

# LOCAL GOVERNMENTS IN EU COUNTRIES: COMPETENCES AND FINANCING OF PUBLIC SERVICES

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**Abstract:** *Local governments in the EU play a major role in the development of local public policies. Local governments provide public services in the public interest, funding them for public resources. The paper deals with the role of the local public sector and the comparison of competences of sub-national governments (local, intermediate, regional) in EU countries and the financial dimension of local and regional governments for development of services. The areas assessed include spending capabilities of local governments in 28 EU countries, with a particular focus on total expenditures of local and regional governments, fiscal decentralisation of expenditures, and local government expenditures by selected function (social protection, health, education, culture and recreation), including the rate of their decentralisation of expenditures. The empirical research renders a comparison of spending capabilities of local and regional governments by selected function in EU countries, making use of cluster analysis and the evaluation of similarities and differences in the individual countries. The most marked differences in EU countries were observed in expenditures of the local public sector on health. Conversely, the least marked differences in all countries are seen in the expenditures of the local public sector on recreation and culture.*

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**Keywords:** *Local governments, Local public services, Local government expenditure, Fiscal decentralisation, Cluster analysis, EU countries.*

**JEL Classification:** *H75, H76, H83.*

## Introduction

The local public sector plays an important role in the implementation of local public policies in European countries. Each reform of public administration should lead to an increased efficiency of public resources, quality of provided services and performance of the public sector. The range of public expenditures is closely associated with financing of public needs and the public sector. Budgetary expenditures of local governments are allocated to the needs of the local and regional sector. The type and nature of a local public service defines the structure and volume of territorial budgetary expenditures. Nevertheless, the volume of territorial budgetary expenditures is constantly increasing, which is a reflection of increased autonomy and responsibility of local governments for securing and financing the public sector within their area, but also the growth of the public sector as a whole (Ahmad, et al., 2008; Aristovnik, 2012; Provazníková, 2015).

This paper aims to evaluate the local public sector and the competence of local and regional governments in EU countries, with particular focus on their spending potential for the development of public services. It attempts to provide a view of local and regional governments and local public expenditures in four key areas of the local public sector, fundamental for the development of human-potential services. The paper concentrates on the expenditures of the local public sector by COFOG functions (social protection,

health, education, recreation and culture) and the extent of their decentralisation of expenditures in the individual countries in 2014. Using cluster analysis and box plot, similarities and differences in expenditures of the local public sector in EU countries are compared by means of clusters.

## **1 Statement of a problem**

The local public sector can be characterised as a non-profit public sector financed from public funding, managed and administered by the local government (municipalities, regions), reaching decisions through public vote and subject to public checks (Bosse, et al., 2013; Kuhlmann, Bouckaert, 2016). Another definition of the local public sector is provided in the ESA methodology (European System of Accounts), where public administration is considered a sector (S 13) comprising four sub-sectors (Central Government, State Government, Local Government, Social Security Funds). Local Government sector is one part of the public administration sector and it includes the sorts of public administration authorities whose competence reach local part of economic area (Neubauerová et al.; 2003; Eurostat, 2013). As stated by Dexia-Cemr (2012) local public sector (classified S1313 by the ESA), it comprises local authorities with general competencies (local and regional governments) and bodies with more specialised competencies (responsibilities vary from one country to the next). The structure of local and regional government in European countries varies markedly with respect to their constitutions, historical development and size. As argued Matei, Matei (2011); Ccre-Cemr (2016), for instance, in EU countries are far from having a unified structure of territorial organisation, making their own decision about the system of local arrangement, including levels of governments. The range of competencies of local and regional governments creates potential for the development and financing of local public services.

The local public sector provides public services in the public interest, financing these from public resources (the budget of local governments). The significance of the local public sector consists mainly in areas where those public services are provided which are not (e.g. financially) attractive for private-sector subjects (Beblavý, Sičáková-Beblavá, 2007; Mikušova Meričkova, Nemeč, 2013). Municipalities and regions procure public services not only from the viewpoint of their, i.e. local, needs, but frequently also public services defined by the range of delegated power and responsibility for their procurement in terms of the decentralisation of the public sector (Provazníková, 2015).

