes a minimum level of competence which municipalities are obliged to provide depending on their size. For instance all municipalities have to provide public lighting, refuse collection and public road maintenance. Large municipalities have also to provide collective urban passenger transport and environmental protection.

Sweden. In Sweden, the tasks of the local government sector fall into two categories: those fulfilled under the general powers granted to municipalities and county councils under the Local Government Act, and those based on special legislation. The division of labour between the municipal and county council sectors has so far been based essentially on the principle that tasks requiring a larger population base should be handled by the county councils. Health care is a typical example.

The Local Government Act stipulates that municipalities and county councils themselves shall take charge of those matters of general interest that are related to their respective territories and that are not the preserve of some other body. Under this general power, municipalities and county councils engage in such fields as the provision of housing, street and road networks, communications and transportation, water and wastewater, generation and distribution of energy, cultural affairs and leisure activities. In recent years, municipalities have also assumed responsibility for a growing number of refugees from abroad, in exchange for special compensation from the State.

The specially regulated tasks of municipalities, which they are usually required to provide, include schools, social services, care of the elderly, care of people with physical or intellectual disabilities, physical planning and building, certain environmental tasks and rescue services. Examples of such tasks handled by county councils are health care and public dental services. Local or regional public transit systems are a joint responsibility of municipalities and county councils and are often operated through jointly owned companies.

The relationship between the State and the local governments is characterized by continuous cooperation in a variety of areas and in different forms. There are constant changes in the division of labour between these levels of government. It is up to the Swedish Cabinet and Parliament to decide on the overall framework of public sector activities. There is a general consensus that within these limits, the municipalities and county councils ought to enjoy a large measure of freedom to shape and carry out public programs on the basis of varying local conditions.

The State provides guidance and supervision to local governments through its power to pass laws and issue ordinances and regulations, and through the monitoring of local governments by State agencies. Special legislation related to education, social services, planning and building matters etc. are also a form of supervision, since it establishes detailed regulations on how municipalities and county councils should manage various programs.

United Kingdom. In the United Kingdom, since 1979 there has been a considerable reduction in local authorities' powers and functions. The main changes have taken place in housing, education and transport.

The most important expenditure responsibilities of local authorities are education, personal social services, police, housing, environmental services, highway maintenance and fire services. In the case of education, local authorities provide schools but not post-school education. Personal social services include services for children in need, elderly people, and other who are handicapped. Highway maintenance covers only secondary roads as primary reads are under the responsibility of the central government. Housing is a scheme of transfer payments in favor of poor people to help them to pay their rent and also the council tax. Environmental services comprise the collection and disposal of rubbish.

3.3 Sub-national finance framework – overall comments

Sub-national authorities in the 8 selected EU member States finance their total spending through four main sources: taxes, charges and fees, grants from other levels of government and loans. The composition and importance of these sources differs between different countries. A common feature that can be identified is that the use of borrowing is generally restricted in all countries to finance only capital expenditure. The other three sources – taxes, charges and grants – are mainly directed to finance current spending.

Specific information on the sub-national finance framework in the selected EU member States is given in the following.

3.3.1 Belgium

The fiscal autonomy of the Regions expanded between 1990 and 1997. The share of revenue over which they enjoy full autonomy increased from only 1.7% of their tax revenue in 1990 to 7.1% in 1997. At the end of the period, tax-sharing revenue from personal income tax was rising much more sharply than the Regions' own taxation, indirectly reducing the relative importance of Regional fiscal autonomy. After the Lambermont agreement the power of regions to establish additional taxes or rebates has been broadened. As a consequence, the Regions now enjoy almost complete autonomy over 40% of their revenue (regional taxes) and they have rate autonomy over the remaining 60% (personal income tax).

Despite federalization in Belgium, the federal government engages in most of the country's public spending. However, the presence of the other federated entities is significant in the realms of health, social assistance and unemployment insurance. Education is the Communities' biggest expenditure item, followed closely by social protection. Economic affairs are a key spending item in the Regions' budgets. Taking into consideration all sub-national government (i.e. Communities, Regions, Provinces and Municipalities), as a share of total sub-national expenditure the most important sectors are education (37.8%), social security (16.5%), general public services (15.4%) and economic affairs (14.9%).

Tax and non-tax revenue. Belgian regions have at their disposal own-source tax and non-tax revenues. Non-tax own-source revenues include hunting and fishing fees and forestry operation fees. Regions' own-source revenues stem from indexed share of the national yield from personal income tax, which has the status of a joint tax, formerly federal taxes, now called regional taxes and new taxes adopted by the regions. Regional fiscal revenues are massively dominated by the personal income tax proceeds. The allocation of funds among Regions, initially set equal to the historical spending, then has been linked to the income tax revenues collected in each Region. The regions have also the possibility of establishing additional taxes or granting rebates on the portion of personal income tax attributed to them as a joint tax. The regions exercise their jurisdiction in respect to general tax reductions or increases, additional taxes or tax reductions without reducing the progressive graduation of personal income tax and at the exclusion of any unfair tax competition. Surtaxes or rebates may not exceed 3.25% of federal tax until 2003 or 6.75% as from 2004. With regards to regional taxes, on a first group (for instance the tax on gambling and betting) regions enjoy complete autonomy and so may freely determine the tax base, exemptions and tax rates. A second group includes the real estate tax and transfer duty upon death and inheritance tax. Regions enjoy autonomy only with respect to tax rates. Sometimes tax autonomy is much less complete. As for registration fees on the transfer for payment of real property central government sets the tax base and rates and regions may only establish additional taxes or grant refunds. Since 1993 environmental taxation has been reserved for the regions. With regards to new regional taxes, according to the constitutional principle "*non bis in idem*" regions may levy taxes on any matter provided that there is no federal tax on this matter or that the federal government has not shown the need to levy such a tax.

Communities could levy taxes under the same conditions as the regions, but in reality they have never exercised this power. French-speaking and Flemish Communities draw most of their revenue on transfer from the federal government related to three taxes, i.e. personal income tax, radio-television fee and above all the value-added tax. In particular, the allocation of VAT was originally based on a historical amount (referred to the education expenditure). Recently it has been adapted to objective criteria, i.e. the number of young people attending elementary and secondary schools. In the future there will be a reduction in the distribution of resources on needs and an increase on fiscal capacity.

The local authorities (provinces and municipalities) have tax autonomy, but under the control of the Regions. Municipalities raise around two-fifths of their total revenue from taxation, the large majority of which results from supplements to federal taxes.

