

Division of Powers between the European Union, the Member States and Local and Regional Authorities – Additional Fiscal/Budgetary Elements

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Executive summary

The current political and economic developments in the EU both require and justify an increased role for subnational governments, in order to become better equipped to tackle the crisis on the ground and act in coherence with the upper levels of government. Indeed, the fiscal and budgetary measures currently discussed or implemented at the European and national level can only have the intended consequences if also supported at subnational level. This paper presents a methodological and operational reflection on the future extension of a set of country fact-sheets previously drawn up by the Committee of the Regions (hereafter CoR) on the issue of the division of powers among the different levels of government. The purpose of extending the country fact-sheets is to explore the relationship between devolution and the provision of adequate financing resources through fiscal decentralisation or federalism. Having regular country fact-sheets on the composition and structural organisation of subnational budgets over time will enable conclusions to be drawn on the evolution of decentralisation, the EU's influence on this process and the coherence between devolution of powers and the provision of adequate financing resources.

The note is divided into four main sections. The first section describes the current political and economic context in the EU, concluding that the interactions between the EU and regional and local levels of government have increased and that the autonomy of local and regional authorities (hereafter LRAs) has indeed augmented as a general trend. However, quantifying the degree of LRAs' independence may not be as straightforward as it seems. This first section also looks at the impact of the economic crisis on subnational budgets and notes that the crisis has not only altered the composition of subnational public expenditure and revenue but has also generally increased fiscal imbalances leading to higher levels of subnational public debt and deficit.

Based on the current political and economic developments Europe is facing, the second section of the note presents the methodology and objectives that the country fact-sheet will follow:

- Demonstrate how fiscal decentralisation and devolution have evolved over time;
- Provide an overview of the structural organisation of budgets at the subnational level;
- Illustrate the importance and impact of EU funds on subnational budgets; and
- Track the impact of the economic crisis and austerity measures on LRAs finances and on subnational public debt.

The third section proposes a structure for the country fact-sheets following the four objectives outlined in the methodology. The last section of the note briefly reviews the existing literature and data relevant for drawing up the country fact-sheets, by objective. While important work has been done on the topic, it is noted that some challenges exist – the information available for the different Members States (hereafter MSs) may not always be comparable, and it does not seem possible to examine the geographical distribution of expenditure, revenue and debt within countries or to get an exhaustive account of the contribution of EU funds to subnational budgets.

Introduction

This CoR note has been produced by the European Policy Centre (EPC) under a Framework Contract on the EU Budget. The paper presents a methodological and operational reflection on the future extension of the country fact-sheets previously drawn up by the CoR. The current political and economic developments in the EU both require and justify an increased role for subnational governments so that they become better equipped to tackle the crisis on the ground and act in coherence with the upper levels of government. Indeed, the fiscal and budgetary measures currently discussed or being put into place can only have the intended consequences if also supported and observed at subnational level. The purpose of extending the country fact-sheets is to explore the relationship between devolution and the provision of adequate financing resources through fiscal decentralisation or federalism. Having regular country fact-sheets on the composition and structural organisation of subnational budgets over time will enable conclusions to be drawn on the evolution of decentralisation, the EU's influence on this process and the coherence between devolution of powers and the provision of adequate financing resources.

The note is structured around four sections. In the first section, the authors look at the key developments of the political and economic context in Europe, which justify the choice of methodology articulated around objectives that the country fact-sheets should follow. The methodology is presented in the second section. The third section proposes a structure for the country fact-sheets following the four objectives outlined in the methodology:

- Demonstrate how fiscal decentralisation and devolution have evolved over time;
- Provide an overview of the structural organisation of budgets at the subnational level;
- Illustrate the importance and impact of EU funds on subnational budgets; and
- Track the impact of the economic crisis and austerity measures on LRAs finances and on subnational public debt.

Finally, the authors make a brief review of the available literature and data that would provide the basis for drawing up the country fact-sheets and identify where information is missing.

1. Political and economic context

Having a comprehensive picture of the current political and economic context is crucial for understanding the division of fiscal/budgetary powers between the EU, MSs and LRAs and its evolution over time. The political and economic context is the driver behind important changes in the division of powers among levels of government and the move towards more fiscal decentralisation. The key changes in Europe's political and economic situation, which have an influence on the fiscal and budgetary aspects of governance, are therefore selected in the first section of this file note and justify the choice of objectives that the country fact-sheets should follow, presented in the second section.

The recent changes in the political and economic context in Europe have led to three key developments: increased interaction between the EU and regional and local levels (1), new trends in the division of budgetary/fiscal powers between the national and regional/local levels (2), impact of the crisis on the composition of subnational budgets (3). While some of these developments have already had some direct consequences on the fiscal and budgetary aspects of the division of powers, others may have a more indirect influence, which may, however, affect systems of governance in the long-run.

1.1. Increased interaction between the European and regional and local levels

Given the process of ever closer integration in the EU and the move towards more decentralisation in individual MSs, the interactions between European institutions and LRAs have intensified considerably over time. LRAs have received increased attention in recent years and references to them have become more numerous in most strategic documents of the EU and beyond, for example in the Council of Europe or the OECD. While the documents produced by the two latter organisations are only intended to provide guidance, they do have potential to change the mindset in the long run and have an indirect impact on how systems of governance are perceived.