In connection with ensuring public services, most advanced countries delegate expenditure competences to the individual levels of local governments: public administration is decentralised. A successful decentralisation joins public finances and fiscal power with responsibility for providing services with functions of local governments (Alexandru, 2016). The scope of decentralisation of public administration is mostly expressed by the share of expenditures of central, regional and local administration on total expenditures of public administration or GDP. Fiscal decentralisation plays a significant role for the development of local public services, expressing that lower levels of public budgets decide about the provision and financing of services of the public sector on the basis of generally valid rules of local specificities as well as specificities of a given local unit (Oates, 1993; Rodríguez-Pose, Krøijer, 2009; Aristovnik, 2012; Finžgar, Oplotnik, 2013; Tamošiūnas, Stanytė, 2015). According to these authors, fiscal decentralisation contributes to an efficient provision of services, mainly because expenditures are more in line with local priorities and preferences, which motivates local governments to improve

mobilisation of resources, thus resulting in a better transparency and responsibility for allocated expenditures.

Local public sector is dealt with in numerous papers, such as Žarska (1996); Bosse, et al. (2013); Mikušova Meričkova, Nemeč (2013); Halásková, Halásková (2015); Provozničková (2015); Ccre-Cemr (2016); Kuhlmann, Bouckaert (2016) in connection with its scope, trends and reform tendencies, procuring and financing public services. Local governments in the EU are dealt with by, for instance, Moreno (2012); Parana, Varney (2013). These authors analyse not only the structure, competence of local and regional governments and legislative conditions in the selected EU countries, but also emphasise the specificities of territorial and administrative structures in these countries and their financial capabilities for the development of public services. The structure of local and regional governments and the comparison of the financial dimension of local public sector in EU countries (structure of local government expenditure by function or investment potential of local governments) are dealt with in studies by CEMR (Dexia-Cemr, 2012). In Kuhlmann, Bouckaert (2016), attention is paid to the comparison of effects of local reforms of public sector in Europe, mainly to financial austerity measures, territorial reforms, democratic innovations and measures in New Public Management, but also other aspects of management.

## 2 Methods

Eurostat data have been used (Eurostat, 2016). The set comprises 28 EU countries (Belgium-BE, Bulgaria-BG, Czech Republic-CZ, Denmark-DK, Germany-DE, Estonia-EE, Ireland-IE, Greece-EL, Spain-ES, France-FR, Croatia-HR, Italy-IT, Cyprus-CY, Latvia-LV, Lithuania-LT, Luxembourg-LU, Hungary-HU, Malta-MT, Netherlands-NL, Austria-AT, Poland-PL, Portugal-PT, Romania-RO, Slovenia-SI, Slovakia-SK, Finland-FI, Sweden-SE, United Kingdom-UK). The paper provides a comparison of total expenditures of local public sector allocated by local governments in EU countries, including selected areas of local public services by COFOG classification (education, social protection, health, recreation and culture, as % of GDP) and the extent of decentralisation in 2014 (the latest available data on local public expenditures by COFOG). By use of cluster analysis, similarities and differences in the allocated local public expenditures by function in EU countries by clusters have been compared (Denmark has been excluded from the set as it shows extremely high expenditures of local public sector on social protection when compared to other countries). Cluster analysis is a multi-dimensional statistical method used to classify objects. It enables sorting observed units into several groups so that similar units occurred in the same group, and, in turn, so that units from other groups differed fundamentally. In the present study, these were EU countries excluding Denmark. In the processing stage, hierarchical cluster analysis was used, and the resulting distances between the individual objects (EU countries) were visualised by means of a diagram called dendrogram (Everitt, et al., 2011). Further, EU countries were compared using Box-plot, which is a form of graphic visualisation of numerical data through their quartiles, dividing the statistical set into quarters, when 25 % of items are below the values of the lower quartile  $Q0.25$  and 75% below the upper quartile  $Q0.75$ . The middle "box" of the diagram is delineated by the third quartile from the top, the first quartile from the bottom, and between those the line defining the *mean value* is found. The height of the box represents an *interquartile range*. The lower vertical line (lower whisker) corresponds with values found beneath the box in the distance not more than the factor of 1.5 of the size of the box. The end of the whisker corresponds with the lowest such value from the set. Similarly, the upper whisker corresponds with the highest value from the set. Apart from whiskers

(below and above them) are seen points which correspond with the so-called outliers (Everitt, et al., 2011).

