

Jackson, Marvin

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Marvin Jackson



Katholieke Universiteit Leuven

LICOS Centre for Transition Economics
Huis De Dorlodot
Deberiotstraat 34
B-3000 Leuven
BELGIUM
TEL: +32-(0)16 32 65 98
FAX: +32-(0)16 32 65 99
<http://www.econ.kuleuven.ac.be/licos>

Fiscal Decentralisation and Regional Development in Transition Countries

Marvin Jackson
LICOS Centre for Transition Economics
Faculty of Economic and Applied Economic Sciences
Catholic University of Leuven, Belgium

Abstract

This paper lays a foundation by reviewing the issues and the comparative dimensions of fiscal decentralisation in four subject countries - Bulgaria, Hungary, Poland, and Romania. It is divided into the following components. First, it briefly reviews the issues: the main points of the economic literature on the subject and the special challenges to the transition countries in bringing about subsidiarity or devolution. Second, it describes the institutional structures of sub-national government. Then it turns to a three-part review of statistics to compare the relative roles of central and sub-national governmental units in revenue and expenditures in both some EU countries and some transition countries. In Part IV of the paper revenue sources and sharing are examined. Part V examines central grants programs both for their overall roles and in terms of a special feature of the paper - *the extent to which central government grants programs are regressive or progressive across a country's sub-national units*. Part VI then looks at the expenditure side and the extent to which functional programs are decentralised to local governments. The paper is concluded by considerations of the connections between the local public and private sector development, especially in terms of strengthening market agents in the transition.

JEL classification: H70, O18, P35, R51

Disclaimer: Many observations and conclusions in this paper are made on the basis of information available from the participants, national sources, and international sources that were available at the time the paper was written in 1998, in most cases only through 1996.

Views expressed in the paper are those of the author and in no way are those of the LICOS Centre for Transition Economics, the Catholic University of Leuven, or the ACE Programme.

Executive Summary

This paper begins with a review of issues from both the economics of public finance and the economics of transition concerning the need for effective decentralisation of public decision making of the transition countries. Sub-national regional development, in transition countries as well as others, is the product of actions by both public and private agents. In the case of public agents in the transition countries, it is agreed that there have been urgent needs to decentralise the public economy as a way of invigorating public agents at the local level. Both intuitions about the over-centralisation of the former system and the body of economic theory consider the proper “vertical specialisation” of decision making concerning both revenues and expenditures to be important in setting levels of expenditures, making choices of revenue sources, allocating financial means across alternative functions, and achieving cost-efficient production of public and merit goods and services.

The paper provides a description of sub-national government organisation in the four subject countries of the project: Bulgaria, Hungary, Poland, and Romania. Then it follows this description with an empirical comparison of the fiscal structures of these transition countries and other European countries. It uses both the database on local governments collected by participants in this project and data assembled by the author from the IMF, *Government Financial Statistics* and national statistical sources. During this work, it becomes obvious that shortcomings in the data presently limit such an approach. For example, in the *GFS* (available at the time of writing) one finds no Hungarian data after 1990 and no Polish data for the period from 1988 to 1994. But limitations also apply to other countries as well. Greece, for example, has no table whatsoever for local government in the *GFS*. In fact, the analysis in this paper was usually limited to four or five transition countries and perhaps five or six other European countries.

The empirical information, presented in nineteen different tables and several diagrams, is not easy to summarise. In most cases variance was high in both country groups and that often the range of variation was similar, except for the other European countries that have a federal structure - Austria, Germany and Spain. One might have expected to find more visible support, so to speak, for the effects of transition on such variables as (1) the ratios of local revenues to central revenues in general and by major source of revenue, (2) the role of grants from the centre in local revenues, and (3) the ratios of local expenditures to central expenditures in general and by major function. This was not the case.

Some points of comparison can be mentioned. Overall ratios of government expenditure to GDP have fallen for transition countries and risen for other European countries since the late 1980s. But what is most remarkable about transition countries is the sharp decline in expenditures and revenues measured in real terms. There is no counterpart to this in other European countries. As might be expected, there has been more instability in local to central ratios of revenue and expenditure with general declines, as adjustments to transition have taken place. In terms of the share of specific revenues going to local units, both groups of countries allocated about 8-10 percent of tax revenues locally, but transition countries allocated small shares of non-tax revenue locally. In another comparison, the share of local revenues coming from individual income taxes was higher for transition countries than for other countries. It is difficult to explain this difference in terms of transition characteristics.

It remains to consider the many other specific comparisons made in the paper. Often this or that difference shows up between the two groups. But a dilemma is always the high variation among the individual countries within each group, and the fact that the range of high-low variation is usually quite similar. So far the distinctive features of transition escape the analysis. Perhaps this will require other techniques or more data.

The research behind this paper started out with the hope of also finding some connections between the behaviour of public and private economic agents at the sub-national level that might help explain patterns of local development. While a great deal of information has been collected towards this end, there was space to present it in this paper.

Introduction

There is good evidence, part of which has been collected in this project (Petraikos, Gorzelak, Nemes-Nagy, Totev, Zaman), that the initial phases of transition bring on forces that increase sub-national disparities. While some scholars see such forces as the more or less unavoidable consequences of geography (space, distance from the core, etc.), others find evidence of weaker responses to market opportunities in areas outside of capital cities, in old heavy industrial areas, on eastern borders, and in rural or agricultural areas. Perhaps properly motivated market agents are slower to take form in such places. A question motivating this paper is whether the lack of fiscal decentralisation and the weaker capacities for local public administration contributes to the problem. What is the connection between private and public agents on the local level in building the basis of market economies?

Concern with the connections between fiscal decentralisation and regional development arises from at least three sources. First, there is a line of public economics under the name fiscal federalism going back to Hayeck (1945), Tiebout (1956), Musgrave (1959), and Oats (1972) which argues that decentralisation of public and merit goods provision and correction of market externalities can be done most efficiently in many cases at the local rather than the central government level. Also, such a shift in the locus of public decision-making can bring benefits of increased political participation and of improved human and civil rights. Second, the Maastricht Treaty accepted the principle of subsidiarity (sometimes also referred to as “devolution”) as an obligation of the members of the EU and presumably it is a principle which underlies the *Acquis Communautaire*. Third, it is generally accepted that the system of decision-making and administration of public and merit goods in the former communist-ruled countries was too centralised either from the point of view of efficiency or of political democracy and, thus, the transition countries should generally engage in subsidiarity or devolution.

This paper lays a foundation by reviewing the issues and the comparative dimensions of fiscal decentralisation in four subject countries - Bulgaria, Hungary, Poland, and Romania. It is divided into the following components. First, it briefly reviews the issues: the main points of the economic literature on the subject and the special challenges to the transition countries in bringing about subsidiarity or devolution. Second, it describes the institutional structures of sub-national government. Then it turns to a three-part review of statistics to compare the relative roles of central and sub-national governmental units in revenue and expenditures in both some EU countries and some transition countries. In Part IV of the paper revenue sources and sharing are examined. Part V examines central grants programs both for their overall roles and in terms of a special feature of the paper - *the extent to which central government grants programs are regressive or progressive across a country's sub-national units*. Part VI then looks at the expenditure side and the extent to which functional programs are decentralised to local governments. The paper is concluded by considerations of the connections between the local public and private sector development, especially in terms of strengthening market agents in the transition.

I. The Issues

I.A. Fiscal Decentralisation in the Economic Literature

The standard argument for fiscal decentralisation. Inman and Rubinfeld (1997)¹ identify three principles of federalism: 1) it encourages an efficient allocation of resources, 2) it fosters political participation, and 3) it helps protect political liberties and freedoms.

Economic efficiency is promoted in much the same way that it is by a market economy. First, decentralisation to small jurisdictions allows a tailoring of outputs according to the diversity of spatially diverse publics. Second, it adds to the voice or voting power of the individual the option of *exit* or moving to a competing jurisdiction, which either provides a better package of public and merit goods or produces a given package at a lower cost. Also, it can stimulate innovation among competing local government units. Finally because it provides a sense of involvement and participation economically as well as politically, decentralisation should increase the supply of effort in the local economy.

The goods and services to be decentralised should be “congestible” in the sense that to accommodate additional households at one level, additional public facilities should be provided. In principle, the level of service should be such that the average cost per user just equals the marginal cost of adding one more user. That sets the efficient size of the community that should be created for provision of a given public or merit good. Communities as small as 10,000 households are thought to be efficient for education, police and fire protection, sanitation, recreation, and even public health.

The central government should provide pure public goods such as national defence or pure research. It should also be assigned to deal with externalities or spillovers across sub-national units. Some examples of the latter are 1) low-income maintenance, 2) regulation, and 3) assignment and collection of income and business taxes.

The central government can provide public goods and correct spillovers 1) by providing the good directly or mandating outcomes (quantity controls), and 2) by subsidising or taxing the local governments.

Opening the ‘black box’ of the public bureau. Quan and Weingast (1997) approach fiscal decentralisation using the tools of the new theory of the firm to open up the ‘black box’ of the public sector bureau in the same way that such theory opened up the ‘black box’ of the firm. Their main point is that fiscal decentralisation not only promotes efficient provision of public goods but also favours market institutions by restricting what Douglass North calls ‘state predation’ and encouraging public agents to promote enlargement of the tax base instead of increasing the tax rate.² Public agents without necessarily having malevolent motives are usually tempted to support

¹ This section of the paper has benefited from a number of recent papers on the subject, in particular four that appeared in the fall 1997 volume of *The Journal of Economic Perspectives*.

² North pointed out that historically state agents tended to choose increasing predation on market agents rather than providing the necessary public goods that promote market and economic development such as protection of private property, establishment of reliable weights and measures, reducing piracy, etc.

inefficient firms and public projects as well as to over-supply income transfer payments in return for public support in elections.

