

REVIEW OF FISCAL DECENTRALIZATION IN EUROPEAN COUNTRIES

Neringa SLAVINSKAITE¹

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Abstract

Fiscal decentralisation has recently emerged as a fundamental issue in the sciences literature. The issue has attracted the attention of both academics and international institutions such as the Organization for Economic Co-operation and Development (Eng. Organization for Economic Co-operation and Development, hereinafter - the OECD) gives it an extreme attention as well as the World Bank. Fiscal the World Bank. Fiscal decentralization is an important aspect of fiscal institutions in both developing and developed countries. The article attempts to provide an overview of the fiscal decentralization concept and analyze fiscal decentralization in different EU countries clusters. The empirical results show that, in general, the degree of fiscal decentralization is higher in high economic growth countries than in low economic growth Europe countries. Fiscal decentralization index ranges from 0,75 till 0,28 (0.75 in Sweden and 0.28 in Lithuania and Bulgaria).

Key words: Fiscal Decentralization, Clusters

JEL Code: C52, F37

1. Introduction

Over the past several decades, the devolution of fiscal powers to subnational governments has taken place in many Europe Union countries. According to International Economic Cooperation Organization (2014), decentralization of public services and funding had caused a growing interest of political representatives in recent years. Mercedes Bresso, the President of EU Committee of the Regions, highlighted significance of local authorities during the report in Brussels, affirming the necessity of the participation of local and regional authorities to achieve the high EU strategy goals of 2020, because in many countries it is the local authorities that play a key role in economic policy. Fiscal decentralization phenomenon is highly discussed at various levels and aspects, and the Organization for Economic Co-operation and Development (Eng. Organization

¹ Assoc. Prof., Vilnius Gediminas Technical University, Sauletekio av. 11, LT-10223, Vilnius, Lithuania, neringa.slavinskaite@vgtu.lt

for Economic Co-operation and Development, hereinafter - the OECD) gives it an extreme attention as well as the World Bank. Fiscal decentralization has become an interesting topic until today because researches about fiscal decentralization are not only considered from the economic perspective, but also from other perspectives such as politic, geographic, other subjects.

The purpose of this article is to analyse literature of fiscal decentralization and evaluate the fiscal decentralization in selected Europe Union countries.

To achieve stated object, the following goals have been set:

- to review the literature of fiscal decentralization;
- to review the fiscal decentralization in selected Europe Union countries.

2. Theoretical concept of fiscal decentralization

Fiscal decentralisation is often discussed as a political issue in many countries, but the term is not sufficiently clear even in the fields of political science or public administration. Generally, fiscal decentralisation is linked to sharing of fiscal responsibilities and power among central, state and local governments. From historical point of view, the demand of good government and governance generated notion of fiscal decentralization. Actually, fiscal decentralization has become main issue for economist and government for last decades, and later it has been discussed to answer the urge in creating good government and governance across the country in the world.

The concept of fiscal decentralization could be understood in several terms. Understanding the concept depends on the context of using the terminology of fiscal decentralization. Some scholarly concepts has defined a fiscal decentralized system which means that central government delegates authorities and responsibilities or transfer functions to local government regarding to financial aspects. The aspects are how to share responsibilities and revenue sources between central government and sub-national government (provincial and district level). Another aspect is related to decision of the amount of authorities and responsibilities transferred to local government in order determine local expenditure and revenue (Davey, 2003). In line with Bocshman (2009) also argue that authorities given to local government is intended to make a proper decision in allocating financial resources. Reviewing the relevent literature, 1 Table provide the variety of definisions of fiscal decentralization.

Table 1. Variety of Definitions of Fiscal Decentralization (source: compiled by author)

Author	Definition
Akai, Sakala (2002)	define fiscal decentralization as devolution of the authority associated with decision making has been allocated on the basis of legal to a lower-level government. To measure fiscal decentralization, it is necessary to know the degree of devolution or the level of authority of the lower-level government. Authority associated with decision-making relationships between higher and lower-levels government. However, it is difficult to measure the allocation of authority quantitatively.
Yulindra (2013)	fiscal decentralization considers a transfer of responsibility associated with accountability to sub-national governments. He maintains that fiscal decentralization is considered as the potential of sub-national governments to increase tax revenues, and make decision how to allocate their monetary resources on various projects within the legal boundary.
Albonoz, Cabrales (2013)	fiscal decentralization is the devolution by the central government to local governments (states, regions, municipalities) of specific functions with the administrative authority and fiscal revenue to perform those functions.
Szarowska (2014)	fiscal decentralization is linked to sharing of fiscal responsibilities and power among central, state and local governments.