### **3 Problem solving**

#### **3.1 Local and regional governments in EU countries and development of public services**

EU countries use neither a common structure of territorial administrative structure nor a system of local arrangement, associated with constitutional arrangement and historical development. It is characteristic for EU countries to use a single-, two- or three-level structure of sub-national governments. Local levels governments in EU countries include cities, municipalities, urban municipalities, towns, local authorities, communities in rural areas, rural municipalities, counties, municipal districts, local councils, parishes, city districts. Intermediate levels of government is typical of Poland, France, Germany, Hungary, etc., as a higher level above local governments and they include, for instance, regions, provinces, counties, departments and overseas departments, metropolitan cities, municipalities with special status. The structure of regional levels of governments is characterised in EU countries by the second or third levels of sub-national governments (regions, overseas regions, self-governing regions, planning regions, autonomous communities, cities, provinces and regions, regional councils, county councils, provinces and counties) (Ccre-Cemr, 2016).

The first level of sub-national government in EU countries is associated with the procurement of services in local communications, water management, garbage collection, public transport, health and social services, and education (pre-school facilities, elementary schools). The second level of sub-national governments in EU countries is active in, for instance, education (high schools), territorial planning, local communications, and administration of the environment. The third level of sub-national government is in charge of regional transportation, regional public administration services, territorial development, education, health-care services, social housing, or services associated with culture. The comparison of the competence of sub-national levels of government (local, intermediate, regional) in EU countries connected with the development of human-potential services is shown in Tab. 1.

The task is to secure social protection (social and welfare services, social assistance, affairs, action, aid, social housing), health (primary health care, health services, hospital provision, health insurance), education (pre-primary, primary, secondary, tertiary, building and maintenance of schools). In terms of recreational and sporting services, the range of sporting services, sporting facilities and leisure was analysed, whilst in terms of culture, cultural services and infrastructures, libraries, museums, local arts and other activities. Table 1 shows the most extensive competences of local governments in EU countries in services of social protection, education and culture.

**Tab. 1: Competences local and regional levels of governments in EU countries by selected function**

Levels	Social protection			Health			Education			Sport			Culture		
	LL	IL	RL	LL	IL	RL	LL	IL	RL	LL	IL	RL	LL	IL	RL
BE	*		*			*	*		*	*		*	*	*	*
BG	*						*			*			*		
CZ	*		*			*	*		*						
DK	*		*	*		*	*		*	*		*	*		*
DE	*	*			*		*		*	*	*		*	*	*
EE	*			*			*			*			*		
IE															
EL	*			*			*								
ES	*		*			*			*	*			*		*
FR	*	*			*		*	*	*	*		*	*	*	*
HR	*			*		*	*		*	*			*		
IT	*					*		*					*		
CY															
LV	*			*			*						*		
LT	*			*			*			*			*		
LU	*						*			*			*		
HU	*				*			*					*	*	
MT	*			*			*			*			*		
NL	*			*			*			*			*		*
AT	*			*		*	*					*	*		
PL	*		*		*		*	*	*				*		
PT	*			*			*			*			*		
RO			*	*		*	*		*						
SI	*			*			*			*			*		
SK	*		*	*		*	*		*	*			*		*
FI	*		*	*		*	*		*	*			*		*
SE	*			*		*	*						*		*
UK	*						*						*		

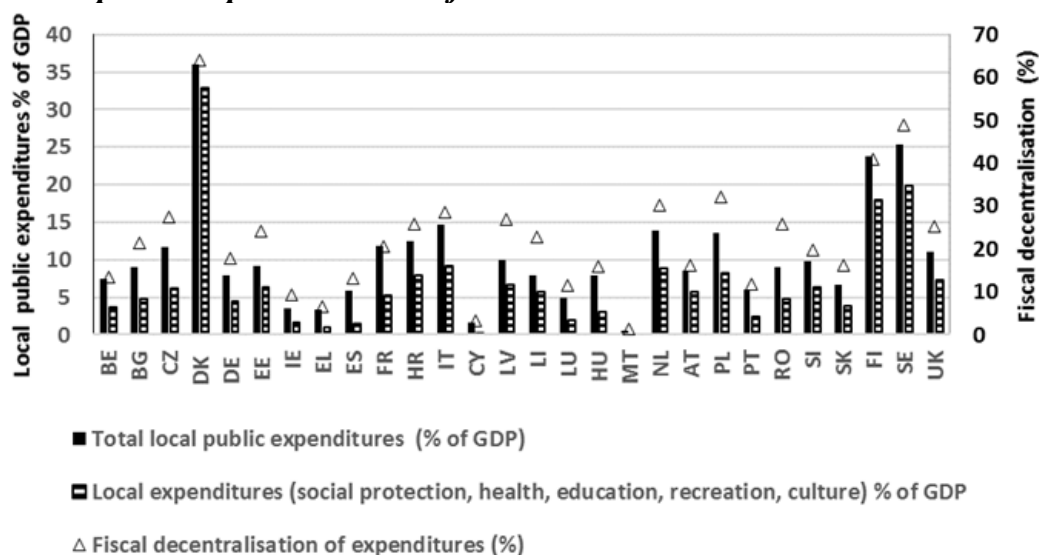
Note: Local level (LL), Intermediate level (IL), Regional level (RL)

