# Analysis of Fiscal and Tax Autonomy of Local government units in selected EU-13 Member States*

**Maja Grdinić[1]**
**Robert Matić[2]**
**Saša Drezgić3**

## Abstract

State and local governments in European Union member states have access to a large number of fiscal resources. The design of fiscal autonomy affects sub-central government's potential and determines outcomes of local government efficiency and equity in access to public services or the long term fiscal stance.
The increased spending responsibilities and the limited self-financing power of the local government units in most of the countries raise the question of the degree of their dependence on the central government. This is why authors find important to measure and assess the degree of tax autonomy of local governments in selected EU-13 member states by means of a set of indicators followed by the OECD classification of tax revenues for the last 10 years (2007-2016) and to determine one of the effects of fiscal decentralization – local self-government's tax autonomy. In this paper authors analyse which countries have less centralized collection of tax revenues and collected local revenues in the mentioned period. The goal of the paper is to assess the level of and differences in fiscal and tax autonomy and to employ comparative research from selected EU-13 member states where there are similar tendencies and processes in regards to fiscal decentralization.
The rich literature on fiscal federalism and fiscal decentralization has provided us with general guidelines which gives us a starting point when we think about the responsibilities of local government units and the fiscal autonomy they have. However, when we are analysing country practices, the difference between country experience and theory appears to be significant. In sum, the results show that along with transfers from central government, taxes are still the most significant revenue source for local government units but that only a small part is under effective control of local government units.

**Keywords:** EU-13, fiscal decentralization, local government, tax autonomy

## 1. Introduction

Tax policy is one of the most complex parts of economic policy, since it has to achieve different efficiency, horizontal and vertical equity as well as fiscal and tax compliance objectives. There is often a trade-off between those competing goals which has to be solved by policy making decisions.
The scope of the local government's fiscal autonomy varies across the countries as a result of decentralization processes in place. The search for the optimum degree and extent of decentralization is a problem addressed by the concept of fiscal federalism. This theory tries to provide solutions for the optimum organization of the country's administrative division in order to make the public sector more effective and more efficient and to properly allocate public goods. Tiebout (1956), Musgrave (1959) and Oates (1972), among the others, are main creators of traditional theory of fiscal federalism and intergovernmental fiscal relations. They conclude that the devolution of tax and expenditure authority to the local government contributes to the greater public sector

---

*The publication of this paper has been supported by University of Rijeka under the project "Pametni gradovi u funkciji razvoja nacionalnog gospodarstva" (uniri-drustv-18-255-1424)
[1] Assistant Professor, PhD, University of Rijeka, Faculty of Economics and Business, Rijeka, Croatia, e-mail: maja.grdinic@efri.hr
[2] PhD student at University of Rijeka, Faculty of Economics and Business, Maroni Ltd., Rijeka, Croatia, e-mail: matic12robi@gmail.com
[3] Associate Professor, PhD, University of Rijeka, Faculty of Economics and Business, Rijeka, Croatia, e-mail: sasa.drezgic@efri.hr

efficiency. In principle, the most important benefit from decentralization is the increased efficiency (and consequent welfare gain) that comes from moving governance closer to the people. Viewing government as a benevolent agent, Oates' well-known decentralization theorem states that in the presence of diverse preferences and needs, provision of public services by a decentralized government structure generally will lead to increased citizen welfare (Martinez-Vazquez et al, 2017). This is one of the basic arguments for decentralization, for the local delivery of public services and, as a consequence, for the establishment of local government units. Decentralisation has also been implemented as part of state reforms to improve efficiency and quality of public services, to enhance regional and local productivity and growth, to meet fiscal consolidation objectives in the aftermath of the recent economic crisis, or in response to the institutional programs of supranational organisations. Since the 1980's, many developed countries have increased their degree of fiscal decentralisation (Blöchliger and Rabesona, 2009).

Outcome of fiscal decentralisation much depend on the way the process is designed and implemented, on adequate subnational capacity, and on the quality of multi-level governance. When it is properly conducted and balanced across policy areas, there is evidence that decentralisation may be conducive to growth (Ebel and Yilmaz, 2002; Ivanyna and Shah, 2014; Iimi, 2005; Akai et al, 2004). Revenue decentralisation seems to have even more positive impacts. This seems to indicate the need to accompany the decentralisation of responsibilities with sufficient decentralisation of resources. Beyond economic benefits, decentralisation might allow enhanced accountability, transparency and citizens' engagement, thus improving democracy (Allain - Dupré, 2018).

Policy-makers ensure the expenditure and revenue functions of each tier of government with a view to balancing efficiency, equity and democratic considerations. Over the last decade, the tendency in a number of countries has been to decentralise both expenditure and revenue functions to lower levels of government. Greater autonomy in raising revenues has been given to intermediate and local levels of government (OECD, 2002.) 47 member states of the Council of Europe has in 1985 adopted "The European Charter of Local Self-Government" with a goal to promote and maintain bigger local autonomy and for promoting and protecting local self-government. The extent and scope of these tasks depend on the progress of decentralization processes (Ebel and Yilmaz, 2002). To address all local needs and to drive local development, the local government units are provided with adequate financial resources. Fiscal autonomy is a condition for the existence of self-government authorities. Strong and sustainable financial resources are the basis for socioeconomic development at local level.