Furthermore to expand concept of fiscal decentralization, it was explained by Beer-Toth (2009) that fiscal decentralization including three elements namely local expenditure, revenue and budgetary autonomy. There are three forms of fiscal decentralization that can be undertaken by a particular government; deconcentration is the transfer of responsibilities within a central government to regional branch offices or local administrative units, delegation is when local governments act as agents for the central government and devolution occurs when implementation and the authority of decision-making is transferred to local governments (Bird, Wallich 1993). In the case of Bolivia, fiscal authority has been a combination of delegation and devolution from the central government to sub-national governments. Implementation and evaluation of fiscal decentralization within a country must take into consideration numerous areas. Another author has defined the four main “pillars” of fiscal decentralization as assignment of expenditure responsibilities, assignment of tax resources, intergovernmental fiscal transfers and subnational deficits, borrowing and debt financing. Within assignment of expenditures, it is critical to establish whether a local government can determine expenditures for itself or if the central government. Those of elements interacts each other, so the main problem - how to evaluate level of fiscal decentralization. In the second part will be present measurement of fiscal decentralization and methodology of evaluation of fiscal decentralization.

3. EU-21 grouping countries into clusters

In this section unitarian countries of the European Union (EU-21) countries will split in two clusters. The split of countries into clusters was done using SPSS programme clustering method. For the selected study EU-21 are divided by the year 2014 country's economic development level (GDP/capita). Luxembourg gapped from other EU countries due to the high GDP per capita and Malta due to the low

level of fiscal decentralization and the gap with other EU countries; Greece beaked away due to the economic situation; as eliminated isolation from the sample of countries and being not grouped into any of the clusters (ABVP, ŽBVP). According to GDP per capita, the EU-21 countries are divided into two clusters as follows:

- the cluster of relatively high economic growth in the EU-21 (ABVP), which included 8 countries: Ireland, Denmark, Italy, Great Britain, the Netherlands, France, Finland and Sweden.
- the cluster of relatively low economic growth in the EU-21 (ŽBVP), which included 13 countries: Bulgaria, the Czech Republic, Estonia, Cyprus, Croatia, Latvia, Poland, Lithuania, Portugal, Romania, Slovakia, Slovenia, Hungary.

The final results of clustering in the EU-21 countries are shown in Figure 1.

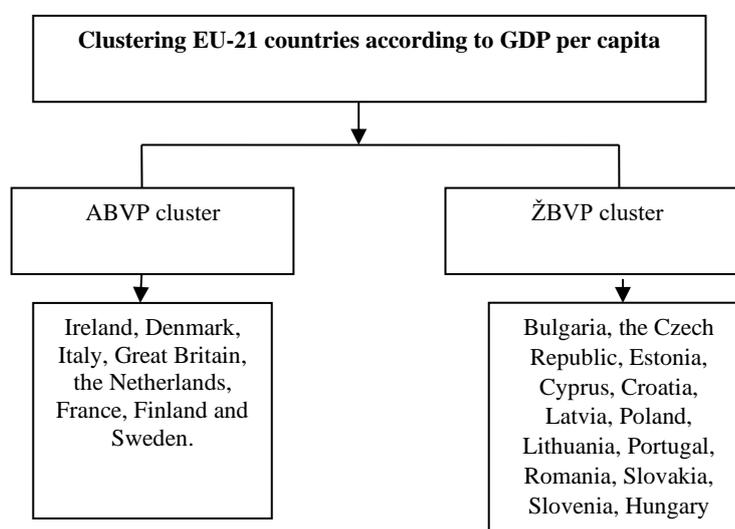


Fig. 1. Clusters of European Union countries by economic development levels (source: author)

Following the process of clustering, eight EU-21 countries have been assigned to the cluster of high-growth economies. Thirteen EU-21 countries belong to the low-economic growth cluster. In the next section, we will look at countries' fiscal decentralization and its indicators by country clusters.