Grants. The German-speaking community is financed on a different basis, relying largely on structural grants not connected to any tax base. The only mechanism designed to reduce differences in financial capacity between the federated entities is a fairly modest program called the *Intervention de solidarite' nationale*. Under the program, those Regions in which the average per capita yield of personal income tax falls below the national average are entitled to an unconditional transfer from the federal government.

Grants from regional government are the most important source of financing for municipalities. In particular each of the three regions manages a Municipality Fund and determines criteria for allocations from it to the municipalities. Some specific grants are made to municipalities and to the city of Brussels by the federal government.

Borrowing. Local authorities have wide freedom to borrow in order to finance capital investment and to cover short-term discrepancies between income and current spending.

3.3.2 Denmark

Danish local authorities are primary financed through local taxes and general block grants. Since the 1970 reform, tax revenue as a share of total local revenue has increased, reflecting both higher tax rates and stronger economic activity. On the other hand, revenues from central government transfers declined in the 1990s. Moreover, the reform process consolidated many of the specific grants into a general block grant. The basis of its allocation was changed from the reimbursement principle to criteria representing local needs and resources. However, significant earmarked grants from central government remain for some areas of current expenditure.

Taxation. Income tax is at the center of the Danish system of local finance. Income tax cover more than 90% of the total tax revenue of local government. There are no formal limits to the local income tax rate. Both counties and municipalities can freely set their own tax rate on income. Income tax base is laid down by law. Regional and local authorities decide the income tax rate each year as part of the adoption of their budget. The tax rate on income are however an important issue in the agreements between central and regional/local governments. Generally, all parties involved agree that the income taxes of regional/local governments on average may not exceed a certain level.

Local authorities have the job of assessing residents' taxable income. On average, the tax rate levied by municipalities is 20%, ranging from a minimum of 13% to more than 22%. The average rate levied by county councils is just under 10%. A much less important tax instrument is that levied on the value of land and premises. Upper and lower limits fixed by central government constraint the tax rates that municipalities may set, while land tax for counties is set by statute at one per cent.

Non-tax revenues. A significant share of local total revenue comes from user charges and fees. There are three different types of those user payments. For public utilities such as gas, electricity, water, public transport and waste disposal, expenditure is in most cases met fully by users through specific charges. A second category is composed of direct charges to users of welfare services. In most cases, local authorities are debarred by law from recovering through charges more than 30% of operating costs. However, some services, such as for elderly people at home, must be provided free of charges. Finally, cultural and recreational services provided by local authorities may be subject to charges in some instances.

Grants. Two basic principles guide the inter-government financial relations in Denmark. The first, called *Expanded Total Balance Principle*, requires the State to compensate local authorities whenever national new legislation increases local spending. Conversely, resources must be refunded where new national legislation has the opposite effect. The second principle, called *Budget Guarantee Scheme*, compensates local authorities for additional expenditure that is though to be driven by factors outside their control.

Compensation is made through specific central grants. Final decisions about the size and allocation of grants are reached by central government jointly with representatives of local authorities through a formal process of annual negotiations.

The total size of transfers made available by central government as block grant to local authorities depends on several factors, such as previous year's transfers; changes in local spending caused by national legislation; price and wage changes in the local government sector. Having determined the total size of transfers, the State calculates an initial allocation to local authorities according to their own tax bases. Then, an equalization mechanism comes into play to adjust the initial allocation, seeking to offset in part the differences among Danish local authorities firstly in resources and secondly in expenditure needs. Resource equalization is achieved through a self-financing mechanism. As in Sweden, local authorities with a per capita taxable base level below the average for Denmark receive a grant, while those with higher-than-average taxable base must pay a contribution. The total grant amount is as large as the sum of contributions. In addition to the distribution according to tax bases, central transfers are adjusted according to expenditure needs. At this aim, the base is calculated from a composite index taking into account: the minimum spending level required to run a sufficiently professional administration in a small local government; demography and social indicators such as the number of the authority's inhabitants in specific age categories or the number of children of single parents. The elements entering the composite index are supposed to be exogenous to individual local authorities to ensure that they have limited ability to manipulate the base. Redistribution is based on differences between revenue and expenditure bases and national averages. For counties, 80% of the deviation from national averages for both tax and expenditure bases are redistributed. For municipalities, only 45% is redistributed, but those municipalities with tax bases less than 90% of the national average are compensated through a specific grant by an additional 40% of the gap.

Specific central grants are paid mainly to finance local authorities spending in the areas of health care, social services and social security cash benefits. The rate of reimbursement varies depending on the service area involved. For instance, the rate is 100% for health care but 50% in the case of assistance to non-insured unemployed people.

Borrowing. Counties are in general excluded from borrowing. On the contrary, municipalities have access to borrowing without permission of central government, but only if they plan to use capital funds for investment in specified sector, for instance electricity, energy saving, construction of elderly people's residence. Otherwise, loans have to be approved by the Ministry of the Interior.

Expenditure. The local expenditure as a share of total government expenditure has gradually increased in last years, from 45.66% to 46.39%. It has remained stable in term of GDP. Social security and welfare is the most important public function carried on by local government in Denmark. Taking into consideration all sub-national government, as a share of total sub-national expenditure the most important sectors are social security and welfare, health, education and other economic affairs.

3.3.3 France

Local authorities in France enjoy significant financial flexibility. The only constraints concern control over legality, control over budgetary balance and compliance with certain prudential rules. Although financial flexibility is high, local spending accounts for a low share of GDP. The French system is characterized by the prominence of local tax resources, their great variety and the significant complexity of grants' system from central government. However, local taxation has been changed by a lot of recent central government decisions including the removal of the wages component of business tax, the withdrawal of the share of residence tax earmarked for the regions, the withdrawal of the regions' and departments' share of property tax on undeveloped land, the abolition of motor vehicle tax. Compensation grants from central government do not reflect local tax circumstances. Local authorities can no longer exercise tax policy options at the same degree as they have lost a large part of their tax instruments. This loss of financial autonomy is a source of serious concern to local authorities.

After a period of fiscal decentralization a trend in the opposite direction has occurred in France in more recent years. In last decade the budgetary performance of local authorities has grown worse. Local authorities' own tax resources have been squeezed by the abolition or reduction in local taxes, which have been replaced with grants from the central government. Local budgets are still balanced and do not lead to macroeconomic risks. However this result has been achieved at the cost of slower growth in capital expenditure.

Capital spending is financed through a combination of central grants, borrowing and own resources. Any substantial investment is usually preceded by negotiation with partners of other levels of government – including State - to secure joint capital funding.

