

COMPARATIVE ANALYSIS OF LOCAL FINANCIAL AUTONOMY IN THE EUROPEAN UNION COUNTRIES

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Abstract:

The comparative analysis of local financial autonomy in the European Union countries suggested there is no universal model of local government finance applicable to all European Union countries. They each have their own specific needs and solution to raise the local financial autonomy. At the same time, local government must be in accord with European Union legislation as European Charter of Local Self-Government and Maastricht Treaty.

For making the comparative analysis, it must be used universal indicators as follows: local financial rate, local public revenues and local public expenditures in gross domestic product (GDP), local public investments, the evolution of local public expenditures, local public expenditures covered by local own revenues, the level of local borrowing, etc.

Key words: local financial autonomy, European Union, local budget, own revenues, competences, expenditures

1. INTRODUCTION

Local authority financing is currently at the heart of the political debate. All the Council of Europe's member states are faced with the challenge of reconciling the need to control and reduce public spending with greater financial autonomy in local government. They are accordingly seeking ways of achieving an equitable distribution of financial resources among the different levels of government in a context of budgetary cutbacks at every level of public administration.

This study is primarily intended to provide the comparative analysis of local financial autonomy in the European Union countries with the help of its relevant indicators and the establishments of legislation limits.

The framework of this paper is based on a set of research programs and papers made by different Romanian and foreign institutions as Council of Europe, Central and Local public administrations, Romanian Institute for Public Policies, DEXIA – France, Universities etc.

2. LEGISLATION LIMITS OF LOCAL FINANCIAL AUTONOMY

Legislation is a key factor in the process of implementation of local financial autonomy. The comparative analysis of local financial autonomy in the European Union countries suggested a diversity of national rules. However, Article 9 of the European Charter of Local Self-Government lists certain general principles concerning the financial resources of local authorities and Article 3 proposes that local authorities should have the right to regulate and manage a substantial share of public affairs. At the same time, fiscal policy has to be judged in the light of the Maastricht criteria [1], which say that candidates for the monetary union must – among other things – not run an excessive deficit (a general government deficit of more than 3% of national gross domestic product and a general government debt of more than 60% of national gross domestic product). Where local authorities enjoy some degree of freedom in their fiscal policy and where their deficits or surpluses form a larger part of the deficit of the General State, the necessity of close coordination among the different levels of the state will arise. This might, at least in some cases, the reduction of financial autonomy of local governments.

3. INDICATORS OF FINANCIAL AUTONOMY

a. Local financial autonomy rate

Financial autonomy rate of local public administration is determined as own local revenues in total local revenues:

$$\text{Local financial autonomy rate} = (\text{Own local revenues} / \text{Total local revenues}) * 100$$

How bigger is this indicator, the local public administration demonstrates a high capacity to generate revenues and the possibility to sustain its competences.