Source: Author's according to Ccre-Cemr (2016).

### 3.2 Public expenditures of local governments for the development of services in EU countries

Local and regional government expenditures account for approximately 17% GDP and approximately 34% of general government expenditures of the public sector (only local public sector 11.8% of expenditures as % GDP a 24% of general expenditures of the public sector) (Dexia-Cemr, 2012). The main areas of local- and regional-government expenditures in EU countries are allocated to general public services, education (pre-primary, primary, secondary, tertiary), social services, healthcare, economics affairs, housing and community amenities (water distribution network, public lighting, building of housing), recreation and culture (sporting services, equipment and other sporting activities, libraries, museums and theatres), environmental expenditure (waste collection and treatment, parks, environmental protection) and public order and safety (regional and municipal police, fire brigades and emergency responders). The present research provides a detailed analysis of the selected expenditures of the local public sector in EU countries in areas of the development of human potential (social protection, health, education, recreation and culture) (see Fig. 1, vertical left axis).

**Fig. 1: Local public expenditures and fiscal decentralisation in EU countries in 2014**



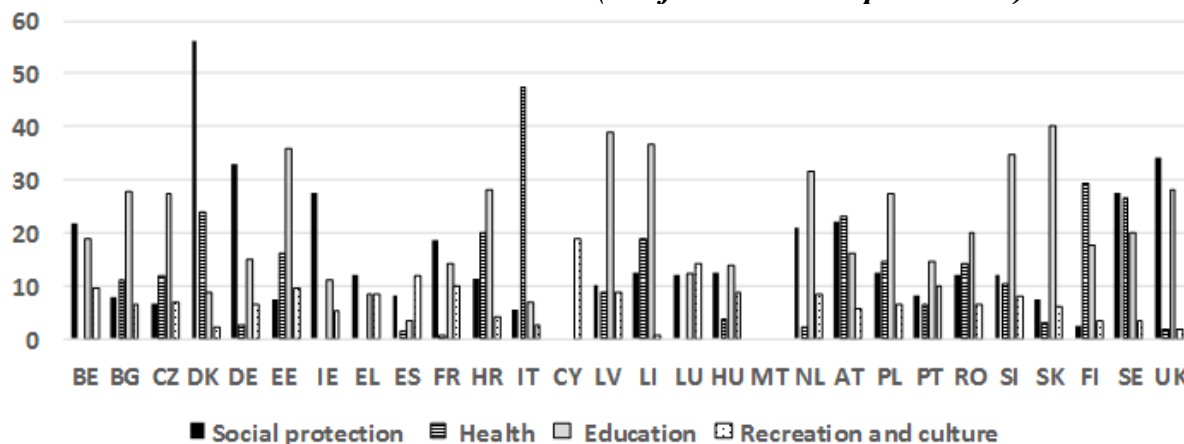
Source: Author's according to Eurostat (2016).

The size of the local public sector as a whole and in selected areas of local public services in EU countries expressed as a share of local public expenditures on GDP in % is seen in Fig. 1. Strong expenditure preferences of the local public sector as a whole as well as by selected functions including services of human development can be observed in Scandinavian countries. The role of local public sector is connected with a huge volume of territorial budgets, possibilities of own local resources, mainly tax resources, and a high autonomy of territorial budgets. The lowest expenditures of local public sector, including expenditures by function, is seen in Malta and Cyprus. Very low expenditures of local public sector by functions are also observed in Ireland, Greece and Spain. These countries demonstrate centralisation of expenditures in the observed public services, resulting from a strong dependence on resources from the government budget and low autonomy of territorial budgets. Evaluating fiscal decentralisation of expenditures (in %) in EU countries (Fig. 1, vertical right axis), the result is that the highest rate of fiscal decentralisation of expenditures is seen in Scandinavian countries, and a high rate of decentralisation is also observed in Poland and the Netherlands, accounting for above 30%. Countries with a moderate rate of decentralisation, between 20-30%, is seen in France, Bulgaria, Lithuania, United Kingdom, Croatia, Latvia, Czech Republic, Estonia, and Romania. Other countries show a low level of fiscal decentralisation, below 20%, with the lowest rate seen in Malta (1.4%), Cyprus (3.2%), and Greece (6.6%)