Borrowing from recent developments from the new theory of the firm they stress the importance of the central government deliberately giving up some information and authority in order to make a credible commitment to decentralisation. Since the theory in this case is somewhat esoteric their example can be cited as a means of explanation. China's central government allowed local governments to maintain 'extra-budget' accounts and even to use private accounts in the state bank under false names. This made it more difficult for the central authorities to monitor the local units and to tax away any local surpluses before it could be reinvested.

Sub-national government agents face many constraints common to private managers. In China and the U.S., for example, they can not finance deficits through a money issuing banking authority as is possible by the central government. In the U.S. there is an active market for city and regional managers that provides strong incentives to be efficient managers. Local politicians, who engage in predatory behaviour, over taxing or over regulating, will see mobile resources depart their jurisdiction. By the same token, those who effectively promote a literate and well-educated population, public order, reasonable infrastructure and other growth inducing public goods and services will attract mobile resources to their jurisdictions.

Problems and limitations of conventional decentralisation theory. Donahue (1997) summarises recent literature that has posed a number of problems and limitations to this seemingly simple approach. To begin with the number and configuration of public sector entities are more often determined by accidents of history. They are unlikely to nicely match the efficient sized units given by the economies of scale for providing various public goods and services. Boundaries of countries and their sub-national regions sometimes cut through densely integrated areas, sometimes even continuous urban developments. Although not impossible, compared to private economic units, changing government configurations through mergers, spin-offs, take-overs, and liquidations can be difficult and even provoke civil and military violence.

"Exit" decisions (movement from one jurisdiction to another) are usually not motivated by considerations of the package of services or cost efficiency. What has been called "citizens surplus" (cultural and ethnic affinities, ties to family and friends, economic and political networks, etc.) plays an important role. Mobility varies greatly across individuals and families. For example, more mobile persons are the retirees, single individuals, childless families, etc. Business enterprises may be more mobile than worker families.

Competition across jurisdictions can often have negative effects. Competitive subsidies for the location of enterprises can lead to a general decline in welfare. In terms of people, more mobile and more desirable persons (young, highly educated, etc.) will be favoured over others. Often, barriers will be set up to discourage unemployed, AIDS infected, social misfits, political radicals, etc. This reminds one of the flight of businesses and the young, more productive persons from the city centres to the suburbs.

When localities lack administrative experience, the central government might well take over tax collection. Yet this can violate the central government's credible commitment to decentralisation if the central government uses this information in ways that would discourage the local government's provision of demanded local goods and services.

Possible connections between fiscal decentralisation and income-equalising regional development processes. At first glance there should be no conflict between well-designed fiscal decentralisation and regional development leading to income convergence across regions. Cost-efficient provision of given public goods and services should increase per capita income. An assortment of public goods and services that matches voter preferences should increase voter satisfaction per unit of public expenditures. Local choices should increase local participation in both public life and economic activities. “Exit” from one region to another more fitting of an individual’s preferences should also simply raise the level of satisfaction from a given public expenditure across regions.

Unfortunately there are also a number of possible conflicts with income-equalising regional development processes. Local choices can conflict with central mandates for the location of freeways, regional and international airports, nuclear power generators, sewage and waste disposal facilities, prisons and detention centres. Localities may undertake to “dump” socially undesired persons on neighbouring localities by eliminating benefits. Local choices might cause general negative spillovers as for example when a local ethnic group refuses to teach a *lingua franca* in its schools, or a locally dominant religious group refuses vaccination against an epidemic disease. A major example appears to be that of the abandonment of American city cores by the white middle class beginning in the 1960s, although the issues in this case remain obscure.³

II.B. Special Problems Facing Transition Countries in Decentralisation

The overriding problem for transition countries is to change the inherited over-centralisation of decision-making and administration in order to provide efficient allocation of resources for public and merit goods and services and to stimulate their least cost production. At the same time there is a great need to stimulate democracy and local participation in the process. Achieving such dramatic structural changes in the public economy and getting it right is alone a formidable task. Unfortunately, there are other conditions and problems accompanying the transition that make decentralisation far more complicated.

Most transition countries undergo a general fiscal crisis. Initial expenditure levels are often swollen by subsidies and generous pension conditions (Sachs 1996). At the same time, major revenue sources of the former system such as enterprise profits, most of which were remitted to the state budget have tended to dry up as enterprises turned to loss makers or successfully hid profits. In such conditions central governments have hesitated to grant local governments the authority to tax sources which might be needed by itself. At the same time, central governments have been tempted to throw off unwanted functions to the local authorities. Locally the complaint is that new responsibilities come without new means of paying for them.

Table 1 provides comparative views of two aspects of fiscal conditions in the four subject countries: the overall size of government compared to the economy and the relationship of expenditures to incomes, again compared to the economy’s size.

³ Ethnic issues play a part of city decay although adequate discussion of them is difficult. Also, it seems as though the Latin- and Asian-American population may be accomplishing a grass roots revival of Los Angeles through small family businesses and light manufacturing.

Table 1 - Key Fiscal Indicators, 1989 to 1995								
	1989	1990	1991	1992	1993	1994	1995	1996
A. General government expenditures								
Bulgaria	58.4	65.9	45.6	45.4	48.1	45.7	43.0	47.6
Hungary		53.5	55.4	59.4	60.6	60.9	53.9	50.9
Poland	48.8	39.8	49.0	50.4	50.5	49.6	49.9	49.2
Romania	42.7	39.3	38.7	42.0	34.2	33.9	34.5	33.6
Spain						36.5		
Ireland						47.0		
Portugal						42.8		
Greece						42.9		
OECD average	44.5					49.5		
Reference middle income countries*						20.5		
B. General government balance								
Bulgaria	-1.4	-12.8	-14.7	-13.0	-10.9	-5.8	-6.4	-13.4
Hungary	-1.4	0.4	-2.2	-5.5	-6.8	-8.4	-6.7	-3.5
Poland	-4.7	3.1	-6.5	-6.6	-3.4	-2.8	-3.6	-3.1
Romania			3.3	-4.6	-0.4	-1.9	-2.6	-3.9
EU	-2.4	-3.6	-4.4	-5.3	-6.5	-5.8	-5.2	-4.4
Ireland	-1.8	-2.3	-2.2	-2.4	-2.2	-2.0	-2.4	-1.0
Spain	-2.8	-3.9	-5.0	-4.1	-7.5	-6.2	-6.6	-4.4
Greece	-14.4	-16.1	-11.5	-12.3	-14.2	-12.1	-9.2	-7.6
Portugal	-2.3	-5.5	-6.6	-3.5	-6.8	-5.7	-4.9	-4.0
* Reference countries: Argentina, Chile, Malaysia, Panama, Rep. of Korea, Swaziland, Turkey, and Zimbabwe.								
Sources: EBRD Transition Report Update various issues IMF, <i>World Economic Outlook</i> . May 1997. World Bank, <i>World Development Report 1986</i> .								

First, consider the size of government expenditures compared to GDP in the upper part of the table. In 1989 the then “socialist” countries tended to have large ratios of government expenditures compared to GDP, as might be considered a reflection of their systemic conditions. This difference is reduced in 1994 except in Hungary by increases in the OECD average and decreases in the other three transition countries.

Nevertheless, matters have been worse than they appear in this simple comparison. Ratios of government expenditures to GDP normally rise as per GDP capita increases. Thus, in this more analytical comparison all the transition countries have unusually high levels of government expenditure to GDP, as is suggested by the low figure just over 20 percent in Table 4 for a reference group of “middle income

countries”. In fact, according to the World Bank estimates ratios in transition countries equal those of “normal” countries having income levels ten times more.⁴

The second part of the table looks at budget balances. Here matters look more normal. The range of the ratio of deficit to GDP is not wider for the four transition countries than the for EU countries. An increase in the deficit-ratio seems to follow serious reforms, as is shown most clearly in Poland’s figures. Hungary, which delayed reforms, also experienced a delayed increase in the deficit ratio, but now both countries appear to be in control. Not so in Bulgaria’s case. Also, Romania is generating larger deficit ratios as its post-Iliescu government struggles to get reforms underway.

	1989	1990	1991	1992	1993	1994	1995	1996
A. Deflated current revenues								
Bulgaria	1.00	0.84	0.43	0.34	0.28	0.29	0.27	0.22
Hungary	1.00	0.93	0.86	0.83	0.88	0.92	0.79	0.76
Poland	1.00					0.90	0.94	0.96
Romania	1.00	0.73	0.78	0.67	0.55	0.54	0.59	
B. Deflated current expenditures								
Bulgaria	1.00	0.96	0.48	0.40	0.38	0.34	0.32	0.33
Hungary	1.00	0.89	0.85	0.87	0.89	0.93	0.80	0.72
Poland	1.00					0.79	0.83	0.85
Romania	1.00	1.03	0.68	0.66	0.47	0.53	0.58	
C. Share of taxes and profits on enterprises in revenues								
Bulgaria	0.37	0.30	0.40	0.30	0.21	0.23	0.22	0.25
Hungary	0.13	0.11	0.10	0.05	0.04	0.04	0.04	0.04
Poland	0.41					0.12	0.12	0.10
Romania	0.66	0.29	0.20	0.21	0.16	0.22		
Sources: Calculated from yearbooks and IMF <i>Government Financial Statistics</i>								

The fall of public resources in real terms. Table 2 looks behind the changes in central government revenues and expenditures by tracking estimated changes in their real levels, using consumer prices as a deflator. Poland followed by Hungary has come closest to maintaining real levels of both government revenues and expenditures since 1989. The worst case is Bulgaria. It not only has faced a reduction of government revenue and expenditures in 1996 to only about 25 percent of real levels in 1989, but also is the only country of the four that has seen revenues fall in real terms more than expenditures. No EU country has had such a large decline in real public sector resources.