4. Fiscal decentralization in Europe Union countries

Figure 2 shows the EU-21 countries fiscal decentralization index for 2016 in different clusters (Slavinskaitė, Ginevičius 2016).

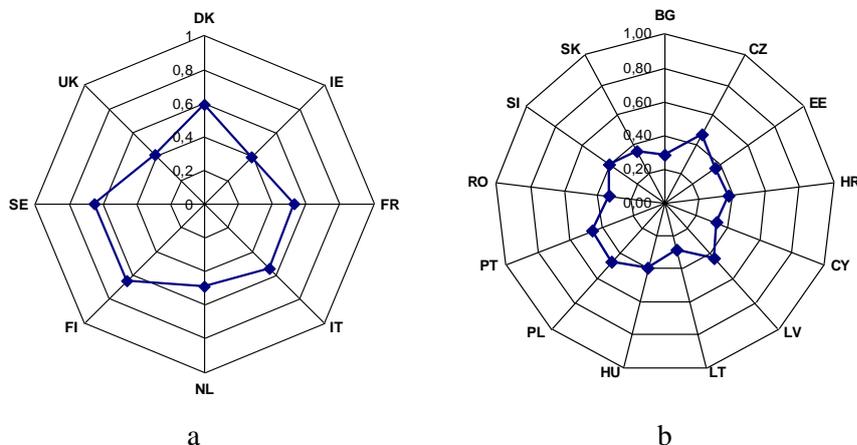


Fig. 2. The fiscal decentralization index by groups of countries in 2016 year:
a) HEG cluster; b) LEG cluster (Source: Author)

From Figure 2, we can see that the the fiscal decentralization index for 2016 ABVP countries cluster is larger than the cluster of ŽBVP and ranges from 0.40 to 0.71. Ireland has the lowest fiscal decentralization in this cluster (0.40), the highest is in Sweden (0.71). The fiscal decentralization index ranges from 0.28 to 0.46 in the cluster of ABVP countries. The lowest fiscal decentralization index in this cluster is in Bulgaria and Lithuania (0.28), in the Czech Republic (0.46) it is the highest.

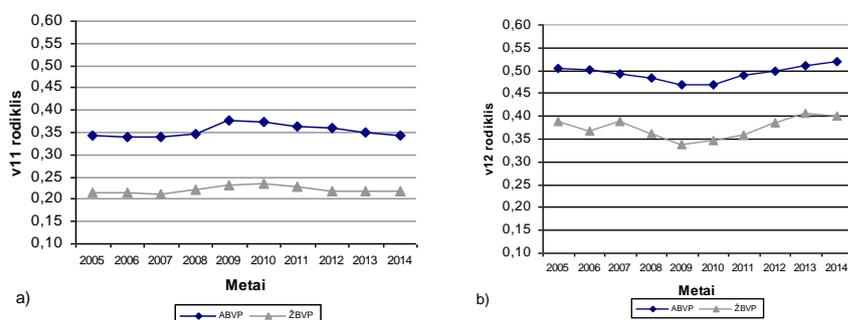


Fig. 3. Fiscal decentralization income autonomy indicators dynamics by groups of countries in 2005–2014 year: a) revenue decentralization indicator (V11); b) indicator of financial autonomy (V12)
(source: author)

To analyze the fiscal decentralization closer, we will review the changes in the indicators of fiscal decentralization income autonomy in 2005-2014 by the groups of the countries (Figure 3).

Local government revenue autonomy is characterized by five indicators. Figure 3 shows the dynamics of decentralization and financial autonomy indicators of the local governments in the analysed countries (EU-21) according to the country cluster. In the group of high economic development (ABVP), the decentralization rate of local government income indicator (an average of 0.36) is about 63% higher than the low economic development group (ŽBVP) indicator (an average of about

0.22). The high level of decentralization of local government income in the ABVP group shows that local governments have more autonomy than the group of ABVP countries.