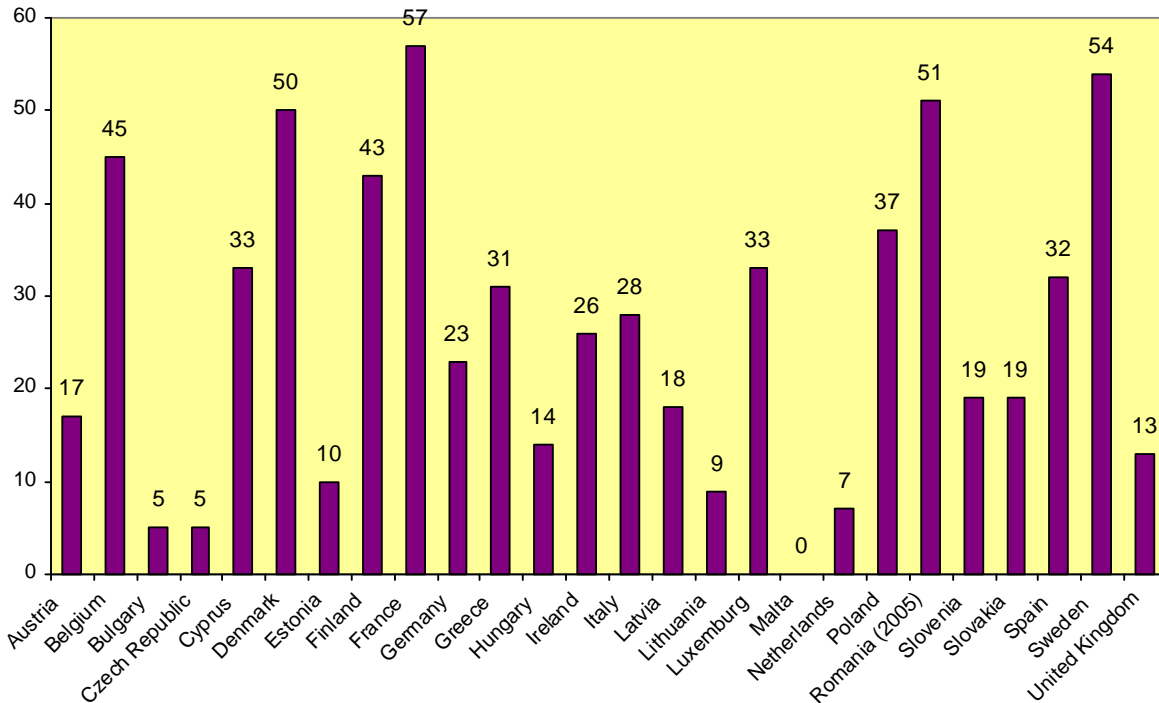


Figure no. 1: Local financial autonomy rate in EU countries in 2002 -2005 (%)

Source: [2]

As data from the figure no.1 shows, in the period 2002 -2005, local financial autonomy rate is under 30% in majority of ex-communist countries (Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Slovenia, Hungary, Slovakia), and, also, in countries as Austria, Germany, Ireland, United Kingdom. The local financial autonomy rate between 30% and 50% is in Cyprus, Greece, Luxembourg, Poland, Portugal, Spain, and Finland.

The biggest rates of own revenues in total local revenues are in Finland (57%), followed by Sweden (54%), Romania (51%) and Finland (50%). Romania has a high local financial autonomy rate because in local financial law is mentioned as own revenue of local budget the income tax rate share.

Almost all countries have left it to local authorities to collect very small taxes, such as dog licence fees or entertainments tax. Very few counties have provision for genuine local taxes that yield an appreciable amount and for full autonomy to collect them. In Romania, United Kingdom and France, the main taxes levied are the various forms of property tax. In most cases, the rates can be determined either freely or within specified limits by the local authorities.

In a number of countries, e.g. France (taxe d'habitation) and the UK (council tax), citizens, who are responsible for a considerable proportion of the expenses incurred by the local authority, have had to pay a separate tax, owing to the limited possibilities of distinguishing between one payer and another, only yields a relatively small amount or else provokes a great deal of resistance.

b. Local public revenues and local public expenditures in gross domestic product (GDP)

Important for to see how local public administrations can cover with their revenues the local public expenditures due of their exclusive, share or delegate competences, is to identify local public revenues and local public expenditures in gross domestic product (GDP) and the differences between revenues and expenditures.

Any examination of local public expenditures and local public revenues in relation to GDP immediately highlights significant discrepancies between the countries, partly due to their varying level of decentralization and also to the varying financial weight of the responsibilities devolved to local public administrations tiers. As data table shows, the majority of European Union members have deficit in the period mentioned, excepting Latvia, the Czech Republic (before being European Union members) and Ireland and Sweden as member countries of European Union.

Table no. 1: Local public revenues and expenditures/GDP in 2001

No.	Country 2005	Total local government revenue % of GDP III	Total local government expenditures % of GDP IV	III-IV
I	II			
1	Austria	8	7,85	0.15
2	Belgium	n.a.	n.a.	n.a
3	Bulgaria	n.a.	n.a.	n.a
4	Czech Republic	11,96	11,72	0.24
5	Cyprus	1,78	1,88	-0.1
6	Denmark	32,66	32,91	-0.25
7	Estonia	n.a.	n.a.	n.a
8	Finland	19,31	20,05	-0.74
9	France	10,94	11,05	-0.11
10	Germany	7,23	7,31	-0.08
11	Greece	3,14	3,13	0.01
12	Hungary	n.a.	n.a.	n.a
13	Ireland	7,01	6,85	0.16
14	Italy	14,69	15,42	-0.73
15	Latvia	9,69	9,69	0
16	Lithuania	8,08	8,13	-0.05
17	Luxemburg	5,22	5,50	-0.28
18	Malta	0,71	0,70	0.01
19	Netherlands	n.a.	n.a.	n.a
20	Poland	13,33	13,54	-0.21
21	Portugal	6,15	6,35	-0.2
22	Romania	n.a.	n.a.	n.a
23	Slovenia	n.a.	n.a.	n.a
24	Slovakia	6,76	6,96	-0.2
25	Spain	5,80	5,94	-0.14
26	Sweden	25,55	25,03	0.52
27	United Kingdom	13,04	13,23	-0.19

Source: [3]

c. Local Public Investments

In countries where territorial governments have extended responsibilities, investment usually represents less than 10% of their budget as most of their expenditure relates to operational costs. This is the case in the three Nordic countries, as well as the United Kingdom, Lithuania and Estonia. Teaching personnel costs take up the lion's share of the budget in the latter three, since

education represents 60% of local expenditure in Lithuania, 45% in Estonia and 38% in the United Kingdom.