It was characteristic of the socialist economy with state owned means of production that a major source of income for the state budget was profits from state enterprises, either as profit taxes or simply remittances of profits to the budget. After all the state was “owner”. In 1989 the shares of such income in the state budget ranged from 66 percent in Romania to only 13 percent in Hungary. As already noted, a major

⁴ A better view of this relationship is presented in the World Bank, *World Development Report 1996*, p. 114.

reason for the fall in state revenues was the collapse of profitability of state enterprises and then the inability of new governments to collect taxes from “corporatised” or “privatised” enterprises after transition began. In this case it was not only the problem of changing the tax system to accommodate new ownership forms, but also the fact that many enterprises in their new forms were loss making. In addition, arrears of taxes and social security contributions become a major problem.

Arrears of taxes and social security contributions. Table 3 shows that the flow of tax and social security arrears in Poland decreases after the economic recovery began in 1992-1993 in that country. Still, the stock of arrears would have increased in 1994 and 1995. Data for Hungary suggests that its arrears would have increased as a share of government expenditures at least through 1995. If Poland and Hungary set a pattern for transition countries, the worst would still be to come in Bulgaria and Romania. According to the OECD, tax arrears in Bulgaria were running 10 to 20 percent of main taxes.⁵

Local governments have found themselves having to assume many responsibilities formerly assigned to major enterprises such as maintenance of roads, ownership of housing, management of health facilities and educational units. At the same time, local shops, service establishments, and housing were returned to previous owners or otherwise privatised so a clearer line could be drawn between public and private realms. Often this brought local residents into serious conflict.

Such problems found few well-trained, local administrators.⁶ The problem was analogous to the initial lack of business managers for private enterprises. Although the former regime had numerous administrators at the local level, most were simply the police or functionaries of the old central apparatus or the party without training in modern public administration.

Relations between the centre and the provinces and localities were often soured by conflict between the new non-communist opposition and post-communist socialists. In Bulgaria and Romania, for example, the former tended to be strong in the capital and other larger cities. In specific localities in both of these countries there were also ethnic problems which were mixed with the political problems. In Bulgaria the Turkish political groups were in conflict with the former communist socialists (who had been responsible for their persecution in the 1980s and earlier) while in Romania the ultra-nationalist coalition partners of the Iliescu regime faced off against the Hungarian minority party in Transylvania.

⁵ OECD, *Economic Survey Bulgaria 1997*, p. 102.

⁶ It was the author's initial aim to include the decentralization of human resources in the public sector, quantity and quality, but data were simply not available.

Table 3 - Measures of Tax Arrears in Transition Countries						
A. The stock of tax arrears as a percent of GDP						
					1994	
Bulgaria					n.a.	
Hungary					7.5	
Poland					6.0	
Romania					4.6	
Czech R.					3.5	
Slovak R.					3.4	
B. As a percent of general government revenue (annual flows)						
	1990	1991	1992	1993	1994	1995
Hungary						
Percent of tax arrears only	0.9	2.8	3.1	3.7		
taxes	33.7	64.2	69.4	95.0	n.a.	n.a.
social security				135.9	186.7	205.0
Poland						
Percent of tax & social security arrears	2.4	9.4	9.8	11.1	9.4	7.5
Amounts (million zloty end of period)						
taxes	620	2830	3630	5223.3	5650.4	6009.4
social security	17.3	515.8	1467.8	3025.7	3861.3	4206.8
n.a. means not available.						
Sources: IMF, <i>World Economic Outlook</i> , May 1996.						
p.88						
OECD, <i>Economic Survey Hungary 1995</i> , p. 45; <i>Economic Survey Poland 1997</i> . p.						
41						

Finally, the incidence of new-type criminality and related corruption tended to be more deeply entrenched in the provincial areas. This added to the hesitation of both non-socialist and socialist governments to undertake serious decentralisation.

II. Changes in the Sub-National Structure of Public Administration and Self Government

Under the former regime, the intermediate levels of central government - *oblast* in Bulgaria, *megye* in Hungary, *województwo* in Poland, and *judet* in Romania - were agencies of administrative control through which the central government dictated and implemented policy. They oversaw the expenditures of local governments and were the channels for central fiscal flows to the localities. What the World Bank (1995) does not report is that the political structure of the communist parties also followed this structure and was most important for influencing the flows of resources for local development.

Since transition began in 1990, both deconcentration (a term favoured by the World Bank 1995) and political decentralisation (authentic local self-government by officials elected in multiparty politics) have been slowly developing. This has involved some collateral fiscal decentralisation. The special character of post-communist politics, as is most evident in Romania has retarded the process. As will become evident the processes of political and administrative decentralisation, like

those of economic decentralisation, have been slower in Bulgaria and Romania than in Hungary and Poland. By the same token, 1997 political changes at the national level in Bulgaria and Romania were expected to have important effects at the sub-national levels.

The World Bank (1995) report points out that, at the time of its preparation, no transition country had yet established an adequate political or administrative structure for designing and guiding the decentralisation process further. According to this report, only Poland had taken a step toward unified leadership by granting a coordinating function to the Council of Ministers and had established an intergovernmental task force. By contrast in Bulgaria regional governors are appointed by the Council of Ministers, while municipal councils manage the municipal level. Responsibility for local affairs in Hungary was split between the Ministry of Interior and the Ministry of Finance. In Romania the formulation of decentralisation policy and implementation of local government reform is the responsibility of both the Department of Local Government Affairs of the Office of the Prime Minister and the Department of Tax Administration and Local Budget Management of the Ministry of Finance and Economy. At the level of *judets* or province there is conflict between the centrally appointed prefectures and the locally elected councils.

Any attempt to provide a logical comparison of both the administrative and governmental structures even in the case of only four countries encounters a great proliferation of terms. There is hardly a standard nomenclature in this area in English. Moreover, this project's participants certainly faced even more confusion when consulting the available dictionaries. The World Bank report does not help matters in this regard. For example, why is the Romanian *judet* considered "a district" and the Polish *województwo* "a province", while a Bulgarian "*oblasti*" and a Hungarian "*megye*" are both "counties"?

The World Bank uses "municipality" not only for the Hungarian "*helyi onkormányzat*" (literally, local self-government), but also for the Bulgarian "*obshtina*", the Polish "*gmina*", and the Romanian "*comuna*", all of which are more correctly translated as "commune" in the normal European usage. In English, the first meaning of municipality is "a city, town, etc. having its own incorporated government"⁷. Hereafter in this paper, "commune" is preferred to "municipality" because it can apply to places which legally and according to the census definitions are either rural -although perhaps focused on a village - or urban. Also, larger towns and cities often are divided into "communes". Possibly an even more accurate rendition is "self-governing locality" when the unit actually is self-governing.

An additional problem is differentiating the designation of a sub-national area, which serves chiefly as a unit of deconcentrated administration, from a unit of sub-national government. This becomes clearer in the following summary of the evolving situation in each country, which is summarised in Table 4, below.

Bulgaria.⁸

The Bulgarian Constitution calls for laws and regulations on a civil service. But still in 1997 no legal framework for one had been established.

⁷ Webster's New Universal Unabridged Dictionary, 1972. A recent Romanian dictionary defines *municipiu* as "a large town or city with an important role" and the second meaning adds "autonomy in internal affairs" (*Dictionarul explicative al limbii Romane*, Bucharest 1996).

⁸ Sources: Panov 1995, Totev 1998, Commission 1997 (Bulgaria), IMF 1996.

Decentralisation is provided in the Law for Local Self-Government and Local Administration of 1991 and in 1995 the Law for Administrative Territorial Organisation. Up to 1987 Bulgaria's sub-national administration was divided into 28 *okraga* (singular:*okrug*) or provinces which merged into 9 *oblasti* or regions. At present, *oblasti* are the main sub-national units identified in the Bulgarian statistical yearbook (the data on the *okraga* came from this project's database). *Oblasti* have state appointed governors and according to the Constitution should have important functions. Their actual role at present seems in some question. The European Commission's paper on Bulgaria says, "The administrative organisation of the country depends on nine decentralised regional arms of the central government in which the regional Governor coordinates action by the State", but Totev (1998) says they are "not in effect performing any real administrative or executive functions". The *okraga* are still used for some administrative purposes or better said, their main towns are locations of local units of central administration.

Some 255 *obshtina* or communes carried over from the previous system and have become the local self-government units in the first reform law of 1991. Their elected mayors and councils serve four years. Within the *obshtina* are some 4000 *kmetskva* or settlements with elected mayors. Their administrative or governing functions are not known. There are also identified over 5000 *naseleni mesta* or occupied places, the largest of which are *kmetskva* and the lesser ones are grouped into one *kmetskvo*. As is the case in other countries, the capital, Sofia, and two other cities, Varna and Burgas, have subordinate *rayoni* or boroughs (a total together of 38 such units). *Rayoni* are legally possible in cities over 100,000 persons.

As of mid-1997 the then-new Bulgarian government planned to provide a new legislative framework that would replace the 9 *oblasti* with 12 to 21 *okraga* which would have rights of self-government. It was also intended that local self-government would be strengthened with greater economic and financial independence for the local units.

Hungary.

A basis of a civil service was laid down in laws of 1973 and 1990 defining the duties of higher officials, both of which were scheduled for amendment (as of mid-1997). A 1992 law regulated the proper basis of an extended Civil Service. Hungary's Law on Local Self Government was one of the first actions of its new parliament in 1990 and has been much supplemented since. At present there are 8 large administrative regions, 20 *megye* or provinces, and 3148 *helyi onkormanyzat* or local self-government units. Each region has a central office called a commissioner of the Republic with only two functions: 1) information gathering and dissemination and 2) monitoring local government actions to see if they are constitutional. A *megye* or province has been down graded in the new regime, retaining only minor fee revenue and serves only interjurisdictional functions for more than one commune or locality. Administratively there is a parallel system of 36 deconcentrated central ministerial organisations at the regional and provincial levels. Budapest has a special administrative and government status. Also, 20 other cities have rights as *megye* or province seats.