In Figure 3 a in the EU-21 clusters, the trend for decentralization of local government income growth from 2007 to 2009 is visible. Although Figure 3 a shows that in the EU-21 group clusters, the ratio of local government income to the government budget revenues since 2009 is decreasing, however, in Figure 3 b, we can see that since 2009, the ratio of local government non-grant revenue with local government expenditure is increasing, which means that intergovernmental transfers in the analysed clusters of the countries are decreasing and government revenue can cover each year more and more expenditure of the local government functions. It should be noted that in Figure 3 a in the ABVP cluster, the financial autonomy of local government income is higher than in the ŽBVP cluster. ABVP countries can cover over 45% of the local government expenditure, while the ŽBVP countries can cover less than 40% of the local government expenditure.

In 2005 in ABVP cluster, one country index of decentralization income was 0.34, which is 62% more than in the group of ŽBVP countries. The largest decentralization indicator for the local government revenue is in Denmark (0.59) and in Ireland it is the smallest (0.18). The Danish Unitarian State is divided into 98 municipalities and regions. Local governments of this country are independent from the central government and have the right to set local government taxes of around 85% tax revenues. The Irish State is also divided into three stages: it has 34 counties and 80 municipalities, but it is a relatively centralized state dependent on grants received from the central government. Irish local government can finance about 30% of the local government expenditure, while Denmark only 45%. Other countries in this cluster have a high income decentralization rate (ranging from 0.4 to 0.5), but lower than Denmark and higher than the Irish state. From 2012, 1st January the Netherlands is divided into 12 provinces and 418 municipalities with wide range of powers in domestic financial affairs. These powers are enshrined in Articles 123-133 of the Netherlands Constitution. Although the local government of this country has high powers in collecting taxes and can control about 66% of the local tax revenues, but tax revenues are rather low and amount to around 10% of all income from the local government.

The dynamics of fiscal decentralization tax income indicators by country group can be seen in Figure 4.

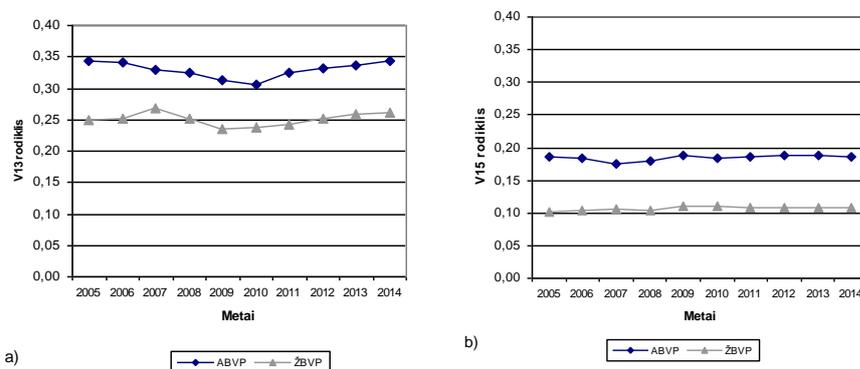


Fig. 4. Fiscal decentralization tax income indicators dynamics by groups of countries in 2005–2014: a) tax revenue as percentage of local government revenue (V13); b) indicator of tax decentralization (V15) (source: author)

Sweden is divided into 290 municipalities, and the Committee of the Regions of the European Union identifies it as the country of the high level of fiscal decentralization. The Constitution of this country explicitly recognizes the principle of local self-government. In Sweden, taxes are collected by the central government and then are reallocated to the local authorities according to the tax base and tariffs. In the reporting period of 2005-2014, local government tax revenue accounted for 55% on average of all income from the local government. France, Great Britain, Italy, Finland also have a high level of decentralization of local government revenue and tax autonomy indicators.