In France, Malta and Greece investments represent more than 20% and in Cyprus, Luxembourg, Ireland and Portugal, investments represent more than 30% of local and regional public expenditures. In these countries the scope of responsibilities falling to local and regional authorities is smaller and they focus on financing public infrastructure and utilities [4].

Local public investments expressed as percentage of GDP differs greatly from one country to the other. On average, the local and regional public investment/GDP ratio is higher in the EU 15 member states than in the new ten member states (see Figure no 2, secondary axis). However, Ireland and Czech Republic have the highest percentages of the local public investments (2.9 % and 2.7%, respectively). The smallest values for the local public investments are observed for Malta (0.2%), Austria (0.5%), Belgium, Greece and Cyprus (0.7%).

The majority of new Member States have been implementing very dynamic investment policies through the period 2000-2005, showing a growth rate of +4.2% per year on average contrasting with +2.9% for the EU15.

Local and regional investment had negative growth in six countries, in particular Austria (-6.9%), Germany (-5.7%) and Portugal (-1.4%). Cuts were mostly linked to falling territorial government income and to restrictive budgetary policies, which had an impact on investment decisions. This was the case in Portugal, which restrained municipal debt accumulation.

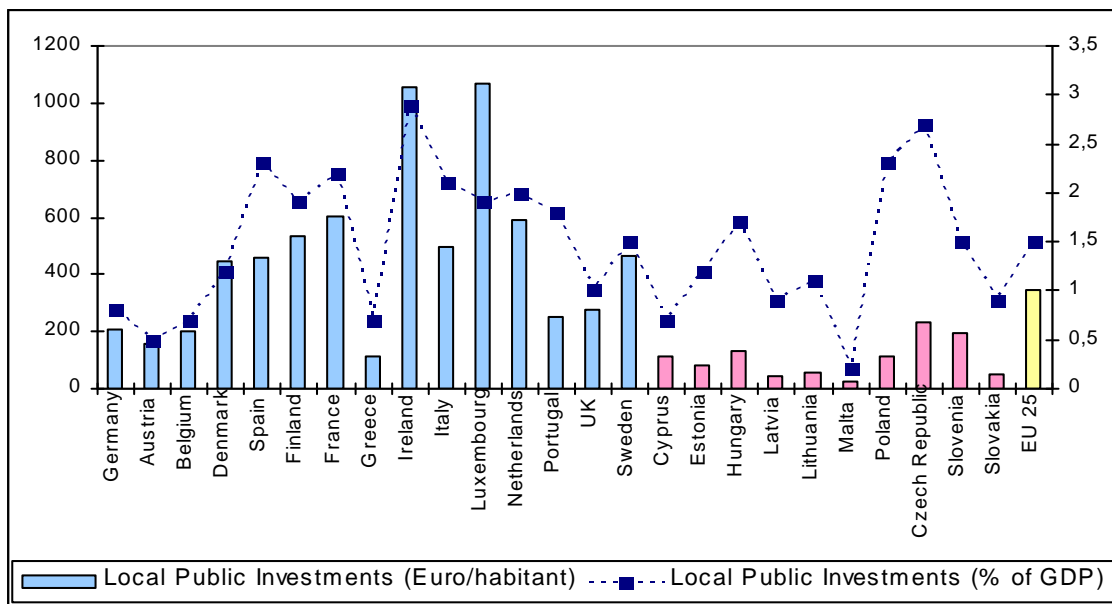


Figure no. 2: Local public investments in EU countries in 2005

Source: [5]

In 2005, local and regional public investment was back on track, but at a slower pace of +1.4%, below the growth of GDP (+1.7%). Several countries experienced a significant rise in investment (sometimes spectacular at over +50%). This happened mostly in the EU10, where investment progressed on average at +10.2%, in sharp contrast with a +0.8% growth for the EU15.

If we consider the level of the local public investments as percentage of the local expenditures (see figure no. 3), the highest values are observed in Cyprus (33%), Luxemburg (31.8%), Portugal (31.2%), Malta (27.6%), and Greece (25.1%). In Denmark, local public investments represent only 3.6% of the local expenditures.