Some 196 other large towns and 2931 village communes are *helyi onkormanyzat* or self-governing localities with extensive expenditure responsibilities, the right to spend national transfers and shared taxes as they see fit, almost unlimited

power to borrow, own, and dispose of property and rights to manage, establish, or sell public enterprises. The number of local governmental units more than doubled from 1523 under the previous regime to 3148 at the time of writing. Although there is a growing number of associations of self governing localities, according to the World Bank report this has resulted in only a few successful efforts to deal with joint problems. At the higher level it is also reported that the regional commissions have found it difficult to co-ordinate either the central deconcentrated functions or the local governments.

Poland.⁹

Poland's Civil Service Act was only passed in July 1996. Decentralisation of administration and government is provided by a Local Government Duties and Power Act of 26 May 1990. The central government is administratively decentralised in 49 *województwo* or provinces. Actual local self-government takes place in 2549 *gminy* (communes). They have councils that are elected every four years. Large cities can be divided into *dzielnice* or boroughs, although only Warsaw has done this. An act in operation since the beginning of 1996 granted additional functions to 46 cities over 100,000 in education, culture, transportation and health. The *gminy* have extensive legal powers, but are de facto limited by the fact that about 85 percent of their income comes from the Central Government.

A *voivodship* or province is a "deconcentrated public service intermediary for certain central expenditures (mainly health and social services) with a budget that is described by Gorzelak and Roszkowski (1995) as "a set of 'sub-budgets', each of them under control of the budget of a given ministry". It has a chief who is appointed by the prime minister and an Assembly of Local Governments that carry out mainly advisory functions and whose representatives are elected by the council of a *gmina*. State administration is also carried out at the level of 267 *rejony* or districts (actually in some 250 medium-sized towns) and many other central expenditures are done at a local level by the ministries themselves. The 17 Regional Audit Offices (created in January 1993) conduct financial supervision of the *gminy*. Finally, the Central Planning and Central Statistical offices distinguish 9 macroregions, which have no political or administrative meaning. For more than four years there has been under discussion the creation of 10-20 large regions having elected councils and perhaps 250-75 *powiat* or district levels of local government also with elected councils.

Romania.¹⁰

Like Bulgaria, Romania still has no legal framework for a civil service. A framework for administrative and political decentralisation in Romania is provided by Law 69 of 1991 on Local Public Administration and Law 70 of 1991 on Local Elections. A two-tier system is made up of 41 *judets* or provinces and 2948 self-governing localities, of which 260 are cities and towns (*municipii* and *orase*)¹¹. Bucharest, the capital with its

⁹ Sources: Gorzelak and Roszkowski 1995, Commission 1997 (Poland), IMF 1996, and Committee for European Integration 1997.

¹⁰ Sources: Cornescu 1995, Anton and Cornescu 1998, Commission 1997 (Romania), and Romanian Government, *Green Paper*.

¹¹ Romania is sometimes divided for statistical purposes into 7 large historical regions, but these have no political or administrative character.

surrounding area has a special status, taking both of a *judet* and a self-governing unit. The surrounding area, called Ilfov Agricultural Sector, has a province status, with self-governing localities of which one is the capital city. Bucharest has two tiers, a centre (with mayor and city council) and six quasi-autonomous boroughs, which have elected mayors and councils. The latter are financially dependent on the city. Of the 260 cities and towns, some 200 have populations over 10,000 persons and make up about half of Romania's total population. At the other extreme are some 14,000 villages and hamlets without specific government and administration.

There are two parallel structures in each of the 41 *judets* or provinces. In one a prefect, who is appointed by the central government, oversees "deconcentrated" territorial activities of the centre. In the other an elected president of an elected council is responsible for "works of provincial interest", but has no hierarchical authority over the 2948 self-governing localities. This can include "co-ordination" of the strictly rural areas, but in urban areas town and city governments co-ordinate subordinate communes. The prefects have had the power to dismiss elected local mayors and town councillors on grounds of negligence or corruption. This led to much conflict during the years 1992 to 1996 when it was claimed such powers were used to get rid of opponents of the President's party or of officials elected in areas having large national minorities.

Table 4 - Name, Number and Size of Sub-National Government Units									
Country	Type	Name	Suggested translation	Number	Population - ths			Country Population in ths	Capital city pop in ths % urban population
					Average	Minimum	Maximum		
Bulgaria	administration	oblast	region	9	843.0	653.3	1,290	8,900	Sofia (20%) 1,313
	administration	okrug (okruzi)	province	28					
	local governing	obshtina	commune	255	29.8	1.8	51.0		
	administration	rayon	city borough						
Hungary	administration	kmetskvo	village	4000				10,300	Budapest (31%) 3,212
	administration	???	region	8					
	administration	megye	province	19	430.5	212.0	949.7		
Poland	local governing	helyi onkormanyzat	commune	3148	2.6	<0.2	243.3	38,400	Warsaw (9%) 2,235
	administration	???	region	17					
	administration	województwo	province	49	738.7	3.9	2,235.0		
	administration	rejon	district	267					
	local governing	gmina	commune	2459	15.6	0.9	848.5		
Romania	administration?							22,700	Bucharest (18%) 2,201
	administrative	judet		41	500.0	237.9	2,201.0		
	local governing	municipii/oras	city/town						
	local governing	comuna	commune	2948	6,954.0	<0.5			

Source: World Bank, Table 1.4, pages 16-17 and participant reports

The change in politics has seen efforts to regulate central control over the localities and to introduce real fiscal autonomy as well as to improve local administration and budgeting. Possibilities of joint work between local public officials and NGOs or even private enterprises have been introduced. Also, a framework for regional development is in the legislative process. It would permit associations of the provinces into development regions, set up a national regional development fund, and possibly divide the country into eight regions, one of which would be Bucharest and its surroundings.

III. The Structure of Revenues

In terms of revenues Table 5 does not show “shared revenues”, which will be more fully explained below nor does it show the contributions of local agents, households and companies, to centrally collected taxes. Another shortcoming is that at the time of writing this report the latest available IMF, *Government Financial Statistics*, the only source of standardised statistics, did not have Hungarian data beyond 1990, Polish data for the period, 1989 to 1993 inclusive, and Romanian data for 1995 and 1996. Although it would have been interesting to compare Greece with Bulgaria and Romania, Greece provides no data for local units. The attempt to match public finance data from the country yearbooks proved impossible. Also, Hungary’s *Regional Statistical Yearbook* did not show specific tax and non-tax revenue sources for its localities.

Table 5 - The Ratio of Sub-National Revenue to Total Government Revenue *							
	1990	1991	1992	1993	1994	1995	1996
Romania	0.15	0.06	0.04	0.06	0.07		
Poland	**0.29				0.14	0.15	0.17
Bulgaria	0.22	0.23	0.21	0.19	0.12	0.12	0.13
Hungary	0.12						
Czech Rep.				0.17	0.19	0.19	0.19
Greece							
Austria *	0.37	0.37	0.37	0.36	0.38		
Portugal	0.05			0.06	0.05		
Spain*	0.26	0.25	0.24	0.25			
Germany*	0.54	0.52	0.51	0.52	0.50	0.51	0.52
Netherlands	0.08	0.10	0.10	0.10	0.11	0.10	0.12
France	0.14	0.14	0.15	0.16	0.16	0.15	0.16
Italy	0.07					0.10	0.11
<p>* Does not reflected "shared revenues" or tax payments of local households and economic units to central budgets. ** Poland for 1988 when Hungary's figure was 0.14. Note: Italy for 1990 is 1989. * indicates both state and local units. Source: Author's calculations from IMF, <i>Government Financial Statistics</i>, 1995, 1996</p>							

Local revenue sources as a share of total government revenues have declined with transition (although one can not judge Hungary’s situation). Across the four transition countries there is no ready explanation of why the Romanian local share is so small. But it is not smaller than in Portugal’s case while the other transition

countries fall in the range of the Netherlands and France. Countries with exceptionally high sub-national revenue shares, Austria and Germany, are both federal states with important government functions at the “state” between the centre and the localities.

Allocation of Revenue Authority. A number of important issues confront the financing of sub-national governments in transition countries. Which kinds of taxes should be defined in terms of both tax base and tax rate by sub-national units, in principle, can be separated from the issue of which level should administer a given tax. For example, in order to minimise tax distortions it is considered useful to have uniform national rates of business income tax and value added tax. At the same time central governments usually have control of taxes which are most redistributive such as the personal income tax, even though the proceeds from such a tax can be shared with sub-national units.

Differentiated local rates of personal income taxes are thought to be less distortive than taxes on business enterprises. Sub-national governments need to have access to stable sources of revenue, the burden of which can not be escaped or shifted by moving activities across the sub-national unit border.

Transition tax assignment must take into consideration the initial weakness of localities in all administrative matters. This also applies to a second major source of local revenues which is user fees. Revenue short local administrations might be tempted to exploit service monopolies without thought to the possible discouragement of private economic development. Otherwise, in hopes of gaining income or wealth they might impede privatisation of facilities needed by the aspiring private sector

National-Level Revenue Sources. Revenue sources differ across countries, as shown by the national-level figures in Table 6. The table does not compare capital and grants income.

Transition national governments depend relatively less on tax revenues and more on non-tax revenues than do other countries in the sample. The greater share of entrepreneurial and property income may reflect the still remaining effects of state ownership of the means of production under socialism. The same historical influence might be reflected in the greater dependence on corporate profit taxes compared to individual income taxes. The latter were quite low under socialism, which directly regulated wages and salaries. Possibly a historical factor is also reflected in the very low share of property taxes. Finally, the transition countries also have a greater dependence on taxes on international trade.