Finland, with a Scandinavian system of local self-government, is divided into 336 municipalities with a highly decentralized management system. Still in 1860 the autonomy of the local self-government, which is legalized by legal acts, remains a stable basis for governance until nowadays. Local governments can control their income through local tax rates, which make up about 46 % of local government revenue. France is also a relatively decentralized state in the ABVP group of countries with nearly 37,000 municipalities. Until 1982 France was one of the weakest decentralized government systems. The balance between the need for free administration of the local government and the control of central government was expressly foreseen in 1958 in paragraphs 2 and 3 of the Constitution article 72. A particularly important shift towards decentralization took place in 2003, when it was legalized following the amendment to the Constitution on decentralized state administration, as well as direct local democracy, financial autonomy of administrative territorial units. In 2005 France's local government revenue accounted over 52% for autonomous taxes, 31.5% grants and 16.5% - other income. The ratio of French taxes collected by local authorities increased until 2014.

The other two countries belonging to this cluster are Great Britain and Italy. Italy is considered to be a regional state, although the local self-government has been recognized since 1947 under the Constitution. This state has 8,092 municipalities. Although the ratio of local government income between Italy and Great Britain to the central government revenue was about 30%, Italy still has more

autonomy in collecting local government taxes than the United Kingdom, respectively by 23% and 6% respectively. Great Britain is a much more centralized state than Italy, with the exception of Northern Ireland. In Northern Ireland, local government revenue make 66.5 % of autonomous taxes and only about 10% - intergovernmental transfers. In the UK, local government revenue makes 15.4 % of autonomous taxes, 13.1% common fees, 48.2 % - grants and 23.3% - revenue from other sources.

The cluster of low-economic development countries includes the Central, Southern Europe and Baltic countries. The low level of decentralization income of the ŽBVP cluster is determined by the fact that most of the countries started decentralization processes only in 1989, after the collapse of communism, while the Western states fiscal decentralization has been developing for decades. In particular, many scholars (Rodriguez-Pose, Kroijer 2009) focus on this group of countries in analysing the impact of fiscal decentralization on economic growth. These countries face a lot of challenge in order to secure the necessary requirements and successfully implement fiscal decentralization reforms. Macroeconomic instability, the legacy of centralized management over the last decade, and weak legal frameworks constituted an obstacle to the successful development of decentralized systems (Rodden 2002). For these reasons, criticism raised questions for the implementation of fiscal decentralization processes, in particular due to lack of transparency and clear division of competences between different levels of the government. Although the local authorities were given more fiscal responsibility throughout the region, in many cases their sources of income were still very limited. In this group of countries relatively high decentralization indicator is in Poland (0.35), Czech Republic (0.29), Croatia (0.28) Latvia (0.29), Romania (0.26), a very low indicator is in Greece (0.09) and Cyprus (0.05). In other countries of this cluster (Bulgaria, Estonia, Lithuania, Portugal, Slovenia and Slovakia), this indicator ranges from 0.15 to 0.25 and is well below the cluster of the ABVP countries. Although Cyprus local government revenue is only 5 % from government revenue, but local government revenue of about 30% of local government tax collection covers around 50% of local government expenditure. Local government is able to finance more than 40% of local government expenditure without central government grants in the Czech Republic, Croatia, Latvia, Poland, Portugal, Slovenia, less than 20% in Bulgaria, Estonia, Lithuania and Romania. In 2014 local government tax revenue was more than 40 % of local government revenue accounted in the Czech Republic, Latvia and Slovenia and less than 10% in Bulgaria, Estonia, Lithuania, Romania.

Another part of fiscal decentralization is the autonomy of expenditure. Below, let's take a look at the indicators of local government expenditure autonomy in clusters.

In 2005 Denmark's (0.65) decentralization of local government expenditure, as well as income, was the largest in the ABVP cluster, with Ireland having the lowest (0.18). Both countries maintained the same position by 2014, although expenditure decentralization dropped to 0.64 and 0.08 respectively. In 2005 in the ABVP

countries cluster, the average cost of decentralization for one country was 0.35, which is 67% more than in the group of countries of the ŽBVP (Figure 5).