Taxation. There are over 40 local taxes. Four major direct taxes together yield four-fifth of total tax revenues. Moreover, these taxes overlap, i.e. the communes, departments and regions independently vote on the tax rates that apply to the same taxation base, without the deductibility of taxes collected at a lower level. This is true of the property tax on undeveloped property, the property tax on developed property and the housing tax, which are based on cadastral values that are supposed to represent the revenue from the property in question. The housing tax, of which the regional share has been eliminated, is subject to keen criticism because of its regressivity in relation to income. The fourth and final local direct tax, the business tax ("Taxe professionnelle") constitutes (or rather, constituted) a high-yield tax. Until recently, this tax alone accounted for nearly half of the tax revenues of local authorities. It was very unevenly distributed and was the principal cause of the very great disparity in tax wealth between local authorities. Its base is made up of rental values of enterprises' buildings and equipment, plus a set percentage of their salary bill (though this element has been gradually removed since 1999). Central government offers a range of relief and exemptions and imposes tight constraints on the rate at which an authority can levy the business tax.

Local authorities do not control tax bases, which are established for remuneration by the State's taxation services on behalf of local authorities. Taxing powers are subject to central constrains even though they are more extensive than in many EU countries.

A lot of less important taxes are levied on specific local authorities' services. These taxes are in effect a substitute for user charges which in France account less than in other EU countries.

Grants. About one-third of total local revenues comes from central grants. Most of these resources are block grant, so recipient authorities can choose how to spend them. Both the total annual amount of central grants and the criteria of allocation are determined for the most part automatically by formula. The main categories of central grants are block grants toward current spending (the most important grant, named *Dotation Globale de Fonctionnement* - DGF), compensation for exemptions and relief on local direct taxation, grant to reimburse value-added tax paid by local authorities and capital grants. Additional grants are paid to specific local authority by government's discretionary judgement. For the DGF formulae are used to determine both its grow and its allocation. Its annual growth rate is set at the rate of inflation plus half of the GDP growth rate. Resources are distributed to local authorities partly according to objective factors related to need and partly according to each authority's fiscal capacity. Compensation for exemptions and relief are also automatic contributions by which central government compensates local authorities for reductions in tax revenues that arise from its own legislation.

Borrowing. Borrowing, contributing around half of all capital spending, is the most important source of finance. French local authorities have exceptionally wide freedom to borrow in order to finance capital investment. The only constraints refer to prudential rules that link debt with current revenues.

Expenditure. The local expenditure as a share of total government expenditure and of GDP has remained stable in last available years (1994-1997), respectively 17.46% and 9.85%. Housing and community amenities are the most important public function carried on by local government in France, followed by education and social security. Taking into consideration all sub-national government in 1993, as a share of total sub-national expenditure the most important sectors are housing (24.11%), education (19.65%), social security and welfare (17.67%).

3.3.4 Italy

In Italy the traditional fiscal inter-governmental relations had the following main characteristics: i) a marked revenue centralization; ii) a correspondingly high share of grants in revenues of sub-national governments and iii) a marked predominance of conditional grants. Over the 1990s this system has been reformed. First, to foster tax responsibility, new taxes have been transferred in 1992 to local authorities and in 1998 to regional authorities. Second, with effect from 2001, the system of central conditional grants to regional authorities has been replaced by a new system of tax revenue sharing. Third, following the 1997 reform sometimes referred to as "administrative federalism", a large decentralization of functions occurred, with around 40% of the administrative functions transferred from the central Ministries to the Regions, Provinces and Municipalities. Finally, as mentioned, during 2001 the most important constitutional reform over the last fifty years has been approved.

Special statute regions have an even broader range of functions. Their financing system is also distinctive. Differently from other regions, they have access to a share of central government's income tax and VAT revenue. Moreover, they benefit from fiscal redistribution since, with 16% of national population, they receive 29% of all regional resources.

Taxation. During the 1990s the structure of regional and local financing has markedly changed. On total revenue the share deriving from central grants has decreased, while that from taxation has increased. As from the '90s, in Italy there has been a stronger push for increasing the tax-raising power of local authorities. An important degree of tax-raising power has been introduced for each level of local government by means of a specific significant tax (Regional Tax on Productive Activities – IRAP for Regions, Municipal Tax on Immovable Property – ICI for Municipalities, Provincial Registration Tax – IPT for Provinces), supplemented by additional taxes associated to national taxes, with a tax rate that could be established at their discretion (Additional Tax on Personal Income for Regions and Municipalities); their own minor taxes are maintained and the relevant regulatory power (for Provinces and Municipalities) has been increased.

More specifically, the tax system of local governments includes the following taxes. The Regional Tax on Productive Activities (IRAP) was introduced in 1998. It replaced a number of central and local levies, including the health service contributions. IRAP is levied on the net value of the production derived in each Italian region by enterprises and professionals. The taxable base is the difference between the value of the production in the tax year and the costs of production, excluding personnel costs and interest. Regions have the power to increase or decrease the ordinary tax rate (4,25) by up to one per cent. Since 1998 Regions have been given access to a tax revenue-sharing on the personal income tax. At present the share is equal to 0,9% of the tax base. Each region may increase such rate up to 1,4%. Other regional taxes include that on motor vehicles, the tax on solid waste depositing in rubbish dump and the tax on methane consumption. Regions have also access to a share of the national petrol tax revenue and have the power to levy surcharges on it.

The last major change in regional financing took place in 2001. The most important central grants, such as those directed to finance regional health spending, has been cancelled and replaced by a new system of tax revenue-sharing, based on VAT. Ordinary regions have access to a share of national VAT revenue equal to 38,55%. This fund is distributed among regions through an equalisation mechanism that takes fiscal capacity and expenditure needs into consideration. In particular, the mechanism is based on the following factors: population; fiscal capacity; expenditure needs (especially those referred to health care); size of regions. The equalisation operates so to compensate those regions having less tax revenues and size and more expenditure needs. The equalisation is not complete, as only the 90% of the inter-regional differences are compensated.

The main municipal tax is the tax on immovable property (*imposta comunale sugli immobili* - ICI). It is levied on the possession of immovable property (buildings, lands) located in Italy. The taxable base is the value of the property. It is paid to the municipality where the property is located. The tax rate is set by each Municipality and may range from a minimum of 0,4 per cent to a maximum of 0,7 per cent. Tax relief is given for the owner's principal property. Municipalities have access to a tax revenue-sharing on the personal income tax. At present the share is equal to 3,5% of the tax base. Each municipality may levy a surcharge on the personal income tax up to 0,5%.

Finally, the most important tax instruments for provinces are the motor vehicle registration tax and the additional tax on the excise duty on energy. A Provincial additional tax on personal income has been introduced, but it is not yet operative.