Table 6 – Comparison of Sources of Fiscal Income of National-Level Governments, ca. 1995

	Bulgaria	Czech R	Poland	Romania	average transition	Austria	Greece	Ireland	Netherlands	Spain	average other	ratio of transition/other
Tax and Non-tax Revenue	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	
IV. Tax Revenue	74.52	94.82	90.86	88.18	87.97	91.09	90.49	94.74	93.34	92.70	92.47	0.95
1. Tax on incomes, profits, capital gains	18.92	14.44	25.71	29.94	22.25	20.66	32.66	39.90	25.86	29.57	29.73	0.75
1.1 Individual incomes	6.17	5.55	18.27	17.15	11.79	15.67	16.75	30.99	16.74	24.25	20.88	0.56
1.2 Corporate profits	12.76	8.89	7.44	12.79	10.47	3.65	9.56	8.91	9.12	5.13	7.27	1.44
2. Social security contributions	20.76	42.17	27.20	28.70	29.71	39.50	2.16	14.26	39.69	39.52	27.03	1.10
3. Payroll taxes	2.17		0.56		1.37	5.20		1.67			3.44	0.40
4. Tax on property	0.02	0.72			0.37	0.41	3.75	2.10	2.86	0.40	1.90	0.19
5. Domestic taxes on goods & services	25.79	32.62	30.73	23.01	28.04	23.20	48.39	32.02	23.51	23.20	32.06	0.87
5.1 V.A.T.	20.87	20.40	19.69	18.99	19.99	15.38	34.10	19.71	15.40	13.72	19.66	1.02
6. Tax on international trade	6.70	3.67	6.56	4.36	5.32	0.38	0.07	4.79		0.01	1.31	4.06
7. Other taxes	0.16	1.20	0.10	2.17	0.91	1.74	3.46		1.42		2.21	0.41
V. Non-tax Revenue	25.26	5.13	8.97	11.75	12.78	8.65	10.34	5.26	6.46	7.24	7.59	1.68
8. Entrepreneurial. & property income	12.51	1.94	2.78	8.74	6.49	5.11	6.78	2.53	3.89	4.01	4.46	1.45

Source: IMF, Government Financial Statistics

Table 7, which comes from the World Bank study, shows central taxes that are shared with sub-national units and then taxes and fees that are levied directly by local units.

Table 7 - Local Government Revenue Shares				
	Bulgaria	Hungary	Poland	Romania
Revenue source	1993	1994	1993	1993
<u>Central taxes</u>				
Turnover or value added taxes	0 or 100 ^a	0	0	0
Corporate income taxes	10 or 100 ^b	0	5	0
Personal income taxes	50	30 ^c	15	wage tax
Natural resources	n.a.	n.a.	n.a.	n.a.
Export taxes	0	n.a.	n.a.	n.a.
Tax on assets of locally owned state-owned enterprises	100	n.a.	100	100
Excise taxes	small amounts shared with centre	0	0	0
<u>Local taxes</u>				
Property taxes	100	100	100	100
Auto and road taxes	---	50 ^d	100	100
Small business taxes	---	100	n.a.	100
Agriculture taxes	100	n.a.	n.a.	100
Poll tax	n.a.	100 ^e	n.a.	n.a.
Other	Cost recovery charges & user fees	All tourism taxes & misc. local taxes	Misc. local taxes	Misc. local taxes
--- not available; n.a. not applicable; a - Local governments received the tax paid by municipal and private enterprises; central government received the tax paid by state enterprises. b- Local governments received all taxes paid by municipal and private enterprises and 10 percent of that paid by state enterprises. c - In 1990 the local tax share was reduced. Source: World Bank, table 1.10, pages 42-43.				

Tax sharing. Tax sharing has emerged as a major source of sub-national unit revenue. In Hungary, Poland, and Bulgaria some of the personal income tax is assigned sub-nationally. Romania initiated sharing of the wage tax in 1993. Nevertheless, in Hungary and Bulgaria the share of the tax assigned locally declined. In Hungary it fell from 100 percent of the tax derived locally in 1991 to 30 percent in 1994. And some localities receive no tax at all because the residents fall below the minimum taxable income. In Bulgaria the local share fell from 100 percent in 1991 to 70 percent in 1992 and only 50 percent in 1993. In Poland, the local share was 15 percent.

Bulgaria and Poland shared taxes on business profits. In Poland localities received only 5 percent. Bulgarian local governments received all profit taxes paid by municipal and private enterprises, and 10 percent of those paid by state enterprises. In

addition, the turnover tax and, in 1994, the V.A.T. paid by municipal and private enterprises were received by local governments in Bulgaria.

Table 8 - Sources of Total Local Government Revenues and Grants 1993 (percentage of total sub-national government revenue and grants)			
Country	Own tax	Non-tax or other revenue	Transfers and shared revenue
Part A. World Bank study			
Bulgaria	1.2	4.1	94.7
Hungary	4.0	19.9	76.1
Poland	25.7	18.8	55.5
Romania	17.0	6.0	77.0
Part B. GFS compilation			
Bulgaria (1993)	*47.0	**7.0	45.0
Hungary (1990)	*31.0	**24.0	45.0
Poland (1994)	*37.0	**33.0	30.0
Romania (1993)	*12.0	**21.0	68.0
*tax revenues. **non-tax revenue plus capital revenue.			
Source: World Bank, table 1.6, page 24, and compilation from IMF, <i>Government Financial Statistics</i>			

Two countries, Hungary and Romania, publish statistics on shared revenues. Table 9 shows this and in more detail below when specific revenue structures are compared. Table 8, Part A, presents a table from the World Bank study on the sum of grants plus shared revenues. By comparing this to a compilation from the IMF *Government Financial Statistics* suggests a measure of shared taxes. The comparison indicates that nearly all taxes on the local level in Bulgaria are shared. In the case of Poland from 12 to 25 percent of local revenues might come from shared taxes.

A problem is that the two data sets differ in important ways. For example, in the case of Romania the share of non-tax and other revenue (capital revenue) is smaller, 7 percent, in the World Bank study than in the *GFS*, a larger 21 percent. Thus, in the cases of Hungary and Poland one can not be sure that the differences arise only because the years of observation are different.

Tax authority and its application. According to the World Bank report, most of the taxes assigned to sub-national governments might be called “nuisance” taxes, which do not provide substantial and reliable revenue sources. Hungary has five local taxes including the property tax, a poll tax, a local business tax, and a bed tax in tourist regions. Hungary also has a local vehicle tax (only 7 percent at the time of the World Bank report). Yet, as can be seen in Table 12 such sources provide only 4 percent of revenues of its sub-national units.

Property taxes had been introduced in Hungary, Poland, and Romania by the time of the World Bank report and there was pending a property tax law in Bulgaria. In Romania the tax rate is set by the central government. It allowed such extensive exemptions to the tax base that the tax generated little income. Exemptions discriminated according to the social character of “private ownership”. In Hungary the central government also defines the rate and the base. In Romania, local governments have a right to both profit and dividend taxes levied by the central government on locally owned public enterprises. The World Bank report notes that, while local governments commonly claim rights over revenues generated in their areas, they

favour escaping fiscal responsibility by allowing the central government to set rates and define exemptions.

Table 9 - Indicators of Shared Taxes and Grants to Local Revenue*							
	1990	1991	1992	1993	1994	1995	1996
Bulgaria billion leva							
Total revenue	4.9	15.4	19.8	34.6			
Own source revenues	.5	6.8	1.0	1.7			
Shared taxes	2.5	11.2	9.6	16.1			
Profit tax	.4	4.3	4.3	4.0			
Income tax	1.9	5.0	4.3	7.6			
Turnover tax	.2	1.2	1.0	3.8			
Other				7.3			
Grants	1.9	3.6	9.1	16.7			
shared taxes to total revenue	0.51	0.72	0.49	0.47			
shared taxes to own source revenues	4.60	16.41	9.58	9.27			
grants to total revenue	0.38	0.23	0.46	0.48			
grants to own source revenue	3.43	5.28	9.10	9.59			
Hungary billion forints.							
Total current revenues						952	1153
Own ordinary revenues						163	217
Local taxes						46	81
Ceded central taxes						96	108
Grants				267	299	320	327
Payments by local governments to central government				1.4	.8	1.0	2.9
shared taxes to total current revenue						0.10	0.09
shared taxes to own ordinary revenues						0.59	0.50
grants to total current revenues						0.34	0.28
grants to own ordinary revenues						1.97	1.51
Romania billion lei							
Total local revenues				713	1767	3336	
Shared taxes				232	668	1203	
Grants				328	763	1200	
shared taxes to total local revenue				0.33	0.38	0.36	
grants to total local revenue				0.46	0.43	0.36	
* Data from country sources are not necessarily comparable. Sources: Bulgaria: World Bank Report. Hungary, Romania: Country general and regional yearbooks							

Table 10 suggests that it is difficult to draw sharp distinctions between transition and other countries in terms of the access of sub-national units to specific revenue sources. Looking at the group averages shows just about the same share of total tax revenues going to sub-national units. Smaller shares of non-tax revenues go to sub-national units in the transition countries, something which also shows up in the lower shares of entrepreneurial and property incomes. Yet the obviously high variability in such a small sample allows few robust conclusions.

Table 10 - Sub-National Shares of Specific Tax and Non-tax Revenues (Sub-national/Total Sub-National and National), ca. 1995														
	Bulgaria	Czech R	Hungary 1990	Poland	Romania 1994	average transition	Austria*	France	Germany*	Ireland 1994	Italy	Netherlands*	Portugal 1994	average other
IV. Tax Revenue (1-7)	0.11	0.13	0.08	0.08	0.22	0.12	0.22	0.10	0.22	0.02	0.06	0.04	0.03	0.10
1. Tax on income, profits, capital gains	0.33	0.47	0.28	0.12	0.01		0.35	0.08	0.47	0.00			0.02	
1.1 Individual	0.50	0.88	0.56	0.15	0.02		0.36	0.11	0.46	0.00			0.00	
4. Tax on property	0.82	0.54	0.00	1.00	1.00		0.74	1.00	0.98	0.52		0.35	0.91	
5. Domestic taxes on goods. & services	0.02	0.00	0.00	0.03	0.00		0.29	0.04	0.33	0.00		0.01	0.02	
3,6,7 Other taxes	0.00	0.02	0.00	0.01	0.43		0.28	0.67		0.00		0.64	0.00	
V. Non-tax Revenue (8-12)	0.11	0.35	0.21	0.38	0.06	0.22	0.28	0.41	0.45	0.53	0.28	0.42	0.14	0.36
8. Entrepreneurial & property income	0.05	0.17	0.17	0.06	0.00		0.59	0.23		0.46	0.08	0.34	0.07	
9,10 Fees, Sales, Fines	0.14	0.47	0.05	0.54	0.21		0.24	0.47		0.57	0.41	0.53	0.20	
12. Other non-tax revenue	0.27	0.24	0.86	0.29	0.16			0.32			0.97		0.16	
Calculated by the author from IMF, <i>Government Financial Statistics</i> * includes both "state" and local revenue shares.														