In Latvia, investment increased due to more flexible borrowing protocols for territorial governments: an amendment to the budgetary law of 2005 raised the ceiling on local and regional government borrowing by 45%.

In Slovakia, the trend is also linked to municipal elections being held in December 2006. The same electoral cycle phenomenon is at work in almost all countries where local or regional elections are due in 2006, for instance Belgium (+24.6%), Greece (+18.2%), Poland (+17.2%) and Slovenia (+15.1%).

In Italy, investments were included in the expenditure budget for the first time in 2005. This had an immediate sobering effect: -9% to be compared with +8.3% in 2004.

In 2005, in Romania, the process of integration to the European Union imposed the development of local public investments as capital expenditures in local public budget.

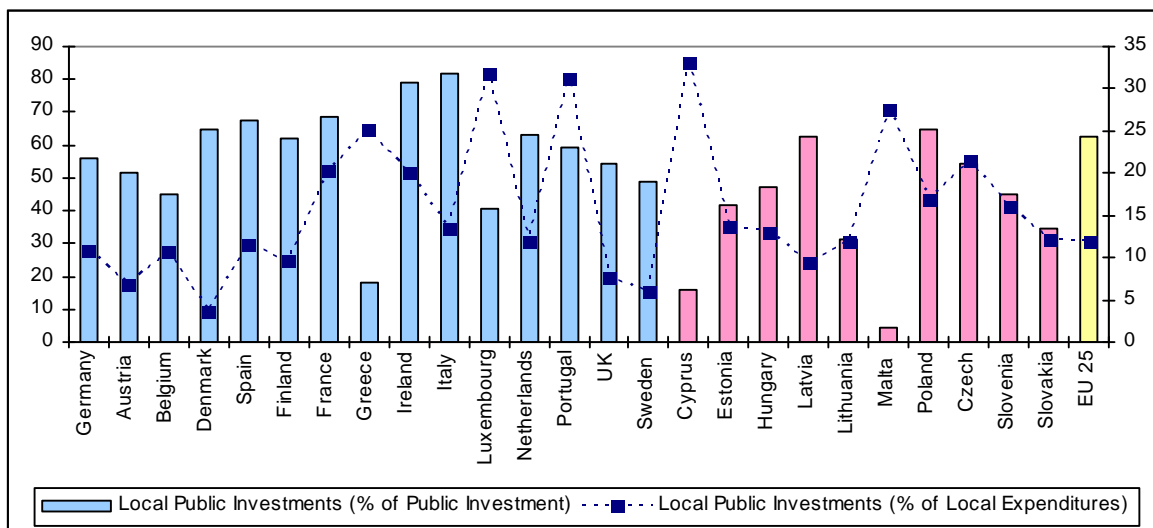


Figure no. 3: Local public investments in EU countries in 2005

Source: [5]

d. The evolution of local public expenditures

Municipal responsibilities have been extended and the impact is very strong because it has significantly increased local government expenditure. The evolution in European local public expenditures was continuously positive through the period 1998 -2005 (see figure no. 4).

Local public expenditure growth is most dynamic in the new Member States of the European Union, the EU 10 showing a growth rate of +5,3% in 2005 contrasting with +2,9% for the EU 15.

A strong increase was in 2002 (+5,8%) following the transfers of responsibilities from central government to autonomous communities in *Spain* and in 2003 in *Ireland* due to the positive impact of European structural funds (+13,5%).

The highest increase was witnessed in *Slovakia* (+25,7% on yearly average), where municipalities and the new regions created in 2002 now finance most public infrastructure and services (education, hospitals, social aid, public transport and roads).

The expenditures growth in *the Czech Republic* (+8,3%) is largely the consequence of a transfer of responsibilities to regions (created in 2000) and to municipalities (social aid, hospitals, retirement homes, culture).

In *Estonia*, education personnel management was transferred to municipalities in 2001, inducing a +21,3% rise that year, and an average growth rate of +7,5% per year over the 2000 -2005 period.

Average annual growth rates ranged from 2,6% in *Denmark* to 3,8 in *Finland* in the period 1998 – 2003. *Finland* and *Sweden* have witnessed steady growth in local and regional expenditure under the influence of rising operating expenditure (especially personnel management, social aid, education and health).

In the *United Kingdom*, after a decade of continuous decline in local and regional spending, then deemed excessive, a reversal of trends intervened in 1997. The UK is now strengthening its collective infrastructure and services, thus raising territorial expenditure (+5,6 per year on average) with large investments in public services and education, one of the main responsibilities of British territorial authorities.