Grants. After the reform entered into force in 2001, the most important central grants to regional government have been eliminated. For local authorities after a long period of central grants distributed on the basis of historic spending, the 1993 reform introduced two main funds (ordinary fund and equalisation fund) to support local current spending and an other one to support capital investment. The ordinary fund is distributed taking into consideration both standardised needs and fiscal capacity. In particular, individual authority receives a grant equal to the difference between its expenditure needs and its tax receipts mainly from the local property tax. The fiscal equalisation fund is allocated to help offset differences in resources between local authorities.

After the 2001 Constitutional reform more emphasis is given to regional taxes and to regional sharing of national taxes. The latter will be assigned to regions according to the regional distribution of tax bases and not, as in the past, according to need evaluation. This will generate greater interregional differences in service levels than in the past. The new Constitution extends to local governments (Provinces, Municipalities and, in the future, metropolitan areas) the same criterion of equalization based on fiscal capacity. Moreover, the Constitution assigns to local authorities the power to execute the whole of legislation, both central and regional.

Non-tax revenue. In last year revenues from user charges and sale of goods and services have showed steady growth, confirming the trend in the Italian public sector towards more private and market-based provision. Moreover, a number of minor local taxes (such as taxes on advertising, on solid waste disposal and on occupancy of public spaces and areas) are going to be transformed into user charges.

Borrowing. Regional and local authorities can borrow and issue bonds. Borrowing is regulated by the so-called golden rule, which has an indirect ceiling fixed by law. Debt service cannot exceed 25% of total own revenues and can finance only capital investment.

Expenditure. For the regional sector health is the major area of service delivery, taking by far the largest share with almost three-quarters of current spending. However, capital investment account for over one-fifth of total outlay and here agriculture accounts for 15 per cent of spending. For Provinces, education together with transport and communications are the main areas of spending, on both current and capital accounts. Education is about 33% of total current expenditure, while transport and communications account for 19% and economic affairs for 11%. Finally, for municipalities the major items of expenditure on both current and capital accounts are welfare, education and transport. These three main services respectively take 34, 13 and 10 of total current spending.

3.3.5 Netherlands

Taxation. Local authorities' tax powers are stipulated in the Municipality Act and in the Provincial Act. In general, municipalities are not allowed to levy taxes that are not covered by the Act, but they are free to set tax rates and also to determine whether the tax has to be levied. Local governments can impose a limited number of taxes, of which the local property tax is by far the most important in revenue terms. Other municipal taxes are benefit tax, residential commuter tax, tourist tax, parking taxes and dog-license fees. The property tax consists of two separately assessed taxes: one imposed on owners and one on renters. Owner-occupiers are subject to both taxes. The tax base of the local property taxes is in both cases the estimated market value of the property. The "Immovable Property Valuation Act" regulates the uniformly taxation and valuation of immovable property in the Netherlands. Local governments assess the value of each object and councils are free to set the rate of the tax. In addition to the property tax, there is another one levied on immovable property, called benefit tax. This is levied on the benefits accruing to property owners in the form of capital gains due to certain activities carried on by municipalities. The property taxes are category (b) taxes in terms of the OECD's tax autonomy classification, because the tax base is defined in central government legislation. This is also the case for most other taxes levied by local government. A few taxes with limited revenue are category (a) but have not been identified as such. Property values estimated by local government for its property tax are also used as the tax base for one levy of the polder boards. In addition, polder boards impose a head tax (fixed amount per address) and a land tax. Polder boards are free to set tax rates only, so that the levies are of type (b).

Provinces impose one tax, a surcharge on the motor vehicle tax levied by central government. Provinces are free to set the rate of the surcharge, subject to a ceiling imposed by the central government.

Non-tax revenue. Municipalities apply a lot of user charges on services they provide. Revenue from these charges may not exceed the operating costs. The most important user charges are refuse collection rates, pollution charges and sewage disposal rates.

Grants. The most important source of local financing consists of transfers from central government. Both municipalities and provinces receive general and specific grants from central government. General grants are distributed respectively from the Municipal and the Provincial Fund. Since the 1997 reform the distribution of both the Municipal and the Provincial Fund is cost-oriented and takes the tax capacity of local authority into consideration. Besides the general grant, municipalities and provinces receive specific central grants to carry out specific duties. For municipalities specific grants cover areas as public education, social benefits, labour and public transport. For provinces the three most important specific grants are those for housing of elderly people, youth help and cleaning of the soil.

Expenditure. The local expenditure as a share of total government expenditure and of GDP has gradually decreased in last years (1994-1997), respectively from 24.21% to 21.71% and from 16.75% to 13.31%. Social security and welfare, housing and education are the most important public function carried on by local government in the Netherlands. Taking into consideration all sub-national government, as a share of total sub-national expenditure the most important sectors are social security and welfare (22.61%), housing and community amenities (19.98%) and education (17.93%).

3.3.6 Spain

Up to last years regional authorities in Spain were financed mainly by central government grants. Some of these grants were presented as "revenue sharing" as they were linked to the yield from specified national taxes. With effect from 1994 reforms have begun to devolve to ACs tax powers. For municipalities with effect from 1988 reforms gave them access to a variety of local taxes and user charges. On the expenditure side capital investment absorbs a larger proportion of total spending than in many other EU countries. Regional and local authorities have been given access to borrowing to finance capital expenditure. Levels of new borrowing have however declined in recent years.

Taxation. The Spanish system of common regime for financing regional authorities is composed by three blocks of resources, known as the *sufficient block*, the *solidarity block* and the *autonomy block*. The first block guarantees the covering of the effective cost of the services transferred to ACs. Revenues originate from two sources: ceded taxes and a share in central government tax revenues. Ceded taxes are tax on net wealth, inheritance and gift taxes, property transfer tax, stump duties and gambling tax. Shares on central tax revenues are the real base of the system. This tax-sharing system returns to the regional authorities a share of national receipts from specified major taxes. Distribution of the revenue-sharing grant to ACs is based on a formula allowing for the following factors: functions performed by the Community; its potential revenue from taxes, fees and charges; expenditure needs, calculated with reference to population, personal income, fiscal effort and the number of provinces within the Community.

The *autonomy block* guarantees additional resources to those ACs that want to increase the level of services they provide. The block is composed of financial instruments like own taxes, surcharges and borrowing. However own taxes are limited by a number of binding conditions (avoidance of double taxation, avoidance of tax exporting, maintenance of the unity of the interior market). So the main taxes created by ACs consisted of taxes on gambling and a number of environmental taxes. Each AC shares directly in the yield of the personal income tax in the amounts declared by the residents of each AC. The revenue share will be gradually increased from 15% to 30%.