Property taxes go to sub-national units in both groups. In this respect, Hungary's situation reflects 1990 before property taxes were allocated to their local governments. The high direct tax shares taken by sub-national units in other countries is mostly a reflection of the special situation in federal states.

User fees. An initial problem in setting appropriate user fees was a tendency for central governments to mandate standard national charges without regard to local variations in costs. For example, in Hungary's case differentiated local costs for sewage and water provision were not possible until fee setting responsibilities were mandated to the localities. A common problem with user fees is a tendency to use subsidised prices as a form of income support. For example, as of mid-1994 none of the four countries in the study had household electricity prices set at long-run marginal costs.

Use of privatisation revenues. Although some privatisation responsibilities had been mandated to local government units (see above), the World Bank report observes that no restrictions had (at the time of the report) been placed upon the use of revenues from privatisation. In Poland, for example, such funds had been used to finance reoccurring operations of the central government with hardly any funds available to localities. In principle, there are no problems with such practices but it must be remembered that such funds are available only one time. By contrast, Hungary used foreign currencies generated in privatisation to pay down the foreign debt. This practice provided a long-term benefit as lower debt interest charges on the state budget.

Government arrears and borrowing authority and its applications. Sub-national government arrears were a major problem in Bulgaria and Romania at the time of the World Bank report. Hungary allowed its cities and local governments to borrow early on. Budapest was one of the first cases (going on at the time of the World Bank report). Local borrowing then became more widespread, but finally was constrained by the threat of the bankruptcy laws being applied to corporate public entities. In 1997 Romania gave some 26 cities and localities the right to issue debt obligations. Yet given the weakness of financial markets generally, local government borrowing will continued to be restrained in transition countries.

Table 11 - Sub-National Government Borrowing, circa 1993		
Country	Local borrowing authority	Local borrowing activity
Bulgaria	Limited borrowing authority but governments accumulate arrears	From Ministry of Finance
Hungary	Unlimited borrowing authority	Some municipalities have past debt. Minimal new borrowing
Poland	Limited borrowing authority	Debt service not to exceed 15 percent of revenue
Romania	No borrowing authority but governments accumulate arrears	Virtually no activity
Source: World Bank, table 1.7, page 26		

Table 12 - Composition of Sub-National Government Revenues

	Bulgaria	Czech R.	Hungary	Poland	Romania	ave	Portugal	Ireland	France	Austria		Italy	Netherlands	Germany		ave	ratio
	1995	1995	1990	1995	1994	transition	1994	1994	1995	1995	1995	1995	1995	1995	1995	others	transition
										state	local			state	local		to others
I. Total Revenue & Grants (II+VII)	1.00	1.00	1.00	1.00	1.00		1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00		
II. Total Revenue (III+VI)	0.57	0.73	0.55	0.71	0.58	0.63	0.51	0.26	0.64	0.56	0.86	0.32	0.30	0.83	0.67	0.55	1.14
III. Current Revenue (IV+V)	0.56	0.69	0.50	0.68	0.55	0.60	0.44	0.22	0.64	0.54	0.83	0.31	0.24	0.82	0.63	0.52	1.15
IV. Tax Revenue (1-7)	0.43	0.52	0.31	0.37	0.49	0.43	0.29	0.06	0.45	0.39	0.51	0.21	0.10	0.69	0.27	0.33	1.29
1. Tax on inc., profits, cap. Gains	0.38	0.49	0.31	0.19	0.03	0.28	0.04	0.00	0.07	0.22	0.19	0.00	0.00	0.37	0.00	0.10	2.84
1.1 Individual	0.27	0.46	0.31	0.17	0.03	0.25	0.00	0.00	0.07	0.18	0.16	0.00	0.00	0.32	0.00	0.08	3.06
4. Tax on property	0.03	0.03	0.00	0.14	0.06	0.05	0.20	0.06	0.16	0.00	0.05	0.00	0.04	0.04	0.00	0.06	0.89
5. Dom. Taxes on gds. & serv.	0.02	0.01	0.00	0.04	0.00	0.01	0.06	0.00	0.05	0.17	0.17	0.00	0.00	0.28	0.00	0.08	0.17
3,6,7 Other taxes	0.00	0.00	0.00	0.00	0.39	0.08	0.00	0.00	0.17	0.00	0.10	0.00	0.06	0.00	0.00	0.04	2.15
V. Non-tax Revenue (8-12)	0.13	0.17	0.19	0.31	0.06	0.17	0.15	0.16	0.19	0.16	0.32	0.09	0.14	0.13	0.37	0.19	0.90
8. Entrepren. & property income	0.02	0.02	0.12	0.01	0.00	0.03	0.02	0.06	0.02	0.02	0.04	0.01	0.06	0.00	0.00	0.02	1.40
9,10 Fees, Sales, Fines	0.07	0.12	0.03	0.26	0.05	0.11	0.03	0.10	0.15	0.13	0.29	0.04	0.07	0.08	0.25	0.13	0.85
12. Other non-tax revenue	0.04	0.03	0.04	0.03	0.01	0.03	0.10	0.00	0.02	0.00	0.00	0.04	0.00	0.00	0.00	0.02	1.49
VI. Capital Revenue	0.01	0.04	0.05	0.03	0.03	0.03	0.06	0.04	0.00	0.02	0.02	0.01	0.06	0.00	0.04	0.03	1.10
VII. Grants	0.43	0.27	0.45	0.29	0.42	0.37	0.49	0.74	0.36	0.44	0.14	0.68	0.70	0.17	0.33	0.45	0.83
18. From other levels of nat. government.	0.43	0.27	0.45	0.29	0.00	0.29	0.40	0.74	0.36	0.44	0.14	0.68	0.70	0.17	0.33	0.44	0.66

Source: Calculated from IMF, *Government Financial Statistics*

Comparison of the composition of sub-national revenue sources. In the overall comparison of revenue sources in Table 12, the group of transition countries average greater dependence on tax revenues and smaller dependence on grant revenues than the other countries in the sample. The slightly larger shares of capital revenues probably reflects revenues from privatisation rather than borrowing in financial markets.

The greater dependence on tax revenues in the transition countries can be traced to the quite big differences among the tax sources. Individual income taxes are much more important in transition countries, something which underlines the role of shared taxes. If the Romanian wage tax were counted as an income tax then the difference would be even greater. Taxes on goods and services play a much smaller relative role at the local level in transition countries compared to the other countries.

These two differences are surprising in the sense that individual income taxes would seem to be difficult to administer unless they are based only on withholding at the source. The number of possible tax payers is much larger than the number of businesses selling goods. Hence, it would seem direct income taxes are easier to avoid and evade than taxes on goods and services.

As in other comparisons, the ability to generalise on the basis of this relatively small sample is weakened by variability within the two groups of countries. Hungary might be an outlier in the transition group because its data reflects conditions in 1990 at the beginning of transition and not after its transition local revenue system has been further developed.

IV. Central Grants to Sub-National Governments

	1990	1991	1992	1993	1994	1995	1996
Romania	0.17	0.46	0.68	0.45	0.42		
Poland	**0.27				0.30	0.29	0.33
Bulgaria	0.16	0.26	0.38	0.45	0.47	0.43	0.34
Hungary	0.45						
Czech Rep.				0.30	0.28	0.27	0.38
Greece							
Austria *	0.27	0.28	0.29	0.29	0.27		
Portugal	0.44			0.44	0.44		
Spain*	0.49	0.51	0.53	0.54			
Germany*	0.21	0.21	0.29	0.28	0.27	0.24	0.24
Netherlands	0.76	0.70	0.71	0.71	0.68	0.70	0.65
France	0.35	0.36	0.36	0.36	0.35	0.36	0.35
Italy	0.80					0.67	0.64

Note: Italy for 1990 is 1989. * indicates both state and local units. ** 1988
Source: Author's calculations from IMF, *Government Finance Statistics*, 1995, 1996

Table 13 presents the calculation of the relative importance of revenues of sub-national units in the form of grants from central government. The data, as in other cases, comes from the IMF, *Government Finance Statistics*. Romania and Bulgaria both have seen the share of central grants increase in local fiscal income sources. With

that difference, the range across the two groups of countries is similar, with the possible exception of the high figure for the Netherlands. The World Bank report pointed out that only Hungary and Poland had explicit formulas for transfer grants that included an equalisation component and the complex formulation of expenditure needs. Romania, according to its recent *Green Paper*, has a grants program that covers financing of social investment projects. The *Green Paper's* authors say that the grants program "favours populated *judets* [districts] with substantial infrastructure assets at the expense of the lesser developed *judets*."

According to the World Bank study, in Bulgaria and Romania (and also in Russia and the Ukraine), empirical studies have been unable to determine a significant relationship between needs-based allocation criteria and income levels across regions or localities. A relatively simple investigation of such relationships has been undertaken for this paper, which is reported in Charts 1, 2, 3, and 4 and Table 14.

The slope coefficients presented in Table 14 indicate that Romania's local grants programs is, as claimed by the *Green Paper*, one that gives larger shares of grants compared to other local revenues to the higher income districts than to the lower income districts. So to speak, success is rewarded. Bulgaria's programs, by contrast, are what might be called "progressive" in the sense that greater shares of grants to local income are given to the lower income districts. Still, the extent of progressiveness declines from 1991 to 1995. Hungary and Poland both have mildly progressive grants redistribution, whether or not capital cities are included in the regression.