Starting with the Council of Europe, recent documents have devoted increased attention to the role of regionalisation in democratic systems. For example, the Congress of Local and Regional Authorities (CLRA) of the Council of Europe noted that 'regionalisation and democracy are clearly two sides of the same

coin'¹ and that it is essential for the people who bear the consequences of political decisions to be involved in the making of these decisions. In this context, the CLRA proposed in 2008 the adoption of a 'European Charter of Regional Democracy', as a legal instrument for regionalisation, having at its core the principle of regional democracy and complementing the European Charter of Local Self-Government. While the charter was not accepted in the form of a convention and is, therefore, not binding, it led to a Reference Framework on Regional Democracy in 2009 as a 'code of rights and duties of regional entities'² to serve the purpose of guiding countries in their decentralisation process, while also enabling the Congress to monitor regional democracy in Council of Europe MSs. This latter Reference Framework, also not binding, was adopted by European ministers responsible for local and regional government and touches on the topic of LRA finances, underlining the importance of enabling LRAs to use their powers and to fulfil responsibilities effectively.

Besides the issue of democratic accountability, the economic and financial crisis has made the discussion of the role of LRAs all the more timely. Any efforts made at EU and national level to counteract the crisis need to be backed by action at the subnational level. Therefore, the involvement of LRAs will be essential if the EU is serious about achieving the goals set in its strategic and economic documents. However, it is still rather early to evaluate the impact these changes will have on the division of powers. Indeed, while some EU documents clearly emphasise the importance of LRAs' involvement, others are more ambiguous.

In the EU, the economic crisis has led to significant developments in terms of economic governance, which will have a direct impact on LRAs. Not only will subnational budgets be subject to increased attention due to stricter fiscal surveillance, but some innovations in EU policies are also likely to affect the budgets of some LRAs. However, most of these innovations have not reached their final forms, some, like macroeconomic conditionality, being very disputed by the different actors involved in the negotiations. While the Commission argues that sound economic policies should underpin spending made through structural and cohesion funds, the CoR remains very reticent. In its opinion on the MFF post – 2013³, the CoR reiterates that it is strongly against any form of

¹ Van Cauwenberghe, J.C. (2007), Chamber of Regions, The Congress of Local and Regional Authorities, *Study on the current situation concerning regionalisation and the prospects for developing regional self-government in Council of Europe member states*, p. 43.

² Council of Europe, the Congress of Local and Regional Authorities (2009) *Regional Democracy, Council of Europe Reference Framework*, p. 7.

³ CdR 283/2011 fin, Opinion of the Committee of the Regions, The New Multiannual Financial Framework Post-2013.

macroeconomic conditionality, as it may cause LRAs to lose funding due to decisions made by national governments.

The Europe 2020 Strategy

Approved by the Heads of State and Government of EU MSs in June 2010 as a successor of the Lisbon Strategy, the Europe 2020 Strategy is a key building block in the EU's new strategic framework. It introduces the strategic goals of the Union, to be achieved at national and EU levels, with a focus on three priorities - smart, sustainable and inclusive growth. The Strategy sets five targets for 2020 in areas crucial for the EU's future – employment, innovation, climate/energy, education and social inclusion – and seven flagship initiatives, structured according to the three priorities mentioned above⁴. The targets and flagship initiatives proposed by the Strategy will be implemented with financial means provided by the Multiannual Financial Framework (MFF) 2014 – 2020.

Subject to the pending negotiations, the forthcoming MFF is thus highly likely to focus on delivering the objectives of the Europe 2020 Strategy. However, despite attempts at EU level to set a strategic direction and concentrate funding on overarching priorities, the success in achieving the Strategy's priorities greatly depends on efforts made within MSs. This implies concerted action at national and subnational level, with LRAs having both great potential and great responsibilities in meeting the objectives. These objectives will be specified in national programming documents, for example the National Reform Programmes (NRPs), which aim to transpose EU priorities and targets to the national level. However, while the Europe 2020 Strategy will surely impact LRAs' budgets and their involvement is essential for achieving the Strategy's targets, references to them or to the way in which subnational budgets should reflect Europe 2020 priorities are not at all clear or straightforward.

Funds covered by the Common Strategic Framework

In its communication for “A Budget for Europe 2020-Part I”, the Commission introduced the Common Strategic Framework that consists of five funds⁵ with structural aims and accounts for a large part of the total budget. Among these funds, three of them will be dedicated to financing economic, social and

⁴ The seven flagship initiatives are: ‘Digital Agenda for Europe’, ‘Innovation Union’ and ‘Youth on the move’ referring to smart growth; ‘Resource-efficient Europe’ and ‘An industrial policy for the globalisation era’ aimed at the sustainable growth priority; ‘An agenda for new skills and jobs’ and the ‘European platform against poverty’, which are targeted at the inclusive growth priority.

⁵ These five funds are: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).

territorial cohesion that will represent 36.7% of total resources in the next programming period⁶.

The CSF was presented as an overarching provision setting out common rules for all five funds, intended to help simplify the use of funds by beneficiaries. In its opinion from May 2012, the CoR states its support for this strategic approach of the CSF, as it is expected to entail better coordination between the different funds⁷. In practice, the CSF is meant to constitute the basis for MSs for drafting their PC, a strategic document signed between individual states and the European Commission defining the priority areas for funding. The degree of involvement of LRAs in drafting these strategic documents would depend on each national government and may vary considerably.

In the abovementioned opinion, the CoR underlines that LRAs should be ‘fully involved in preparing, negotiating and implementing the various strategy documents’⁸, especially the CSF and even more so the PC. This is called for in accordance with the principle of multilevel governance and in congruence with the division of powers among the different levels of government in each MS. In line with the partnership principle, it is important that all competent LRAs are actively involved in drafting these documents.