After the 1997 reform ACs have also independent access to taxation on personal income, which means that they can determine tax rates for the regional devolved part and decide on deductions and exemptions. Surcharges may be made on central income tax and ceded taxes with two limitations: the nature of the taxes surcharged must not be modified (for instance the progressive character of the personal income tax) and the central government tax revenue must not be reduced. In practice, no community has ever established a surcharge. All ACs have chosen to finance their additional expenditure by borrowing.

For historic reasons, a different system applies to Basque Country and to Navarra. The system, known as *foral regime*, is based on an agreement whereby the AC receives all revenue from central taxes and then returns a proportion of them to the central government.

For provinces, tax powers are negligible, extending no further than a surcharge on the municipal business tax. Five taxes are available to municipalities, three that are mandatory and two that they can levy at their discretion. The most important taxes are property tax and business tax. Municipalities' discretion in setting tax rates is limited by upper and lower bounds.

The financing system of municipalities is similar to that of ACs. Own taxes and a share in central government taxes are the two basic sources of finance. As for ACs tax-sharing grants to municipalities are general and unconditional. But while for ACs each community has its own percentage, for municipalities total resources are calculated as a percentage of central government's aggregate yield from specified central taxes, for instance personal income tax. The percentage is fixed periodically by agreement at national level. Distribution among municipalities is then determined by a need formula whose main factors are population, tax effort and number of school places.

Grants. For ACs taking on the health service role as part of high level of competence an addition central grant is distributed according to population. The *solidarity block* compensates the disparities in the endowment of stocks of public capital between ACs. The block is composed mainly of central government grants, which are available only to regions with income level below 75% of the EU average.

Non-tax revenue. Two other sources of financing are available to municipalities: user charges and public prices. User charges are levied on services or administrative functions supplied universally to all citizens. They cannot be set at a level higher than actual service cost. Public prices replace user charges for services with a more market-oriented approach.

Borrowing. Finally, municipalities may borrow only to finance investment and only for a maximum term of twenty years. Formal authorization is required by the Finance Ministry or in some cases by the Community, but not when annual debt service and repayments are less then 25% of current revenues. Central government can set additional limits and constraints for reasons of macroeconomic policy.

Expenditure. The central government is responsible for most public spending in Spain, but ACs are assuming an increasing role in the public sector. Their share of public spending has risen from 19.2% to 23.9% in last years. As shown in Table 3, the local expenditure as a share of total government expenditure and of GDP has gradually increased in last years (1995-1997), respectively from 30.20% to 32.40% and from 15.91% to 16.56%. Health and education are the most important public functions carried on by local government in Spain. Taking into consideration all sub-national government, as a share of total sub-national expenditure the most important sectors are health (20.54%), education (18.27%) and housing and community amenities (10.69%).

3.3.7 Sweden

The finances of sub-national government differ from most other EU member countries for two reasons. First, exceptionally large fiscal powers have been given to local and intermediate authorities. Second, fiscal power rests entirely on a single tax base – personal income.

Taxation. Before 1991 the local tax base included corporate profits, household income derived from capital and certain types of real estate. Today the local tax base consists entirely of earned income and pension income. The State has a great interest in controlling the overall tax burden in Sweden. This may conflict with the taxation and self-determination rights of local governments. During the years from 1991 to 1994, the Swedish Parliament froze local income taxes at existing levels. In 1995 and 1996 these rules were relaxed and as a result, many municipalities boosted their tax levels. During the years from 1997 to 1999, any municipality or county council that increased its income tax relative to the 1996 level lost half the extra revenue that this tax hike might have yielded, due to reductions in their State grants. Since the beginning of 2000, there have been no restrictions on tax levels. As of 2000, the highest combined municipal and county council tax is 33.17 percent of tax-able income and the lowest is 27.13 percent. The average rate is 30.53 percent.

Grants. Since 1996 in Sweden there is a new equalization system for municipalities and county councils. The purpose is to enable all local governments to offer their inhabitants the same standard at the same price. The equalization scheme is designed to be self-financing so that it can operate without contribution from the State. Municipalities and county councils with a per capita taxable income level below the average for Sweden receive a grant, while municipalities and county councils with higher-than-average taxable income must pay a fee. The total grant amount is as large as the sum of the fees. The fee and grant, respectively, total 95 percent of the difference between local per capita taxable income and the national average. Municipal and county councils also receive a block grant from the State. This consists of two portions: a population-related and an age-related portion. The former is payable as an equal sum of money per inhabitant, while the latter is payable per inhabitant belonging to various specified age categories. The size of the grants is different for municipalities and for county councils.

Non-tax revenues. A relatively large proportion of local government revenues consists of fees for services provided. In 1999, these amounted to around 5.5 per cent of total sub-national revenues and to more than 8.4 per cent of total municipal revenues.

Borrowing. Capital spending as a percentage of total municipal and county councils expenditures has declined continuously since the early 1970s. Both municipalities and county councils may finance their capital spending without permission from central government. Recent proposals from the central government could lead to the reintroduction of stronger controls on local capital spending.

Expenditure. Public sector expenditure in Sweden was equal to 59 per cent of GDP in 1999. Central government was responsible for just over three-fifths of this spending, most of it in form of transfer payments, and local government for just under 35 per cent. In the same year the expenditures of Swedish municipalities and county councils totaled 22.7 per cent of GDP. The local government sector grew rapidly during the 1960s and 1970s. This growth slowed by half in the 1980s, compared to the 1970s. Education is the largest branch of municipal operations, accounting for 29 percent of total gross expenses. The next largest item is care of the elderly and programs for people with functional impairments (28 percent), followed by pre-school activities (12 percent). Effective from 1992, the municipalities assumed responsibility for care of the elderly. They also took over care of the intellectually disabled (1991–1996) and responsibility for paying the costs of long-term psychiatric patients (1995). Health care totally dominates the role of the county councils, accounting for more than 80 percent of their total operating expenditures. Capital spending as a percentage of total municipal and county council expenditures has declined continuously since the early 1970s. In 1999, such investments accounted for 5.6 percent of all municipal and county council expenditures.