Fig. 2 shows the extent of decentralisation of expenditures of the local public sector (as % of total local expenditures) in EU countries. The strongest extent of decentralisation of expenditures in social-protection services is observed in Denmark, the UK and Germany. In Italy, Finland and Sweden, the strongest decentralisation of expenditures is seen in health services, and a strong decentralisation of expenditures in education is observed in Slovakia, Lithuania, Latvia, Estonia, Slovenia and the Netherlands. By contrast, a low extent of decentralisation of expenditures can be observed in cultural, recreational and sport services (except for Cyprus). Cyprus and Malta are characterised by a strong decentralisation in other local public services. As there is no single system and structure of local administration in EU countries, there are also differences in the extent of decentralisation and centralisation of expenditures in public services, which are influenced by numerous other factors, external as well as internal, in the individual

countries (system of taxation, cultural, social, political, demographic, historical or economic influence).

**Fig. 2: Decentralisation of expenditures in the local public sector by public services in the EU countries in 2014 (% of total local expenditures)**



Source: Author's according to Eurostat (2016).

### 3.3 Comparison of public expenditures of local public sector by functions in EU countries using cluster analysis

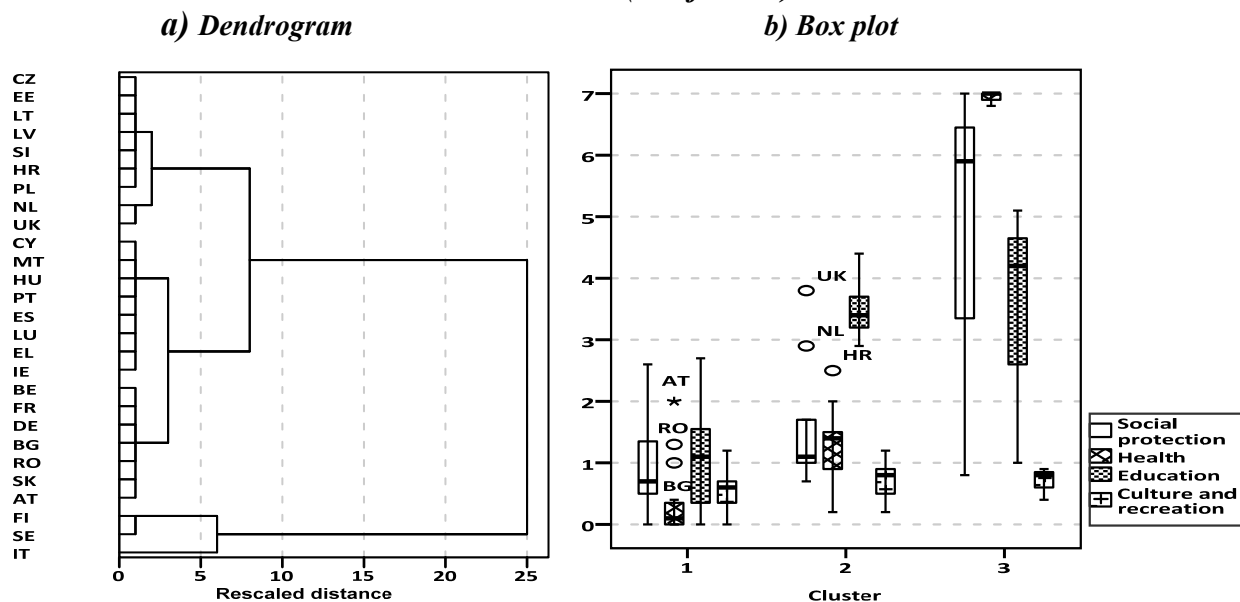
The comparison of expenditures of local public sector by COFOG functions (education, health, social protection and recreation and culture) in EU countries, excluding Denmark in 2014 was generated through the method of cluster analysis. Results of the cluster analysis enabled division of EU countries (without Denmark) into three clusters based on internal similarity. The first cluster comprises Belgium, Bulgaria, Malta, Germany, Ireland, Greece, Spain, France, Cyprus, Luxembourg, Hungary, Austria, Portugal, Romania, and Slovakia. The second cluster consists of the Czech Republic, Estonia, Croatia, Lithuania, Latvia, the Netherlands, Poland, Slovenia, and the United Kingdom. The third cluster is composed of Italy, Finland, and Sweden.