At the same time, other innovations introduced in the draft legislative package for Cohesion Policy 2014-2020, such as the increased concentration of funding on the priorities of the Europe 2020 Strategy, imply important changes in the design and implementation of the policy. While this measure aims to increase focus on effective and efficient spending, it will also limit LRAs’ room for manoeuvre in exercising their budgetary powers and might pressure them to provide a contribution to Europe 2020 targets at the expense of regional/local specificities and needs. However, as mentioned earlier in this paper, the final form of all these innovations has not been agreed yet, with strong differences in opinions making negotiations more intense. For instance, while the CoR welcomes the introduction of those ex-ante conditionalities that would serve as instruments for improving efficiency, it strongly opposes the introduction of any kind of macroeconomic conditionality. The Commission Staff Working Paper on the ‘Results of the public consultation on the conclusions of the fifth report on economic, social and territorial cohesion’ also mentions that LRAs manifested a strong opposition towards macroeconomic conditions, seeing them

⁶ See: <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/468>

⁷ Committee of the Regions, 95th plenary session, 3-4 May 2012, *Opinion of the Committee of the Regions, Proposal for a general regulation on the funds covered by the Common Strategic Framework*, p. 4.

⁸ *Idem*, p. 3.

as ‘potentially counter-productive, because they could penalise regions in less performing Member States, despite their successful management of EU funds’⁹.

New European economic governance

The recent developments of the European economic governance not only aim at increasing coordination of economic policies but also at bolstering the surveillance and advisory role of the European level. These developments will have a direct impact on LRAs in the sense that while they do not necessarily intend to give more budgetary powers to LRAs, they do mean to improve coordination among different levels of governance and ensure budget balances at all levels. The new economic governance comprises a series of key instruments: the (revamped) Stability and Growth Pact (SGP), the European Semester, starting with the presentation of the Annual Growth Survey (AGS), and the Treaty of Stability, Coordination and Governance (TSCG). The common denominator in all of these instruments is increased coordination, aligned priorities and reinforced surveillance. These principles have been put forward as proposals in a report presented by the President of the European Council, Herman Van Rompuy, called ‘Towards a genuine Economic and Monetary Union (EMU)’ at the European Council on 28/29 June 2012. This report specifies that an integrated budgetary framework would be a ‘qualitative move towards a fiscal union’ and a necessary step for a stable EMU encompassing some form of debt mutualisation. In more concrete terms, the report proposes that annual budgets’ and government debt levels’ upper limits be agreed in common. In addition, the measures proposed in the report are far stricter than the ones presented in the Commission’s ‘two pack’: under the report the EU would have the power to require changes to budgetary envelopes if they are in violation of fiscal rules.

The consequent implementation of this ‘robust framework for budgetary discipline’ will both require and facilitate coordination between the different levels of government on budgetary policies and procedures, bringing about both constraints and opportunities for LRAs. On the one hand, as conditions that MSs have to obey when drawing up their budgets become stricter, the role of LRAs in restoring fiscal sustainability becomes more important. Notwithstanding, this also entails stricter rules and conditions and enhanced enforcement at subnational level. As a consequence and as envisaged in the proposal for a regulation of the European Parliament and of the Council on the European

⁹ Commission Staff Working Paper ‘Results of the public consultation on the conclusions of the fifth report on economic, social and territorial cohesion’, 2011, p. 8.

system of national and regional accounts¹⁰, regional and local authorities will have to provide more detailed data to Eurostat. On the other hand, all these developments require more active involvement and efforts on the part of LRAs to increase transparency and adapt to the rules of the European system of accounts.

It is important to mention that EU-level mechanisms like the ones referred to above may also influence subnational budget cycles, making them more uniform across MSs and subjecting them to more scrutiny and control. In practice, the EU was influencing national budgetary cycles earlier on as well. With the intent of building a database of medium-term budgetary frameworks, the Commission regularly surveys¹¹ the existing frameworks and budgetary procedures in MSs¹². Evidence shows that a large majority of MSs have already put in place a domestic Medium Term Budgetary Framework for fiscal planning¹³, as a result of the Maastricht Treaty and the Stability and Growth Pact requirements. These budgetary frameworks required governments to ‘extend the horizon for fiscal policy making beyond the annual budgetary calendar’¹⁴. The new economic governance mechanisms reinforce these requirements, with the revamped SGP’s preventive arm stating that MSs have to make sure that their frameworks, at all administrative levels – national, regional and local – reflect the budgetary framework of the EU.

1.2. New trends in the division of powers between the national and regional/local levels

Almost all EU MSs have been going through processes of decentralisation over the past forty years, with countries like Spain starting the process as early as the 1970s, and others like Romania and Bulgaria having initiated it in recent years. Decentralisation usually starts by conferring to regions more responsibilities and the instruments they need in order to fulfil them, increasing their independence in making decisions and taking action. In Eastern Europe, this process has started relatively recently, given that communist regimes were based on the principle of total centralisation of state power.

¹⁰ See:

http://eurlex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lg=EN&type_doc=COMfinal&an_doc=2010&nu_doc=774

¹¹ Surveys done in 2006, 2008, 2009 and 2010.