Table 14 - Slope Coefficients of Grant Ratios to Per Capita Income Measures for Districts							
Romania		Bulgaria		Hungary		Poland	
93 GDP	0.04	91 wage	-10.74	95 GDP	-0.40		
94 GDP	0.12			95 wage	-1.06	95 wage	-0.48
95 GDP	0.13	95 wage	-1.04	without capital city			
				95 GDP	-0.24		
				95 wage	-0.66	95 wage	-0.42

Calculated from data supplied by project participants and the author.

A question can be raised about the effects of measuring income with average wages rather than per capita GDP. Regressions of the two for Romania and Hungary shows that the ratio of GDP per capita to wages rises as wages or GDP per capita rise. Hence, it would appear that the Bulgarian and Polish local grant support programs would be even more "progressive" if one used measures of GDP per capita for their districts.¹²

V. Differences on the Expenditure Side

As in the case of revenues, one can explore the general comparative pattern over time and across countries of the ratio of local (and state) expenditures to total central

¹² Other issues can be raised such as the effect of end points on the slope of the regression line and the direction of casuality. These and other issues will be investigated in the follow up research to the project.

expenditures from the IMF *Government Finance Statistics*. In this case, interest payments are removed from central expenditures. Local expenditures of decentralised central agencies are not included.

The main difference between transition countries and other countries is the instability of figures for the former. The decline in local shares in Poland and Romania is not matched elsewhere, what happened in Hungary according to *GFS* definitions is not known. Instability in Bulgaria's case takes the form of first increases in local shares and then after 1992 decreases. The instability probably reflects both the budget crisis of central governments and adjustments to a new expenditure pattern.

As in other cases, one observes the quite high expenditure shares of federal states - Austria, Germany, and Spain. Otherwise, the range or diversity of shares is similar in both transition and other European country. Thus, aside from instability, no exceptional pattern can be found for the five transition countries in this data set.

Table 15 - Ratio of Local* to Consolidated Central Government Expenditures (local & state/consolidated central government expenditures minus interest payments)							
	1990	1991	1992	1993	1994	1995	1996
Romania	0.18	0.11	0.10	0.11	0.12		
Poland	***0.36				0.21	0.22	0.27
Bulgaria	0.25	0.32	0.39	0.32	0.30	0.29	0.23
Hungary	0.25						
Czech Rep.				0.30	0.26	0.27	0.31
Greece							
Austria **	0.48	0.49	0.51	0.50	0.50		
Portugal	0.10			0.11	0.10		
Spain**	0.47	0.50	0.49	0.47			
Germany*	0.73	0.67	0.77	0.78	0.75	0.74	0.73
Netherlands	0.33	0.36	0.37	0.36	0.35	0.34	0.37
France	0.22	0.23	0.23	0.23	0.23	0.23	0.23
Italy	0.36					0.33	0.37

* Does not reflected expenditures of decentralised units of central government.
Note: Italy for 1990 is 1989. ** indicates both state and local units. ***1988
Source: Author's calculations from IMF, *Government Financial Statistics*, 1995, 1996

The structure of expenditures of central governments. The functional structure of national-level government expenditures is reviewed, having in mind the chance that differences can be found for the transition countries that help explain patterns in sharing and assignments of functions to local governments. The most important comparisons brought out in Table 16 is the similarity in rankings at the top - social welfare, health, and then defence or education for both groups. Also, the transition countries spend greater shares on public services and order, defence, and economic functions, but smaller shares on education, social welfare, health, and housing. The latter is surprising because it seems to contradict the fact that transition countries spend large shares of GDP on social programs generally (Sachs 1996). Once more one is warned of the great variability within the two groups of countries.

Table 16 - Comparison of National-Level Government Expenditures by Main Functions, ca. 1995

	Bulgaria	Czech R	Poland	Romania	average transition	Austria	Greece	Ireland	Netherlands	Spain	average other	ratio of transition/other
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	
1+3.General public services plus public order & safety	5.23	13.04	8.38	7.40	8.51	7.99	6.37	8.41	9.55	5.39	7.54	1.13
2. Defence	4.92	5.48	3.86	7.44	5.43	2.06	7.43	2.96	4.00	2.93	3.88	1.40
4. Education	3.40	11.64	5.87	9.71	7.66	9.35	9.04	13.27	10.76	4.07	9.30	0.82
5. Health	2.75	17.10	11.14	8.12	9.78	13.12	6.76	14.91	14.06	5.92	10.95	0.89
6. Social security & welfare	18.69	24.99	50.10	28.79	30.64	44.99	17.93	27.03	37.66	39.07	33.34	0.92
7. Housing & community amenities	0.51	0.71	2.68	0.89	1.20	2.50	1.68	2.62	1.44	0.34	1.72	0.70
8. Recreation, cultural, & religious affairs & services	0.73	0.99	0.95	0.85	0.88	0.77	1.11	0.54	0.32	0.67	0.68	1.29
9. fuel & energy	0.73	1.98	0.56	0.51	0.95	0.02		0.76	0.17	0.29	0.31	3.05
10. agriculture, forestry, fishing, hunting	1.27	1.63	1.79	8.23	3.23	4.77	3.11	3.61	0.57	0.57	2.53	1.28
11. mining & mineral resources, manufacturing, construction	0.32	0.36	0.67	7.96	2.33	1.18	1.03	2.89	0.17	0.33	1.12	2.08
12. transport & communication	1.60	4.75	1.75	4.56	3.17	3.62	4.49	4.74	3.41	3.39	3.93	0.81
13. other economic affairs & services	11.24	3.80	0.65	5.65	5.34	0.22	1.06	2.66	1.06	2.30	1.46	3.65

Source: IMF, Government Financial Statistics

Devolution of expenditures for the support of and the production of public activities to sub-national government. There are two distinct activities. One is the location of decisions for expenditures (the “purchase” decision) for public activities. The other is the organisation of the production of such activities (the “production” decision). The two need not and probably should not be done by the same unit of government. The expenditure or purchase decision, according to Oates (1990), should be assigned to the lowest level of government that encompasses all or most of the service benefits, meaning the externalities associated with the public good. Organisation of production can be done either by another unit of government or by the private sector, according to the applicable economies of scale and the means of providing effective incentives to the producers.

It is generally thought that efficiency calls for central governments to be responsible for the expenditure or purchase decisions for 1) national defence, 2) basic postal services, 3) national roads and highways, 4) development of port and civil aviation facilities, 5) operation of sea and air navigation and traffic management, 6) regulation of inter-regional commerce, and other activities. The special realms for sub-national government are 1) construction and maintenance of local roads, 2) assurance of intra- and inter urban transit, 3) rural low density passenger transit, 4) water and sewerage, 5) garbage and other solid waste management, 6) parks and recreation facilities, 7) at least basic education at all levels, 8) promotion of basic health care services, and others.

Possible problems of fragmentation versus flexibility. The World Bank report considers fragmentation into too small local units to be a problem and suggests this is the case, for example, in Hungary, where the average size in the new system is only 2600 people. Half of Romania’s population lives in the 90 percent of local units with populations less than 3000. One fifth of Bulgaria’s 255 *obshtina* have less than 5000 people. A general comparison across the four countries involved in this study is found in the following table. A solution to fragmentation has been the encouragement of associations of local units, first in Hungary, then in Poland and Bulgaria, and soon in Romania. Such arrangements would seem to answer the need for flexibility when the economical scale of major activities is quite different.

Three somewhat different views of local expenditures have been encountered. Table 17 is a qualitative classification from the World Bank report on whether key functions are shared (S), assigned to sub-national units (SN), or assigned primarily to central government (C). It might be expected that this table would bear some identifiable relationship to Table 18, which is based on expenditure statistics in the *GFS* and shows the ratio of local (and state) expenditures to consolidated state expenditures by main functions. Thus, it answers the question of centralisation or decentralisation by which level spends the money.

Here are some problems. In Hungary’s case, while health is listed as (SN) assigned sub-nationally, the local expenditure share for health is only 16 percent. Also in Hungary’s case, police is SN, but its local share is nil. Possibly such divergences in Hungary’s case arise from the statistics being based on 1990 data, the latest available in the *GFS*, while Table 17 reflects reassignments done by 1993-1994.

Activity	Bulgaria	Hungary	Poland	Romania
Education				
Primary	S	SN	SN	C
Higher	C	C	C	C
Housing	SN	SN	S	SN
Water and sewerage	C	SN	SN	SN
Health	S	SN	C	C
Social services	SN	SN	SN	S
Roads	S	C	S	S
Police	C	SN	SN	C
Public utilities	S	S	S	SN
Public amenities	S	SN	SN	SN
Public services	S	S	S	S
S - shared responsibility; SN - Primary responsibility with sub-national government; C - Primary responsibility with the central government. <i>Items in dark italics have been moved up one level of centralisation according to specific statements made in the text of the World Bank report.</i>				
Source: World Bank, table 1.9, pages 32-33.				

From Table 17, the most decentralised activities across the four countries are housing, social services, and public amenities. The most centralised are higher education and health. The extent of centralisation appears to be higher in Bulgaria and Romania than in Hungary and Poland. There is a sharp contrast, for example, in the expenditure responsibilities for police services. In both Bulgaria and Romania there are four services that are provided primarily by central government and only three in the list provided primarily by sub-national government.

According to the World Bank report, in Bulgaria's case central mandates and pre-emption of local authority are pervasive. Differences in Tables 17 and 18 may arise when important local services are financed through local budgets, but there is no local control over the provision of most services. Local officials have little discretion over personnel expenditures in their budgets. In education, with local expenditures 74 percent of central expenditures (Table 18), the central government appoints school directors who control the hiring of personnel, although the mayor is legally responsible for such appointments. Localities have been subject to central mandates for payroll wage increases, which are often made without prior notice and without much attempt to determine the impact of the increases on local budget. In the case of municipal hospitals (see local expenditures at 76 percent in Table 18), the Ministry of Health often mandates expenditures down to details, even the number of hospital beds. Yet, a recent study reveals that some Bulgarian hospitals are operating at only 17 percent of capacity. Local governments, which must finance these facilities, are unable to do anything to reduce the excess capacity because of the central dictate.