In the first cluster, seven countries: Cyprus, Malta, Hungary, Portugal, Spain, Luxembourg, Greece, and Ireland; demonstrate the highest internal similarity in allocated local public expenditures on public services. Another internal similarity in the first cluster is seen in six countries: Belgium, France, Germany, Bulgaria, Romania, Slovakia, and Austria. In the second cluster, the highest similarity in the structure of local public expenditures in services is seen in the Netherlands and the United Kingdom. Another internal similarity of local public expenditures in the second cluster is seen in seven countries: in the Czech Republic, Estonia, Lithuania, Latvia, Slovenia, Croatia, and Poland. The third cluster is composed of three countries (Sweden, Finland, and Italy), where the highest similarity in expenditures of local public sector by functions is seen in Finland and Sweden (see dendrogram, Fig. 3).

Fig. 3 (box plot) further describes the form of graphic visualisation of local public expenditures as % of GDP in EU countries in clusters. **The first cluster** is composed of countries with lowest expenditures of local public sector on health, culture and recreation. These countries also have relatively low expenditures on social protection (with a mean value of approximately 0.8%) and expenditures on education (with a mean value of approximately 1.1%). The highest value in local expenditures on social protection is seen in Germany, 2.6% GDP, as opposed to nil local public expenditures on social protection in Malta and Cyprus. The dispersion of value is apparent in expenditures on education,

with highest expenditures in Slovakia (2.7%), as opposed to nil expenditures in Malta and Cyprus again. Outliers can be observed in expenditures of local public sector on health in Austria (2%), Romania (1.3%) and Bulgaria (1%) with significantly higher local expenditures compared to other countries in the first cluster.

**Fig. 3: Evaluation of expenditures of local public sector by selected functions in EU countries (% of GDP)**



Source: Authors

**The second cluster** shows countries with the highest expenditures of the local public sector on education (with a mean value of approximately 3.3%, with the highest local public expenditures seen in the Netherlands, 4.4%, as opposed to Lithuania, 2.9%) and low local public expenditures on other observed public services. Outliers are represented by the United Kingdom (3.8%) and the Netherlands (2.9%) in expenditures of local public sector on social protection, in comparison with the mean value, approximately 1.1%. In Croatia, an outlier can be observed in local expenditures on health (2.5%, against the mean value of 1.5%). **The third cluster** comprises three countries (Italy, Sweden and Finland) with the highest local public expenditures on health (with the mean value of approximately 7%) and low local expenditures on recreation and culture (with a mean value of approximately 0.8%). The widest dispersion of value in terms of the inter-quartile range is seen in expenditures of local public sector on social protection and education. Apart from Italy (0.4%), Finland and Sweden also have the highest expenditures of the local public sector on social protection (mean value of approximately 6%), compared to other EU countries excluding Denmark. In expenditures of the local public sector on education (mean value of 4.2%), the lowest value of local expenditures is observed in Italy (1.0%), as opposed to Sweden (5.1%) with the highest value.

The most marked differences between EU countries found through cluster analysis were observed in expenditures of the local public sector on health. Conversely, the smallest differences between the clusters are seen in expenditures of the local public sector on recreation and culture. The widest dispersion of values was observed in expenditures of local governments on education and social protection. The results showed a varied extent of fiscal decentralisation of expenditures by function in EU countries.