¹² See: http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/framework/index_en.htm

¹³ See:

http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/documents/analysis_fiscal_framework_reforms_pfr_2010.pdf

¹⁴ See: http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/framework/index_en.htm

The impact of EU policies

The EU Cohesion Policy, with all the requirements attached to it for allocating structural funds, has a strong impact on national systems of government, in some cases, especially countries with low levels of regionalisation, triggering important reforms. Cohesion Policy and structural funds more specifically have impacted on EU MSs in different ways. Some countries benefit more than others from transfers and so are more willing to implement regionalisation and decentralisation in order to facilitate the use of these funds.

In the draft legislative package for Cohesion Policy 2014 – 2020, the Commission has proposed to introduce a number of changes in the way the policy is designed and implemented. Among these, it proposed to increase and facilitate the use of innovative financial instruments in order to maximise the leverage effect of the EU budget and cope with limited public finances. These financial instruments are to complement grant funding and support projects expected to generate substantial financial returns. Ready-made solutions at EU level and models for national and regional funds based on standard terms and conditions will be offered by the Commission and the possibilities for using these instruments will be extended, with the intention of simplifying and streamlining their utilisation. Also, incentives are given to encourage MSs to allocate Structural Funds to growth-enhancing projects and engage in loans in cooperation with the EIB. Hence, the conclusions of the European Council on 28/29 June 2012 indicate that MSs have the possibility to use part of their Structural Funds allocation to share loan risk and provide loan guarantees for knowledge and skills, resource efficiency, strategic infrastructure and access to finances for SMEs¹⁵. In addition, EU leaders decided at the European Council that the Project Bond pilot phase must be launched immediately. According to the Commission, these bonds will bring additional investments of up to €4.5 billion for pilot projects in key transport, energy and broadband infrastructures. Should the evaluation of the pilot phase be positive, the volume of these instruments will be further increased in all countries.

The introduction of such instruments might have a significant impact on subnational budgets. Facilitating their use could help alleviate some of the pressure on public sources of financing, especially since they are meant to combine public and private financial resources. However, LRAs will have to learn how to use these instruments and make the most of their advantages, which may prove to be a challenge.

¹⁵ Conclusions of the European Council, 28/29 June 2012, p. 12.

Overall, the institutional landscape at subnational level varies considerably in Europe. In addition, administrative powers and responsibilities at subnational constitute a moving target. They are influenced by two contrasting factors: on the one hand, by forces pushing towards regionalisation and decentralisation in different MSs, such as EU accession or structural funds allocation; on the other hand, by the reduction of central government transfers as a result of the crisis, which limits subnational governments' (hereafter SNGs) room for manoeuvre. However, according to Dexia¹⁶, in most countries regionalisation and decentralisation are reaching lower tiers of SNG, such as municipalities and provinces. More responsibilities, including fiscal powers, are transferred to the LRAs.

What autonomy for LRAs in Europe?

One way, perhaps the most common, of assessing the autonomy of LRAs is to look at their share in total government spending, where a larger share would be a sign of more independence. However, it is questionable if the degree of autonomy of a subnational governmental institution is actually proportional to the amount of money it spends or raises. The central state might have the power to direct subnational governments not only with regard to how much to spend, but also to what to spend on, for example through regulation or earmarked grants.

An important source of SNGs' revenues is represented by transfers from the state level. These transfers can be general, that SNGs may use freely, or earmarked, which have to be allocated to specific types of spending. A pilot study by the OECD in 2009 performs a detailed assessment of institutional, regulatory and administrative control of central over subnational levels of government and concludes that SNGs' discretion over their own budgets is limited. The study looks at a sample of five countries¹⁷ and at four policy areas, namely education, public transport, child care and elderly care. Among the conclusions it reaches, several are very relevant for the purposes of this note. On average, SNGs are more involved in policy fields with smaller share in the total public budget. Exceptions to that are policies like education and health protection. Nonetheless, the apparent transfer of responsibilities in these fields to SNGs is counterbalanced by the central government keeping the essential regulatory and financial powers. Overall, the study concludes that spending power indicators show relatively low SNGs spending autonomy, especially when compared to the results from analysing the more commonly used share in total government spending.

¹⁶ Dexia (2008), *Sub-national governments in the European Union. Organisation, responsibilities and finance*, p. 11.

¹⁷ The five countries the study looks at are: Germany, Switzerland, Denmark, Portugal and Slovak Republic.

The responsibilities of SNGs are usually set out in laws and only rarely in the Constitution of a state. Most often, the legislation does not present the allocation of specific responsibilities, but makes reference to the principle of subsidiarity, according to which action is to be taken at the most relevant level of government. According to Dexia¹⁸, LRAs' responsibilities may be distinguished by their nature: own responsibilities, usually concerning issues of local interest, delegated responsibilities performed on behalf of the central government or other subnational authority and responsibilities shared with other institutional levels. In most cases, delegated responsibilities are financed through state transfers, while own responsibilities are financed by local funds. In order to carry out the abovementioned responsibilities, LRAs may have regulatory powers, power to levy taxes, administrative powers and management powers. According to Dexia¹⁹, legislative powers of regions depend on whether the state in question is unitary, regionalised or federal²⁰:

- in non – regionalised unitary states, the central state has sole regulatory power;
- in federal and regionalised states, central governments' responsibilities are clearly defined. In regionalised states these are presented in the Constitution and the regions have exclusive legislative powers in all sectors that are not specifically under central state control.