In Romania, education and health is assigned to the central level. These functions in Table 18 have only nil and 17 percent shares, respectively, for local levels. The main spending responsibilities are assumed by local governments for water, local transportation, and district heating. These show up in Table 18 with local shares, respectively, of 84 percent (both housing and amenities) and 37 percent (transport & communication). No separate figure is given for district heating. Public

security, for which the local expenditure share is nil in Table 18, and fire protection are also provided throughout Romania by local branches of a central ministry.”

Other features in Table 18 are that transition countries generally have smaller local shares than the other European countries in the table, with health care a major exception. Housing and community amenities, and cultural activities rank among the highest local (& state) shares in both groups of countries. But a major difference is the very small shares of local governments in transition countries for public order and fuel & energy. The low figure for public order, one notes, is not always consistent with the assignments given in Table 17.

Table 19 contains the last calculation from the *GFS* that compares the composition of local (& state) expenditures by main function. The major difference in the two groups of countries is the much smaller share of expenditures for social welfare of the transition countries, 8 percent compared to 19 percent for the other European countries. At the same time, shares spent locally for education, housing and amenities, and transportation and communication are higher. Still, aside from the social welfare function, the general pattern across the two groups is rather similar. As in other cases, it is more the variation within the two groups that catches the eye. It is this variation that leaves one wondering, after all of this quantitative comparison, what the main features of transition public finance really are.

Table 18 - Sub-National Government Expenditures compared to National Government Expenditures by Main Functions													
	1994	1995	1993		1991			1990	1994	1995	1995		ratio
				Germany		Average						ave	transition
	Ireland	Netherlands	France	Total	state	local	other**	Hungary	Romania	Czech	Bulgaria	transition	to other
Total	0.25	0.24	0.18	0.39	0.23	0.16	0.26	0.19	0.10	0.20	0.22	0.18	0.68
General public services	0.08	0.31	0.26	0.34	0.22	0.18	0.25	0.12	0.23	0.35	0.28	0.25	0.99
Defence	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Public order & safety	1.00	0.27	0.28	0.92	0.90	0.72	0.62	0.00	0.00	0.12	0.02	0.03	0.05
Education	0.22	0.34	0.37	0.93	0.91	0.76	0.47	0.75	0.00	0.20	0.74	0.42	0.90
Health	0.49	0.05	0.02	0.28	0.16	0.17	0.21	0.16	0.17	0.08	0.76	0.29	1.37
Social security & welfare	0.07	0.16	0.09	0.23	0.13	0.13	0.14	0.06	0.02	0.08	0.09	0.06	0.45
Housing & community amenities	0.64	0.68	0.82	0.92	0.74	0.89	0.76	0.28	0.84	0.87	0.68	0.67	0.88
Recreation, cultural, & religious affairs & services	0.57	0.82	0.73	0.91	0.76	0.87	0.76	0.44	0.24	0.58	0.46	0.43	0.57
Economic affairs & services	0.25	0.29	0.29	0.45	0.32	0.25	0.32	0.17	0.10	0.24	0.12	0.16	0.50
fuel & energy	0.58	0.42	0.81	0.67	0.63	0.23	0.62	0.00	0.00	0.10	0.00	0.03	0.04
agriculture, forestry, fishing, hunting	0.02	0.01	0.00	0.67	0.64	0.22	0.18	0.16	0.01	0.12	0.05	0.08	0.47
mining & mineral resources, manufacturing, construction	0.00	0.34	0.00	0.05	0.05	0.00	0.10	0.00	0.00	0.00	0.00	0.00	0.00
transport & communication	0.42	0.40	0.42	0.44	0.28	0.29	0.42	0.31	0.37	0.43	0.22	0.33	0.79
other economic affairs & services	0.11	0.00	0.21	0.44	0.28	0.28	0.19	0.19	0.06	0.12	0.28	0.16	0.85
Other expenditures	0.04	0.18	0.00	0.43	0.38	0.12	0.16	0.00	0.01	0.03	0.00	0.01	0.07

Source: IMF, Government Financial Statistics

Table 19 - Share of Expenditures by Main Functions for Sub-National Governments, ca. 1995

	Bulgaria	Czech R.	Hungary	Poland	Romania	average	Austria state	France	Germany state	Germany local	Ireland	Netherlands state&local	average
	1995	1995	1990	1995	1994	transition	1995	1993	1991	1991	1994	1995	others
Total	1.00	1.00	1.00	1.00	1.00		1.00	1.00	1.00	1.00	1.00	1.00	
1. General public services	0.05	0.15	0.08	0.10	0.08	0.09	0.13	0.11	0.06	0.07	0.02	0.09	0.08
2. Defence		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3. Public order & safety	0.00	0.03	0.00	0.01	0.00	0.01	0.00	0.02	0.08	0.03	0.02	0.03	0.03
4. Education	0.33	0.10	0.42	0.23	0.00	0.22	0.21	0.20	0.22	0.10	0.11	0.18	0.17
5. Health	0.31	0.05	0.06	0.06	0.15	0.13	0.20	0.02	0.09	0.13	0.45	0.03	0.15
6. Social security & welfare	0.09	0.11	0.07	0.10	0.04	0.08	0.22	0.18	0.18	0.25	0.06	0.23	0.19
7. Housing & community amenities	0.14	0.29	0.11	0.40	0.42	0.27	0.04	0.24	0.04	0.18	0.14	0.20	0.14
8. Recreation, cultural, & religious affairs & services	0.03	0.06	0.06	0.05	0.02	0.05	0.03	0.08	0.02	0.07	0.02	0.06	0.05
9. fuel & energy	0.00	0.00	0.03	0.00	0.00	0.01	0.00	0.00	0.01	0.00	0.03	0.00	0.01
10. agriculture, forestry, fishing	0.00	0.01	0.00	0.02	0.00	0.01	0.06	0.04	0.04	0.01	0.00	0.00	0.03
11. mining, manufacturing, construction	0.00	0.00	0.08	0.00	0.00	0.02	0.02	0.00	0.00	0.00	0.00	0.00	0.01
12. transport & communication	0.02	0.15	0.09	0.02	0.24	0.10	0.05	0.00	0.04	0.07	0.10	0.07	0.05
13. other economic affairs & services	0.01	0.01	0.00	0.01	0.03	0.01	0.01	0.04	0.03	0.05	0.01	0.00	0.02
14. Other expenditures	0.01	0.02	0.00	0.00	0.00	0.01	0.02	0.08	0.18	0.06	0.02	0.11	0.08

Source: IMF, Government Financial Statistics

VI. Summary and Conclusions

This paper began with a review of issues from both the economics of public finance and the economics of transition concerning the need for effective decentralisation of public decision making in the transition countries. Sub-national regional development, in transition countries as well as others, is the product of actions by both public and private agents. In the case of public agents in the transition countries, it is agreed that there have been urgent needs to decentralise the public economy as a way of invigorating public agents at the local level. Both intuitions about the over-centralisation of the former system and the body of economic theory consider the proper “vertical specialisation” of decision making over both revenues and expenditures to be important in setting levels of expenditures, choosing of revenue sources, allocating of financial means across alternative functions, and achieving cost-efficient production of public and merit goods and services.

The paper provides a description of sub-national government organisation in the four subject countries of the project: Bulgaria, Hungary, Poland, and Romania. Then it follows this description with an empirical comparison of the fiscal structures of these transition countries and other European countries, using both the data base on local governments collected by participants in this project and data assembled by the author from the IMF, *Government Financial Statistics* and national statistical sources. During this work, it became obvious that shortcomings in the data available at the time the study was written limited such an approach. For example, in the *GFS* up to the time one finds no Hungarian data after 1990 and no Polish data for the period from 1988 to 1994. Greece, for example, had no table whatsoever for local government in the *GFS*. In fact, the analysis in this paper was usually limited to four or five transition countries and perhaps five or six other European countries.

The empirical information, presented in nineteen different tables and several diagrams, is not easy to summarise. In most cases it was found that variance was high in both country groups. Often the range of variation was similar, except for the other European countries that have a federal structure - Austria, Germany and Spain. One might have expected to find more visible support, so to speak, for the effects of transition on such variables as (1) ratios of local revenues to central revenues in general and by major source of revenue, (2) the role of grants from the centre in local revenues, and (3) ratios of local expenditures to central expenditures in general and by major function. This was not the case.

Some points of comparison can be mentioned. Overall ratios of government expenditure to GDP have fallen for transition countries and risen for other European countries since the late 1980s. But what is most remarkable about transition countries is the sharp decline in expenditures and revenues measured in real terms. There is no counterpart to this in other European countries. As might be expected, there has been more instability in local to central ratios of revenue and expenditure with general declines, as adjustments to transition have taken place. In terms of the share of specific revenues going to local units, both groups of countries allocated about 8-10 percent of tax revenues locally, but in transition countries small shares of non-tax revenue was allocated locally. In another comparison, the share of local revenues coming from individual income taxes is higher for transition countries than for other countries. It is difficult to explain this difference in terms of transition characteristics.

It remains to consider the many other specific comparisons made in the paper. Often this or that difference shows up between the two groups. But a dilemma is always the high variation among the individual countries within each group, and the fact that the range of high-low variation is usually quite similar. So far the distinctive features of transition escape the analysis. Perhaps this will require other techniques.

The research behind this paper started out with the hope of also finding some connections between the behaviour of public and private economic agents at the sub-national level that might help explain patterns of local development. Finally, a great deal of information has been collected towards this end, but space in the paper and time available for the project limited what could be done. The subject is worthy of further effort.

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