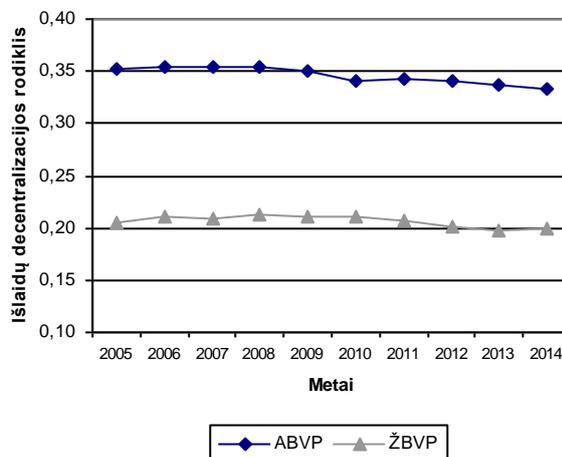


Fig. 5. Expenditure decentralization of local government dynamics by groups of countries in 2005–2014 (source: author)

In 2014 the average decentralization of local government expenditure in the ABVP cluster has dropped to 0.33. During the same period, the two groups of countries (ABVP and ŽBVP) reduced the decentralization of local governments by about 5%. In terms of government expenditure in this group of countries, decentralized expenditure is as follows: in Denmark, health care (99%), housing and communal amenities (92%) in Ireland, environmental protection (92%), health care in Sweden (97 %).

In Denmark, the greatest decentralization has been achieved in terms of health and leisure (83%), culture and religion (69%) expenditure. France has the most decentralized environmental protection (88%) and recreation, culture and religion (78%). Other countries in this cluster (Italy and Great Britain) have the largest decentralization of expenditure on health (98%) and education (57%).

In 2005 in the cluster of ŽBVP countries, more than 20% of decentralized costs are in the Czech Republic, Estonia, Croatia, Latvia, Lithuania, Hungary, Poland and Romania in 2014. Romania and Slovenia are joining these countries, only Hungary reduces the cost of decentralization to 16%. Decentralization of income in Greece and Cyprus in 2014 respectively makes 7% and 3%. In this cluster of countries, more than 50% of expenditure is decentralized on education: Bulgaria, Czech Republic, Croatia, Estonia, Latvia, Poland, Lithuania, Romania, Slovakia and Slovenia. In the analysed period, on average, 71% was decentralized on the cost of education in Croatia, while in Cyprus 0%. Another important function of public expenditure is healthcare, the cost of which is decentralized by many developed European countries (Denmark, Italy, Finland, Sweden), but only in Poland it is decentralized by more than 45% in the cluster of ŽBVP. Estonia, Lithuania and Hungary - about 30%, in Greece and Cyprus these costs are centralized. Housing and communal services which are financed for more than 50% expenditure, are

decentralized by Bulgaria, the Czech Republic, Estonia, Greece, Poland, Latvia, Lithuania, Portugal, Romania, Slovakia and Slovenia. In Estonia 100% is decentralized, while in Croatia it makes only 2%. Social protection costs are quite centralized both in countries with high and low levels of economic development. In Denmark about 80% of public expenditure is decentralized on social security, while in Cyprus it is 0%. In most clusters of ŽBVP countries, these functions to finance expenditure are decentralized less than 10% of public expenditure.

4. Conclusions

Fiscal decentralisation is influenced by many countries specific factors such as politics, history and culture. Therefore the measurement of fiscal de-centralisation with consistent criteria across countries is a challenging task.

The fiscal decentralization index, generated by suitably adapted multi-criteria decision making methods, enables to evaluate and compare the fiscal decentralization in the context of the EU-21 countries:

- The index combines 24 indicators of four measures of fiscal decentralization (5 of revenue autonomy, 4 of intergovernmental transfer, 10 of expenditure autonomy and 5 of borrowing autonomy).
- The value of fiscal decentralization index can range from 0 to 1. A higher value indicates a higher degree of country fiscal decentralization.

Results show that the degree of fiscal decentralization varies widely across country: from 0.26 in Bulgaria and Lithuania to 0.70 in Sweden and Finland. The degree of fiscal decentralization in high level economically developed countries is higher than in low level economically developed countries. These results show that local government in high level economically developed countries (such like Sweden, Denmark and other countries) has a big power to control own revenue and expenditures than in low level economically developed countries (Estonia, Poland and other countries).

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