Cooperation among different levels of government

With few exceptions, responsibilities of intermediary levels of government (provinces, departments, counties etc.) are considerably more limited than those of regional or municipal levels and they have diminished even further in recent years²¹. Another notable trend in Europe is inter-municipal cooperation, according to which municipalities can pool resources and 'find a size more adequate for handling certain responsibilities such as waste, water and public transport'²². This type of cooperation is usually voluntary, although it can be encouraged by direct or indirect financial incentives or organised as an independent cooperation structure that is a legal entity. Dexia²³ also mentions the existence of formal and institutionalised cooperation among different levels

¹⁸ Dexia (2008), *Sub-national governments in the European Union. Organisation, responsibilities and finance*, p. 59.

¹⁹ Dexia (2008), *Sub-national governments in the European Union. Organisation, responsibilities and finance*, p. 58.

²⁰ Among the 27 EU MSs, 22 are unitary states, 2 are regionalised (Spain and Italy) and 3 are federal (Germany, Austria and Belgium).

²¹ Dexia, 2008, *Sub-national governments in the European Union. Organisation, responsibilities and finance*, p. 63.

²² *Idem*, p. 66.

²³ *Idem*, p. 68.

of SNG that are set up for various purposes, among which to manage joint projects or co-funding.

1.3. Impact of the crisis on the composition of subnational budgets

As a general trend, the significance of the subnational public sector in EU MSs has increased over time, both in the West and in the East, even though its importance varies considerably from one country to another. The economic crisis has significantly affected the composition of subnational budgets, having effects not only on the expenditure and the revenue sides, but also on the level of debt.

Subnational public expenditure

On average, the EU subnational public expenditure as a percentage of aggregate GDP was 17% in 2010²⁴. By economic function, the main components of LRAs' expenditure, in provisional 2010 values, were social protection – 20%, education – 18.3%, general public services 13.7%, healthcare – 13.2% and economic affairs – 12.2%²⁵.

Unsurprisingly, subnational expenditure has stagnated in 2010 after a decade of sustained growth. However, there are significant differences across economic functions and expenditure categories; for example, capital expenditure appears to have fallen markedly. Generally, subnational public expenditure by type in the EU is dominated by current expenditure, which consists mostly of staff costs, social benefits and other transfers, and other operating expenditure. According to Dexia²⁶, current subnational expenditure registered only moderate growth in 2010 as compared to previous years. According to the same source, staff costs and spending on goods and services declined considerably, while social expenditure remained high.

While both national and subnational government spending has been counter-cyclical over the past 30 years, the OECD²⁷ concludes that spending at subnational level fluctuated less, partly because SNGs are usually responsible for policy areas less prone to cyclical behaviour, like education. The same research states that while spending seems to be more stable at subnational level,

²⁴Dexia and CCRE CEMR, EU Subnational Governments. 2010 key figures. 2011/2012 edition.

²⁵ Eurostat online database.

²⁶ Dexia, (2011), *Subnational public finance in the European Union*, p. 11.

²⁷ OECD (2010), OECD Network on Fiscal Relations across Levels of Government, *Fiscal Policy across Levels of Government in times of crisis*.

investment tends to fluctuate more at this level. In other words, while in most cases spending needs to be maintained at a certain level even when confronted with budget constraints, investment is easier to cut.

Subnational public revenue

On average, the EU subnational public revenue represented 16.2% of GDP in 2010²⁸. The structure of subnational government revenues varies across Europe, but we can identify several common features. The largest source of revenue for subnational budgets is grants and subsidies – from the central state, the EU or other levels of subnational government. The other two important sources are revenue from the operation of goods and services provided at subnational level and tax revenue from businesses and households.

After a steady increase over the last decade, subnational revenues are found to have dropped on average in 2010. Notably, in about half of the MSs revenue has actually increased, whereas the other half has seen a drop in revenue. This trend is associated with budget cutting measures taken by central governments (i.e. a drop in grants). In addition, revenue from user fees and charges is said to have increased on average, whereas tax revenue has slightly fallen. When talking about the impact of the crisis on the composition of subnational budgets, revenues are expected to fall as a consequence of that, the extent of their decline depending on the sources of these revenues – grants or different types of taxes. According to OECD²⁹, countries where business taxes account for a large share of SNGs' revenues will see a steeper decline in revenues at subnational level than countries where these rely more on property taxes. The same reasoning applies for personal income taxes versus indirect taxes. In the short term, subnational revenues will be cushioned from the impact of the crisis as long as the central level of government is still able to provide grants. However, earmarked grants – funds destined to specific categories of spending – are used more widely than general grants.

The OECD³⁰ finds that the extent of revenue fluctuations at subnational and national levels is similar, with more important differences being identified among countries, depending on the different tax structures financing subnational budgets and their reaction to the economic cycles. On average, SNGs' revenues present a lagged reaction to economic cycles, which point at 'differences in the

²⁸Dexia and CCRE CEMR, EU Subnational Governments. 2010 key figures. 2011/2012 edition.

²⁹ OECD (2010), OECD Network on Fiscal Relations across Levels of Government, *Fiscal Policy across Levels of Government in times of crisis*, p. 13.

³⁰ OECD (2010), OECD Network on Fiscal Relations across Levels of Government, *Fiscal Policy across Levels of Government in times of crisis*.

revenue mix between central and sub-central governments, and particularly at the role of intergovernmental grants over the cycle'³¹.

Subnational public deficit and debt

It is now obvious that the two trends – decreasing revenues and increased spending – will lead to increasing fiscal imbalances. With marked differences across countries, the subnational public deficit has increased on average and so did outstanding debt. The subnational public sector debt in 2010 represented 12.2% of GDP and 15.2% of total public debt³². According to OECD³³, the number of SNGs facing budget imbalances is increasing, as the crisis exacerbates the need for increased spending, while tax revenues are decreasing. SNGs' reaction to the crisis depends to a great extent on each country's structure of government and the level of autonomy these enjoy. The abovementioned OECD paper states that SNGs' deficits are usually lower than those of central governments, most probably partly because SNGs have to comply with fiscal rules that keep them from registering deficits.