3.3.8 United Kingdom

The share of local expenditure financed by tax revenues has changed dramatically in recent years. Until the 1980s the sole local government tax was a property tax called rates, which was levied on both domestic properties and non-domestic properties at tax rates set by local authorities. The tax base was the rental value of the property. During the 1980s tax revenues (rates) accounted for 50% local current expenditure and grants for the other half. In 1990 in England, Wales and Scotland control over the local tax on non-residential property (non-domestic rates) was transferred to the central government, which simultaneously replaced the residential property tax (domestic rates) with the community charge system or poll tax. Officially domestic rates were abolished for different reasons. The burden was very high in areas with high property values. Domestic rates were seen as inequitable. There was very little relation between the public services received by taxpayers and tax paid by them. The new poll tax was a flat rate tax on adults, with local authorities setting the tax per head in their areas. It was very unpopular as poor people paid as much for local services as very rich people. Public pressure forced the poll tax to be replaced in 1992, except in Northern Ireland where domestic rates still survive. In England, Scotland and Wales the poll tax was replaced in 1992 by a tax known as the council tax, which is in effect a combined property tax and personal tax on the occupiers of domestic property. The effective tax rate depends on the statutory tax rate set by the local council, the value of the property in which the taxpayer lives and the characteristics of the people who live in the property. Much of the administration of the council tax lies in the hands of the local government, but the determination of the tax base lies with the central government through the government Valuation Office. Since 1993 the share of local expenditure paid for through the Council Tax has gradually begun to increase again from less than 20% to around 25% in recent years. In 1990 non-domestic rates were transferred to the central government, transforming a local tax in to an assigned revenue. Only local authorities in Northern Ireland retain control over the setting of non-domestic rates, but there are a large number of mandatory exemptions, particularly on industrial property. Central government sets the tax rate (known as the Uniform Business Rate). Companies pay a tax bill based on the national uniform rate poundage multiplied by the rateable value of the properties they occupy. The rateable value is an official estimate of the market rent for the property. Business properties are revalued every five years.

Taxation. The share of local expenditure financed by tax revenues has changed dramatically in recent years. During the 1980s tax revenues (rates) accounted for 50% local current expenditure and grants for the other half. In 1990 in England, Wales and Scotland control over the local tax on non-residential property (non-domestic rates) was transferred to the central government, which simultaneously replaced the residential property tax (domestic rates) with the community charge system or poll tax. The new poll tax was a flat rate tax on adults, with local authorities setting the tax per head in their areas. Public pressure forced the poll tax to be replaced in 1992, except in Northern Ireland where domestic rates still survive. In England, Scotland and Wales the poll tax was replaced in 1992 by a tax known as the council tax, which is in effect a combined property tax, personal tax and income tax on the occupiers of domestic property. The effective tax rate depends on the statutory tax rate set by the local council, the value of the property in which the taxpayer lives and the characteristics of the people who live in the property. Much of the administration of the council tax lies in the hands of the local government, but the determination of the tax base lies with the central government through the government Valuation Office.

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Central government sets the local tax rate (known as the Uniform Business Rate). Companies pay a tax bill based on the national uniform rate poundage multiplied by the rateable value of the properties they occupy. The rateable value is an official estimate of the market rent for the property. Business properties are revalued every five years. Revenue from national non-domestic rates is pooled nationally and then distributed to local authorities on an equal amount per capita basis. Assigned revenues are taken in to account when determining Revenue Support Grant so that more tax revenues do not necessarily lead to higher total revenues for local authorities. Although revenues from Uniform Business Rate are considered as tax revenues, it is more appropriate to see them as a type of general grant from the central government.

Since 1990 the local government's freedom to set tax rates has been effectively limited by a system of capping, although, strictly, capping applies to expenditure rather than taxes. Before each financial year the central government can force an authority to reduce its budget, and so effectively force it to cut its planned tax rate.

Non-tax revenues. Local authorities charge for over 600 activities, bringing in over 10% of total revenues. Charges typically cover a relatively small percentage of operating costs. Approximately 70% of local income from user charges arises from charges for housing services. Charging for many local services is banned or heavily restricted by law. Moreover all the revenue raised has to be used to finance expenditure on the relevant activity.

Grants. The most important source of finance for local authorities is an unhypothecated block grant from central government, known as Revenue Support Grant, which intends to compensate local authorities for differences in their needs and resources. The grant system differs between the four nations, but the central principle of "point equalization" is the same. Grants ensure that all local governments which plan to spend at a level determined by central government (known as Standard Spending Assessment – SSA) would be able to set the same standard tax rate. SSAs differ from council to council and are calculated separately for seven main groups of services (education, personal social services, police, fire, transport, capital finance and other services). Although councils are notified of their SSA for each of seven services, the grant is a block grant which local authorities have the freedom to allocate to services according to their needs. Tax revenues which are taken in to account in determining grants are revenues from national non domestic rate and revenues from local Council tax at the standard tax rate.

Councils also receive specific grants which are paid in order to cover costs of services which councils administer on behalf of central government or new services that central government intends to promote.

Borrowing. Capital spending, which accounts for about 20% of local total spending, is financed through a combination of grants, borrowing, the receipts from selling off existing assets and from general revenues. Housing is the most important element of local capital budgets. Local governments are prevented by law from borrowing for current expenditure purposes. They are permitted to borrow for capital spending. There are tight controls over the spending from capital receipts: only 25% of capital receipts from housing and 50% of other capital receipts may be used for capital expenditure, with the residual to be set aside for debt repayment.

Expenditure. The local expenditure as a share of total government expenditure has remained stable (around 22.1%). It has gradually decreased in term of GDP (from 11.9% to 10.45%). Social security, welfare and education are the most important public function carried on by local government in the United Kingdom. Taking into consideration all sub-national government, as a share of total sub-national expenditure the most important sectors are social security and welfare (32.54%), education (28.69%) and public order and safety (12.28%).

3.4 Profiles on sub-national revenues

Table 3.3 summaries the revenue profiles of the eight selected EU member States.

With regard to the size of sub-national governments – indicated by share of sub-national revenue out of GDP in last available years – the selected countries seem to fall into three groups.

France and the United Kingdom are located around 10% of GDP that is in line with the un-weighted average of OECD Unitary countries (9.5%).

Netherlands, Spain and Italy are centered around 13-16% of GDP that is over the un-weighted average of OECD Unitary countries.

Belgium, Denmark and Sweden are quite different. The first is centered around 16-16.6%, which however represents a percentage under the un-weighted average of OECD Federal countries (18.6%). Sweden and above all Denmark report the highest percentage among the selected countries (respectively around 21% and 31% of GDP).

When considering total sub-national revenues out of total national government revenue, a different pattern appears. Three countries (Denmark, Sweden and Belgium) show percentages (respectively around 44%, 31% and 33%) much higher than the others. The Netherlands, France, Italy, Spain and the United Kingdom are centered around 18-23%.

With regard to the development in fiscal decentralization in the period considered, the selected countries show certain stability on their inter-governmental fiscal relations. However, in Italy and the United Kingdom in last two years there has been a decrease in the size of fiscal decentralization. But in Italy probably it reflects transitional adjustments, which do not change the ongoing process in fiscal decentralization.

The composition of sub-national revenues varies a lot between the selected countries, reflecting the different approaches to fiscal decentralization.