Evolution of local public expenditure was more moderate in *Greece* and *Netherlands* (+2,1% for both countries) as well as in *Sweden* (+1,4) and was negative in *Austria* (-0,2%), *Germany* (-3,2%) and *Portugal* (-1,9%) in 2003. This trend was quit new for *Portugal* and us mainly due the implementation of debt capping measures at local level in an attempt to reduce the national budget deficit.

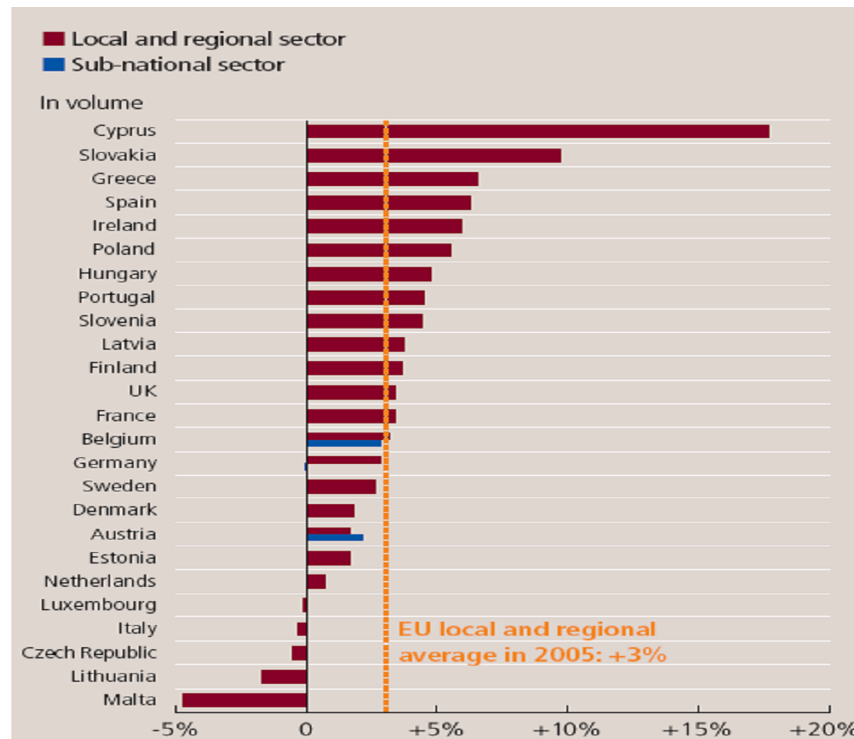


Figure no. 4: Evolution of local public expenditures in 2005

Source: [4]

German territorial expenditures (Sub-national public finance in the European Union, Dexia, November 2006, p. 10) have rebounded in 2005 (+2,8%) after decreasing several years in a row. This is partly due to Hartz IV, a reform of the labor market which extended the municipalities' social responsibilities.

In *Belgium*, local public expenditures remained robust (in the region of 3,5% in value of ordinary expenditure) thanks to the good progression in local tax revenue and the significant increase in regional to Wallon municipalities.

French local public expenditure has increased, exceeding 7% in value thanks to the additional responsibilities handed over to local governments in several areas (management of minimum insertion wage and professional training). The Acte II de la decentralization (August 2004) launched a gradual transfer of State responsibilities and personnel to the regions and the departments from 2005 onwards: for instance, regions now monitor vocational training and apprenticeship and departments are in charge of social aid. That law triggered a rise in local expenditure by +3,3% in 2005.

The progression in local public expenditures in *Sweden* (in the region of +3% in value) resulted to a great extent from an increase in social welfare and medical spending.

In *Italy*, the growth of expenditures is more moderate because local public expenditures are affected not only by continuing freeze on the tax rates for regional business tax and the local surcharge on national income tax but also by the capping of local expenditures set out the *taglia spese* decree of July 2004 (Local finance in the European Union, Dexia, November 2004, p.7).

In *Portugal*, local public expenditures have recorded modest growth due to the continuing restrictions on local government borrowing in 2004.

A growing number of countries are involved in structural reforms which allow them to outsource spending (through financial dealings with satellite bodies which do not appear as public expenditure), to private local public companies or to transfer certain public utilities – like water services, electricity or municipal waste – to the private sector (Austria, Belgium, Denmark, Germany, Portugal, Sweden, Spain).

4. CONCLUSION

The local financial autonomy represents an important issue in the global context of economic development and a result of implementation of local autonomy principle and decentralization process. The legislation of European Union and the evolution of European Union society are oriented to raise the local financial autonomy.

There are differences between countries even the convergence criteria are applied to the states and both to the state and to the local communities until the total economic integration, the last step in the European Union integration process.

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