The way of addressing territorial inequalities, including the issue of public debt, varies from one country to another. While the most common model of solidarity consists in vertical equalisation, i.e. in transfers from the central State to subnational governments, some countries have also developed horizontal equalisation models, which imply re-distribution mechanisms among same-level subnational governments.

³¹ *Idem*, p. 7.

³² Dexia and CCRE CEMR, *EU Subnational Governments. 2010 key figures. 2011/2012 edition*.

³³ OECD (2010), OECD Network on Fiscal Relations across Levels of Government, *Fiscal Policy across Levels of Government in times of crisis*, p. 3.

2. Methodology and fact-sheets' objectives

In order to reflect the significant changes shaping the economic and political context in Europe and impacting the division of powers between the EU, the MSs and LRAs, we believe that the country fact-sheets should follow four objectives:

- 1) Demonstrate how fiscal decentralisation and devolution have evolved over time;
- 2) Provide an overview of the structural organisation of budgets at the subnational level;
- 3) Illustrate the importance and impact of EU funds on subnational budgets; and
- 4) Track the impact of the economic crisis and austerity measures on LRAs' finances and on subnational public debt.

By following these four objectives, the country fact-sheets will not only enable the reader to understand the structure of subnational budgets and the fiscal and budgetary powers of LRAs, but also to better assess the impact of the economic crisis and EU policies on LRAs. While each fact-sheet will be country-specific, having a consistent structure articulated around the four objectives will allow a certain degree of comparability. We suggest therefore that the country fact-sheets should devote a section to each of the objective mentioned above.

More details about each objective are available below:

- 1) Development of fiscal decentralisation and devolution across the EU:

The fact-sheets should chart the budgetary and fiscal powers at local and regional level and provide an overview of the main reforms carried out in MSs to (re)assign (new) responsibilities to LRAs, as well as the corresponding changes in the structure of the budget of those entities. In Spain, Italy and Germany, for instance, regional revenues have been reinforced by new laws on

fiscal federalism. In this respect, it would be interesting to see where subnational budgets are covering new policy areas. This first part of the fact-sheet will allow seeing how the devolution of powers has evolved over time in each MS. Having such information for each country will help identifying whether the division of powers is mainly a domestic process or whether EU policies are the drivers of change.

2) Overview of the structural organisation and composition of budgets at the subnational level

A comprehensive understanding of the structural organisation of budgets of regions and localities requires an overview of budget cycles and duration, their eventual alignment with those of the European and central level, the eventual creation of subnational Multiannual Financial Frameworks, and the composition of budget by expenditure and revenue. All of this information will not only provide the reader with up-to-date information on the composition of subnational budgets, but it will also illustrate the concrete impact of EU policies in terms of budget cycles. Therefore, the year of the introduction of eventual multiannual financial frameworks at subnational level should be indicated in the fact-sheet.

Last but not least, given the complexity of the system of government and the existence of an intermediary level, the fact-sheet should aim to contain the same information for all subnational levels, i.e. the regional, the intermediary and the local one. Such information will allow analysis of which level has benefited most from the division of powers.

3) Importance and impact of EU funds on subnational budgets:

This section will indicate the share of EU funds, particularly structural and cohesion funds, in subnational budgets and the variation of this proportion across MSs. It would contribute to a better understanding of the significance of EU funds for each of them. Analysing how this proportion has developed over time and the repartition by thematic priorities would not only permit to identify trends in the importance of EU policies for specific regions and localities but also to assess what has been the impact of a (re)prioritisation of structural funds on LRAs. Ideally, this exercise should be carried out every year so that one can assess the evolution. However, it would be useful to have comparable information before and after the enlargement for the first edition issue of the fact-sheet in order to assess the impact of the enlargement on the repartition of EU funds.

4) Impact of the economic crisis and austerity measures on LRAs finances and on subnational public debt:

This section should shed light on to what extent austerity measures undertaken by the central government have affected subnational entities in terms of revenue and expenditure. This would also include figures on subnational public revenue, including internal transfer mechanisms and the share of European innovative financial instruments, subnational public expenditure as well as information about the level of indebtedness at the subnational level.

Other interesting questions relate to how the liabilities for subnational debt are shared across regions or with the central government. Furthermore, possible bail-out mechanisms should be examined.

3. Draft model fact-sheet

The structure of the template of the fact-sheet on the ‘Division of powers between the EU, the Member States and Local and Regional Authorities – Additional Fiscal/Budgetary elements’ presented below takes into account the structure of the fact-sheets developed in the context of the update of the study on ‘Division of Powers between the European Union, the Member States and Regional and Local Authorities – Constitutional aspects’ so as to facilitate the work of the CoR and ensure compatibility between the different fact-sheets. We indeed believe that a high level of compatibility and consistency between the different fact-sheets is a key element for facilitating the understanding of the public information provided to citizens. The structure of the fact-sheet is also based on the methodology and the four objectives presented in the section above. Last but not least, it is important to recall that such an exercise should be carried out on a regular basis to make it meaningful. Some categories of the fact-sheet presented below, in particular the one of Objective 3, underline the need for having data of different years in order to see the evolution over time. While this exercise is useful for the first edition of the fact-sheet, it will be no longer necessary if the fact-sheet is updated every year, as it ideally should be.