The last available data show that four countries focus primarily on tax revenues for the financing of sub-national government. As a share of total local revenues, tax revenues represent around 51% in France, 47% in France and 37% in Spain. The highest shares are in Sweden and Belgium (around 75-78%). On the opposite side we find Netherlands and the United Kingdom, with shares respectively around 10% and 14%.

Table 3.3 **Profile of sub-national revenues: Composition by revenue source. Share of national government revenue and GDP, 1997-99**

Country / Year	Composition of sub-national revenues (%)									Share of total sub-national revenues in total national government revenue			Share of total sub-national revenues in GDP (tax revenue)		
	tax revenues			non-tax revenues			grants								
	1997	1998	1999	1997	1998	1999	1997	1998	1999	1997	1998	1999	1997	1998	1999
Denmark	50.6	51.2	51.4	8.4	8.2	8.2	41	40.6	40.4	43.9	44.1	43.8	30.9	30.9	30.7
													(15.6)	(15.8)	(15.8)
Sweden	79.2	74.5	75	5.1	5.1	5.5	15.7	20.4	19.5	31.1	30.8	30.6	19.9	21.2	21.1
													(15.8)	(15.8)	(15.8)
Netherlands	9.6	n.a.	n.a.	14.4	n.a.	n.a.	76	n.a.	n.a.	23.2	n.a.	n.a.	13	n.a.	n.a.
													(1.2)	(1.3)	(1.3)
France	47.0	n.a.	n.a.	19.0	n.a.	n.a.	34.0	n.a.	n.a.	18.7	n.a.	n.a.	10.0	n.a.	n.a.
													(4.7)	(4.7)	(4.6)
United Kingdom	13.1	14	n.a.	12.8	13.3	n.a.	71.1	72.6	n.a.	22.8	21.4	n.a.	10.4	9.9	n.a.
													(1.4)	(1.4)	n.a.
Spain	37.1	n.a.	n.a.	8.9	n.a.	n.a.	54.0	n.a.	n.a.	18.2	n.a.	n.a.	15.7	n.a.	n.a.
													(5.7)	(5.8)	(5.9)
Italy	22.9	39	33.8	11.4	11.3	13.5	65.6	49.6	52.6	21.7	23.9	22.1	12.5	12.8	12
													(2.9)	(5.0)	(4.0)
Belgium	78	78.5	n.a.	3.1	3.12	n.a.	18.88	18.38	n.a.	32.9	33.2	n.a.	16.3	16.6	n.a.
													(12.7)	(13.0)	(13.1)

Source: OECD, *Revenue Statistics*, 1965-2000, Paris, 2001; OECD, *National Accounts*, Paris, 2001

Data reported for Italy show a very different profile. While between 1997 and 1998 tax revenues, as a share of total sub-national revenues, have increased significantly (about 70%), in the following year (1999) they have decreased for about 13%.

The distribution of the country reporting with regard to the composition of local tax revenues by tax base is shown in Table 3.4.

Belgium (local level), Denmark, Sweden and the United Kingdom reported a biased focus on one tax base. The tax base is income and profits for Belgium (local level), Denmark and Sweden. This is more than double the OECD average of 41%. Property is the preferred tax base in the United Kingdom' sub-national levels of government.

In the other countries sub-national tax revenues come from two or three main tax bases. They are income and profits in Belgium (State level), property and goods and services in the Netherlands, property, goods and services and other tax bases in France and Italy.

In identifying own taxes of sub-national level of government, the essential question concerns the effective tax autonomy of local authorities.

As shown in Table 3.5, when considering "own taxes" – categories a-c where local authorities have control over the tax base and/or tax rate – Denmark, Netherlands, Sweden and the United Kingdom report a very large degree of control on their tax revenues.

A high degree of control exists also in Belgium and Spain, but only by regional and local government in Belgium (not by the Communities) and by local government in Spain (not by Regions).

Table 3.4 **Classification of local taxes by tax base (in %), 1999**

		Belgium		Denmark	France	Italy	Netherlands	Spain	Sweden	United Kingdom
		State	**Local**							
1000	**Income and Profits**	55.2	84.2	93.3	0	7.7	0	26.4	100	0
2000	**Social security contributions**	0	0.3	0	0	0	0	0	0	0
3000	**Taxes on payroll and workforce**	0	0	0	4.4	0	0	0	0	0
4000	**Taxes on property**	6.2	0	6.6	51.6	21.7	62.5	35.5	0	99.7
5000	**Taxes on goods and services**	38.6	15.5	0.1	10.5	26	37.5	35.1	0	0
6000	**Other taxes**	0	0	0	33.5	44.6	0	3	0	0.3
Total		100	100	100	100	100	100	100	100	100

Source: OECD, *Revenue Statistics*, 1965-2000, Paris, 2001

Table 3.5 **Tax autonomy at the sub-national government level: degrees of control given as percentages out of all tax categories**

Category	Sub-national government taxes as % of total tax revenue	a	b	c	d.1	d.2	d.3	d.4	e
Belgium	28								
Local Government	6	13	84				2	1	
Communities	13		3			97			
Regional Government	10	8	92						
Denmark	31								
Municipalities	22		96				4		
Counties	9		93						7
Netherlands	3								
Municipalities	1		100						
Polder boards	1		100						
Provinces			100						
Spain	13								
Local Government	9	33	51			16			
Regions	5	15	7			78			
Sweden	32								
Municipalities	22	4	96						
Parishes		2	98						
Country councils	11		100						
United Kingdom	4								
Local Government	4		100						

Source: OECD, *Taxing Powers of State and Local Government*, Paris, 1999

3.5 *Profiles on sub-national expenditure*

Table 3.6 summarizes the expenditure profiles of the eight selected countries according to the last available data.

The level of decentralized expenditure – seen as the proportion of total government expenditure of which sub-national authorities dispose – varies between the selected countries.

The level is somewhat higher in Sweden, Denmark and Spain (respectively 38.54%, 57.33% and 40.16%) than in the other five countries. Italy, Netherlands and the United Kingdom show a similar level of decentralized spending (around 28-29%), higher than in France and Belgium.

There are some significant differences in the composition of sub-national expenditure, by policy sector, across the selected countries.

In Denmark, more than 86% of total sub-national expenditure is divided between the three sectors of "Social security and welfare", "health" and "education".

A similar concentration of expenditure, but in relation to quite different public functions, is found in Italy (only the Regional level) and in the United Kingdom. In particular, in Italian regions about 68% of total spending is concentrated in the two sectors of "health" and "social security and welfare". In the United Kingdom more than 73% of total spending is divided into the three sectors of "public order and safety", "education" and "social security and welfare".