## 4 Discussion

Local public sector plays a significant role in procuring and financing public services. Differences in local and regional governments in EU countries for the development and financing of public services are influenced by not only the structure of sub-national governments and the scope of their competence, but also constitutional arrangement, economic, cultural and other internal conditions of the given country. Recommendations of some authors can be summarised as regards the local public sector, associated with procuring public services (Oates, 1993; Brown, Potoski, 2003; Ahmad et al., 2008; Finžgar, Oplotnik, 2013; Halásková, Halásková, 2015; Provazníková, 2015). With respect to allocation, most services should be procured at the local level in case they serve a local purpose. Those products and services should be procured at the central level whose purpose goes beyond the local area. Services leading to market failure, but still wanted by the society, should be provided at the central level in case of a low government failure. Subsidies from a higher level of the budget should be provided only on the services whose benefit overlaps local boundaries and to ensure balancing of income in municipalities. Based on the results, it can be argued that the higher the engagement of local public sector is, the higher the volume and variety of structure of public expenditures, and vice versa. According to some authors, Oates (1993); Žarska (1996); Rodríguez-Pose, Krøijer (2009); Aristovnik (2012); Halásková, Halásková (2015); Alexandru (2016), decentralisation of public administration (fiscal decentralisation) can be considered the pillar for the development of local public sector. These authors based their opinion on the assumption that provision of public services at the local level is more efficient and economical, mainly because local expenditures conform more to local priorities and preferences, which motivates local governments to improve on exploiting their resources, resulting in higher transparency and responsibility for allocated expenditures. As the present as well as other results from EU countries show, e.g. Finžgar, Oplotnik (2013); Halásková, Halásková (2015), the higher number of lower administrative levels of sub-national government in most countries fails to have any impact on the higher level of fiscal decentralisation.

The extent of decentralisation or centralisation of expenditures varies in the observed services in the countries, which was also confirmed by the present research. Many factors come into play, mainly the economic level of the country, political and demographic factor, local specificities, the size of the local public sector and the local governments' willingness to procure, provide and finance the respective public services. As argues Beblavý, Sičáková-Beblavá (2007:245), "local governments deal with whether it is more beneficial for the public sector to provide a given service in terms of its direct authority or to delegate the provision of the service to other subjects for a particular fee (either explicit - regular payments from public budgets, or implicit - authorisation for the collection of particular fees from the public)". As the present results, as well as other pieces of research or studies, such as Dexia-Cemr (2012) or Halásková, Halásková (2015), show, Cyprus and Malta demonstrate a strong centralisation of expenditures in most observed public services (social protection, health, education), Malta also in recreation and culture. This fact can be explained by their small size, comparable to the size of a municipality, where the role of local public sector is quite limited or none. By contrast, these countries demonstrate the impact of the public sector and a strong decentralisation in general public services. It is therefore more economical and efficient to provide most public services in a centralised manner.

The results are difficult to define and the efficiency of resources impossible to measure directly in the public sector. It is therefore necessary to consider various approaches to measuring and evaluation of allocated public expenditures in the individual areas of local public sector. In analysing the efficiency of the public sector and for the sake of an objective system of public expenditures, specific methods and processes are applied, mainly comparative methods (temporal, spatial), performance, norms or standards. Also, a comprehensive audit or a system of public control of the given country can be considered a significant method contributing to the evaluation of public-expenditure efficiency.

## **Conclusion**

The structure of local and regional governments in EU countries is characterised by three levels. The widest scope of competence of local public sector associated with securing public services is seen in local governments (municipalities, local authorities, cities, towns, etc.) in EU countries with a single level of sub-national government. Increased responsibility of local governments in advanced countries in procuring and financing of the public sector in their area reflects increased autonomy and volume of territorial budgets. Nevertheless, a particular fiscal system is always a compromise in the given country, based on historical, political and other aspects. Different preferences of local expenditures by function have been proved in EU countries, as well as their extent of decentralisation. The results show that the highest expenditures of local public sector as a whole as well as by selected functions that include services of human development are seen in Scandinavian countries, and the lowest expenditures of local public sector, including local expenditures by function are seen in Malta and Cyprus. The comparison of expenditures of local public sector by use of cluster analysis revealed rather significant differences in preferences of expenditures of local public sector in the individual countries, which are reflected to various degrees in centralisation or decentralisation of public services, but also in financial capabilities of their development. The largest differences in EU countries were found in expenditures of local public sector on health; conversely, the least differences in all countries were found in expenditures of local public sector on recreation and culture. The highest volume from the observed expenditures of local public sector in EU countries was proved in education and social protection. Also, the widest dispersion of values of local public expenditures was also found in these services in the given countries. There are numerous unanswered questions connected with the role of local public sector and financing of local public services in the EU, such as the evaluation of efficiency of allocated expenditures and the quality of public services, which may serve as a theme for further research.

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