General Box for each MS

- Typology of MSs (unitary, regionalised, federal, hybrid) according to the constitution and the parliamentary system.
- Overall presentation of the institutional scene at the subnational level: total of regions, provinces, municipalities.
- Key principles, i.e. hierarchy between levels.
- Degree of financial autonomy enjoyed and total share of decentralised-run finances, as monitored by Dexia.
- Key legal sources pertaining to the fiscal and budgetary aspects of division of powers.

Objective 1: Demonstrate how fiscal decentralisation and devolution have evolved over time.

Main reforms	
Year	Changes brought by the reform

Objective 2: Provide an overview of the structural organisation and composition of budgets at the subnational level

Regional level	
Budget cycle	
Existence of multiannual financial framework (if applicable)	
Total amount (2010) in Euros	
Expenditure - Composition of expenditure by policy areas (2010) in percentages	
Revenue – Composition of resources by nature (2010) in percentages	
Intermediary level (if applicable)	
Budget cycle	
Total amount (2010) in Euros	
Existence of multiannual financial framework (if applicable)	
Expenditure - Composition of expenditure by policy areas in percentages	
Revenue – Composition of resources by nature in percentages	
Local level	
Budget cycle	
Total amount (2010) in Euros	

Existence of multiannual financial framework (if applicable)	
Expenditure - Composition of expenditure by policy areas in percentages	
Revenue – Composition of resources by nature in percentages	

Objective 3: Importance and evolution of EU funds in subnational budgets³⁴

Level of governance dealing with EU funds (it is often the regional level but might be the intermediary one in some countries)	
Importance of EU funds in the regional/local public budget in percentages (if information available)	
Repartition of funds by thematic priorities (if information available)	

Objective 4: Impact of the economic crisis and austerity measures on LRA finances and subnational public debt

Impact on subnational public revenue
<i>This section could contain information about the impact of the crisis on the level of transfers, be it from the central State or the same-level of government and on other sources of revenue such as operation of goods and services and tax revenue. Further, information on the importance of European innovative financial instruments could show how such instruments have compensated for the reduction in subnational public revenue.</i>
Impact on expenditure

³⁴ This table should include data from before and after the enlargement so that one can observe its impact on the repartition of funds across the EU.

<i>This section could contain information about the impact of the crisis on the composition of subnational public expenditure and look at what category (ies) and/or policy areas have been the most affected.</i>	
Public debt at subnational level	
Key principles with regard to solidarity mechanisms	<i>This section could provide information about whether some solidarity mechanisms (between the state and LRAs and/or between same-levels of government) are provided for by law.</i>
Fiscal rules about registering deficits	
Level of indebtedness for indebted regions in each MS	
Eventual bail-out mechanisms	

4. Prior work and available data

The existing work and available data are structured according to the four fact-sheets' objectives outlined in the previous section.

Objective 1: Development of fiscal decentralisation and devolution over time

The OECD (2012) paper on '*Reforming fiscal federalism and local government*' outlines the main lessons from fiscal relations reforms and presents country case studies for a sample of 10 countries, 7 of which are EU MSs.

The research carried out by Professors Gary Marks and Liesbet Hooghe (2009), '*The rise of regional authority: a comparative study of 42 democracies*', provides an index measuring the degree of decentralised autonomy for each of the 42 states that it analyses.

The Dexia report on '*Sub-national governments in the European Union*' (2008) draws on data extracted from Eurostat and provides comprehensive and country-specific information about the territorial organisation at the subnational level. It links variations across countries to the different responsibilities at the subnational level and provides an overview of reforms implemented and in the tube.

In its report '*A Study on EU Spending*' ECORYS (2008) identifies long-term trends with regard to assigning government functions – including expenditures and revenues – to subnational authorities.

In their paper on *The Taxing Powers of Subnational Governments: and the Role of Own Taxes in Italy: Issues and Perspective*, from 2008, Buglione E. and Maré M. look at main issues of fiscal federalism and tax decentralization in Italy, describing issues like the allocation of taxing powers to subnational level of governments, the use of these powers in the last ten years and the current structure of own taxes.

Other country – specific sources will be used to illustrate the developments in terms of fiscal decentralisation and devolution over time, like public finance and regional public finance laws or information presented on the websites of national ministries.

The *Study on the Division of Powers between the European Union the Member States and Regional and Local Authorities*, developed in 2008 by the European

University Institute for the Committee of the Regions, presents both general conclusions on the local and regional government in thirty European countries and a fact-sheet with detailed information for each of these states.

Committee of the Regions and European Commission (2007), *Structured Dialogue with Commissioner Joaquín Almunia-The role of regional, national and EU budgets in the Economic and Monetary Union* touches on the importance of reshaping budgetary competencies for the conduct of fiscal policy in the European Monetary Union (EMU).

For historical information, this can be drawn from the 2003 fact-sheets Committee of the Regions - *Devolution process in the EU and the candidate countries*.

Objective 2: Provide an overview of the structural organisation and composition of budgets at the subnational level

This objective requires an overview of different national ministries' websites, like those of ministries of budget, finance and economy, in order to identify information on, for instance, budget cycles and the degree to which subnational levels depend on the central level from this point of view.

The public finance statistics published by *Eurostat online* show the expenditure and revenue at central government, state and local level per sector/ type for each MS, Switzerland, Iceland and Norway. The statistics allow distinguishing between central government debt on the one hand and state and local government debt on the other hand for each of these countries (except Iceland).