In the remaining countries there is a more diversified composition of sub-national spending. The most important policy areas seem to be "housing and community amenities" and "education" in France, "social security and welfare" and "housing and community amenities" in the Netherlands and "health" and "education" in Spain.

More particularly, education is the Communities' biggest expenditure item, followed closely by social protection. Economic affairs are a key spending item in the Regions' budgets, while public security and education for local governments.

In particular, as a share of total spending for provinces the most important expenditure areas are education (34.6%), culture (13.2%), followed by health care (6.2%), industry (6.1%), environment (5%) and social services (4.1%). For municipalities they are education (17.1%), public safety (13.6%), social services (12.5%) and culture (11.5%). Taking into consideration all sub-national government (i.e. Communities, Regions, Provinces and Municipalities), as a share of total sub-national expenditure the most important sectors are education (37.8%), social security (16.5%), general public services (15.4%) and economic affairs (14.9%).

In Denmark the local expenditure as a share of total government expenditure has gradually increased in last years, from 45.66% to 46.39%. It has remained stable in term of GDP. Social security and welfare is the most important public function carried on by local government in Denmark. Taking into consideration all sub-national government, as a share of total sub-national expenditure the most important sectors are social security and welfare (56.69%), health (16.46%), education (13.39%) and other economic affairs (4.95%).

In France, the local expenditure as a share of total government expenditure and of GDP has remained stable in last available years (1994-1997), respectively 17.46% and 9.85%. Housing and community amenities are the most important public function carried on by local government in France, followed by education and social security. Taking into consideration all sub-national government in 1993, as a share of total sub-national expenditure the most important sectors are housing (24.11%), education (19.65%), social security and welfare (17.67%).

In Italy, for the regional sector health is the major area of service delivery, taking by far the largest share with almost three-quarters of current spending. However, capital investment account for over one-fifth of total outlay and here agriculture accounts for 15 per cent of spending. For Provinces, education together with transport and communications are the main areas of spending, on both current and capital accounts. Education is about 33% of total current expenditure, while transport and communications account for 19% and economic affairs for 11%. Finally, for municipalities the major items of expenditure on both current and capital accounts are welfare, education and transport. These three main services respectively take 34, 13 and 10 of total current spending.

In the Netherlands, the local expenditure as a share of total government expenditure and of GDP has gradually decreased in last years (1994-1997), respectively from 24.21% to 21.71% and from 16.75% to 13.31%. Social security and welfare, housing and education are the most important public function carried on by local government in the Netherlands. Taking into consideration all sub-national government, as a share of total sub-national expenditure the most important sectors are social security and welfare (22.61%), housing and community amenities (19.98%) and education (17.93%).

In Spain, the central government is responsible for most public spending in Spain, but ACs are assuming an increasing role in the public sector. Their share of public spending has risen from 19.2% to 23.9% in last years. As shown in Table 3, the local expenditure as a share of total government expenditure and of GDP has gradually increased in last years (1995-1997), respectively from 30.20% to 32.40% and from 15.91% to 16.56%. Health and education are the most important public function carried on by local government in Spain. Taking into consideration all sub-national government, as a share of total sub-national expenditure the most important sectors are health (20.54%), education (18.27%) and housing and community amenities (10.69%).

Public sector expenditure in Sweden was equal to 59 per cent of GDP in 1999. Central government was responsible for just over three-fifths of this spending, most of it in form of transfer payments. In the same year the expenditures of Swedish municipalities and county councils totaled 22.7 per cent of GDP. The local government sector grew rapidly during the 1960s and 1970s. This growth slowed by half in the 1980s, compared to the 1970s. Education is the largest branch of municipal operations, accounting for 31 percent of total gross expenses. The next largest item is care of the elderly and programs for people with functional impairments (28 percent), followed by pre-school activities (12 percent). Effective from 1992, the municipalities assumed responsibility for care of the elderly. They also took over care of the intellectually disabled (1991–1996) and responsibility for paying the costs of long-term psychiatric patients (1995). Health care totally dominates the role of the county councils, accounting for more than 80 percent of their total operating expenditures. Capital spending as a percentage of total municipal and county council expenditures has declined continuously since the early 1970s. In 1999, such investments accounted for 5.6 percent of all municipal and county council expenditures.

In the UK the local expenditure as a share of total government expenditure has remained stable (around 22.1%). It has gradually decreased in term of GDP (from 11.9% to 10.45%). Social security, welfare and education are the most important public function carried on by local government in the United Kingdom. Taking into consideration all sub-national government, as a share of total sub-national expenditure the most important sectors are social security and welfare (32.54%), education (28.69%) and public order and safety (12.28%).

Table 3.6 **Sub-national expenditure by function, as a percentage of sub-national government expenditure**

		Belgium (1999)	Denmark (2001)	France (1993)	Italy (2000)	Netherlands (1997)	Spain (1997)	Sweden (1999)	United Kingdom (1998)
1	General public services	21.1	3.98	10.61	6.09	9.41	6.88	2.00	3.95
2	Defence								0.02
3	Public order & safety		0.34	2.29		3.36	4.24		12.28
4	Education	34.6	13.39	19.65	1.19	17.93	18.27	4.00	28.69
5	Health	6.2	16.46	2.29	68.35	2.56	20.54	87.00	
6	Social Security & Welfare	4.1	56.69	17.67		22.61	5.14		32.54
7	Housing & community amenities		0.76	24.11	1.27	19.98	10.69		5.42
8	Recreational, cultural & religious affairs	13.2	2.80	7.68	1.38	5.83	5.55		3.05
9	Fuel & energy			4.22		0.47	0.07		
10	Agriculture, forestry, fishing & hunting				1.68	0.03	3.49		0.14
11	Mining, manufacturing & construction, except fuel & energy				1.14	0.46	0.99		0.02
12	Transportation & communication			3.64	5.69	6.73	7.16		4.86
13	Other economic affairs	6.1	4.95		1.77		2.73		1.01
14	Other functions	14.7		7.85	11.45	10.62	14.24	7.00	8.01
15	Total	100	100	100	100	100.00	100	100	100
	Total government expenditure. Consolidated % of GDP	47.58	53.20	46.16	46.50	45.94	41.23	58.9	36.85
	Total sub-national government expenditure. % of GDP	n.a	30.50	10.01	13.81	13.31	16.56	22.7	10.45

Source: Country Reports; OECD, *National Accounts,* Paris, 2001.

Note: Data on sub-national expenditure by function refer only to Provinces in Belgium, to ordinary Regions in Italy and to County Councils in Sweden

ANNEX 1

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ANNEX 2

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