The Dexia report on '*Sub-national governments in the European Union*' (2008) draws on data extracted from Eurostat and present information about the composition of the revenue, expenditure and debt at national and subnational level.

Objective 3: Illustrate the importance and evolution of EU funds on subnational budgets

In order to demonstrate the importance and evolution of EU structural funds in MSs at national and subnational levels, programming documents, such as the National Strategic Reference Frameworks (NSRFs) will be analysed. Also, information will be gathered from budgets published by LRAs on their websites, in cases where these include information on revenue from transfers from the EU. However, these sums may be difficult to identify, as in some states with a communist past, like

Romania, there seems to be no consistent way of identifying the amount of these grants at regional or county level. Moreover, in Romania, development regions are not political regions, but coordination structures set up for purposes of regional policy implementation. Therefore, budgets are not drawn up and information on EU funds is not aggregated at this level.

The country fact-sheets on *‘Priorities and Impact of Cohesion Policy in the Member States’* published by the Directorate-General for Regional Policy (2009) line out how the different parts of the MSs benefit from Cohesion Policy. However, inconsistencies and gaps have been identified in the information presented in these factsheets.

Objective 4: Track the impact of the economic crisis and austerity measures on LRA finances and on subnational public debt;

The OECD (2011) report on *‘Making the Most of Public Investment in a Tight Fiscal Environment’* examines the extent to which stimulus packages and austerity measures were divided between central and subnational governments and calls for better coordination between different levels of government. It also looks at a sample of eight European and non-European states.

The Dexia (2011) report on *‘Subnational public finance in the European Union’* elaborates on the way in which the subnational public sector in Europe is adapting to an environment marked by austerity plans, drawing on Eurostat data from 2010 and earlier.

The paper on *‘Public finances in EMU – 2011’*, published by the Directorate-General for Economic and Financial Affairs looks at current developments and prospects in EMU countries, the evolving budgetary surveillance, fiscal governance and debt sustainability in the EU.

The OECD (2010) publication on *‘Fiscal policy across levels of government in times of crisis’* illustrates the fluctuations in revenue, expenditure and debt over time in EU MSs. It also looks at the measures taken by central and subnational governments as a reaction to the economic and financial crisis.

In their analysis of the impact of the global financial crisis on subnational debt financing, *‘Subnational Debt Finance: Make It Sustainable’* O. Canuto and L. Liu (2010) provide information on the rising importance of subnational debt finance.

Open questions and missing information

While the country fact-sheets on the fiscal and budgetary division of powers among the EU, the MSs and LRAs should ideally present the elements mentioned in the description of the four objectives, it is important to underline that the required information and data are not available or presented consistently for all regions. It is partly due to the fact that the division of powers varies significantly among MSs. Therefore, the qualitative information on the impact of the crisis, though relevant, may not be available for all countries analysed, at national and subnational levels. Additionally, especially due to differences in the structure of governments across MSs, there might be difficulties in comparing available data and information.

As mentioned above, Eurostat data does not cover all of the countries which shall be included in the fact-sheets. Furthermore, it does not seem possible to examine how expenditure, revenue and debt are geographically distributed within each country. The fact that, in the above-mentioned report by Dexia (2011), certain items at a subnational level were reassigned to different categories to take reforms into account suggests that Eurostat might be able to share more detailed information on request.

Furthermore, there does not seem to be a comprehensive document available providing an overview of budget cycles, budget duration and structure at the subnational level in all MSs. It may be the case that this kind of information is only available via national or subnational authorities directly. Similarly, the share of EU funds in subnational budgets is rarely available.

Conclusions

The fiscal and budgetary measures currently discussed or implemented at European and national levels, in the context of the recent changes in the EU's political and economic frameworks, justify the need for extending the country fact-sheets previously drawn up by the CoR. Regularly updated fact-sheets on the composition and structural organisation of subnational budgets will enable conclusions to be drawn on the evolution of decentralisation, the EU's influence on this process and the coherence between devolution of fiscal/budgetary powers and the provision of adequate financing resources.

Recent changes in the political and economic context in Europe have led to three key developments, as analysed in this note. Firstly, interactions between the EU and regional and local levels have increased, with references to LRAs becoming more numerous in most strategic documents of the EU and beyond. This indicates a realisation of the fact that any efforts made at EU and national level to counteract the crisis need to be backed by action at subnational level. Furthermore, the autonomy of LRAs has indeed augmented as a general trend. However, it is important to underline that quantifying the degree of independence these authorities have is not at all straightforward. Last but not least, the impact of the crisis on the composition of subnational budgets is visible, with effects on subnational public expenditure and revenue trends leading to increased fiscal imbalances which, in turn, bring about higher levels of subnational public debt and deficit.

The above findings justify the selection of the four objectives the country fact-sheets will follow:

- Demonstrate how fiscal decentralisation and devolution have evolved over time;
- Provide an overview of the structural organisation of budgets at the subnational level;
- Illustrate the importance and impact of EU funds on subnational budgets; and
- Track the impact of the economic crisis and austerity measures on LRAs finances and on subnational public debt.

Following these four objectives, the fact-sheets will not only enable the reader to understand the structure of subnational budgets and the fiscal and budgetary powers of LRAs, but also to better assess the impact of the economic crisis and EU policies on LRAs. However, some challenges have been identified in the drawing up of fact-sheets for all EU MSs, as in some cases the information may not be available

or comparable for the different states and regions, especially regarding subnational governments' finances.

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