The increased spending responsibilities and the limited self-financing powers of the sub-central government raise the question of the degree of their dependence on the central government. This is why we find important to measure and assess the degree of tax autonomy of local governments in selected EU member states by means of a set of indicators for the last 10 years (2007-2016) and to determine one of the effects of fiscal decentralization – local self-government's tax autonomy. We will analyse which countries have less centralised collection of tax revenues and collected local revenues in the mentioned period.

An intergovernmental system and tax sharing mechanisms relate to many other issues such as general level of fiscal decentralization of particular country, administrative-territorial organization, tax structure (both in general and in intergovernmental sense), quality and efficiency of local and central government. The main purpose of this paper is to assess the level of and differences in fiscal and tax autonomy of local government units across selected countries. The final goal of this research is testing the degree of tax autonomy of local governments in selected EU-13 member states, comparing local tax revenues and proposing measures and activities necessary for implementing the better model in the tax systems of the analysed countries. The selected countries (Croatia, Estonia, Hungary, Czech Republic, Latvia, Slovenia and Slovak Republic) have similar characteristics - they are unitary countries with similar political and socio-economic 'history', all of them were members of the former 'Eastern Bloc' and after 1989-1990 set on the path of transition from a highly centralized planning system to a decentralized free-market economy, facing a number of challenges.

The rest of the paper is organized as follows. Section two presents a theoretical background in the context of fiscal and tax autonomy and local government, section three describes a methodology and data used in this analysis. Section four gives some recommendations for decision makers both on central and local government level and section five concludes.

## 2. Fiscal and tax autonomy of local government units - theoretical background

Autonomy is a term which is associated with independence, sovereignty, and self-reliance in making one's decisions concerning her/his own matters. When we observe the context of territorial units, it can be defined as a right of a given population to take the decision for themselves of their internal affairs. It includes both the right to make independent decisions and the aspect of financing their activity. When it is used with reference to local territorial units, focus is placed on its three dimensions: the unit's freedom from central authority's intervention; the territorial unit's freedom to make decisions regarding meeting defined objectives; and the reflection of local identity (Pratchett, 2004).

If local governments want to be truly autonomous, most of the authors put the biggest emphasis on the importance of own resources and the possibility of making decisions about the way of spending those resources (Vetter, 2007; Pratchett, 2004).

According to Rondinelli (2000), the goal of decentralization is to increase local government`s sensibility concerning local living needs and conditions and to encourage greater representation of diverse cultural, ethnical and political groups in decision making process. It provides much better opportunities for all the local residents to be a part of decision making process and also provides national unit and political stability by allowing citizens more control over public programs at the local level. Bahl and Linn (1992) emphasises that when fiscal decentralization is properly structured, overall resource mobilisation will be increased as a result of easier taxation of the fast growing parts of their economic base by local governments.

But to make the process of decentralization successful, it is important how we design the system of fiscal autonomy because it affects sub-central government's financial opportunities and defines outcomes such as quality of provided public services, public sector efficiency and effectiveness, or the long term fiscal stance (Blöchliger and King, 2006). It is strongly suggested by both theory and experience in a variety of circumstances that if fiscal decentralization is to produce sustainable net benefits in countries, subnational governments require much more real taxing power than they now have (Bahl and Bird, 2008). The term "tax autonomy" (or taxing power) captures the extent of freedom sub-central governments exert over tax policy. It encompasses features such as sub-central government's right to introduce or to abolish a tax, to set tax rates, to define the tax base, or to grant tax allowances or reliefs to individuals and firms (Blöchliger and Nettley, 2015). Enhancing tax decentralization implies a better alignment between spending and funding responsibilities and, as remarked by several economists, a potential improvement of the efficiency (as well as of the effectiveness) of public services provided to citizens (Boetti et al., 2012). In line with this argument, Gemmell et al. (2013) find evidence of positive revenue decentralisation effects on growth in OECD countries during 1972 - 2005. Also, considering that fiscal or tax autonomy reflects better the decision-making power of local governments, it has given an additional boost solving and linking empirical and theoretical research in the field of fiscal decentralization.

In current studies, own-tax revenue is understood as a type of funding that generates greater fiscal autonomy for subnational governments in comparison to intergovernmental transfers. Although variation among types of own-tax revenue autonomy have also been developed (OECD, 1999), it is generally understood that when subnational governments can extract revenue directly from their own jurisdictions, this means more independence from central government from a fiscal point of view (Gomes, 2012).

The design of fiscal autonomy affects sub-central government's behaviour and determines outcomes like public sector efficiency, equity in access to public services or the long term fiscal stance.

For the local government, fiscal autonomy does not mean that local public tasks are financed exclusively with the local government's own funds (self-financing). However, it is important to design the financing system for local government units to provide the them with financial resources corresponding to the amount of costs they incur to meet their tasks (Brezovnik and Oplotnik, 2012). Bird (2011) pointed that a local government which has complete discretion over its choice of tax instruments, can set tax rates, define the tax base, or to grant tax allowances or reliefs and etc., would actually operate like an independent country, and would no longer be local government unit in the context of intergovernmental system. If the local government do not have enough own incomes to perform the public tasks allocated by central authorities, local government becomes dependent on the public administration. A situation where local government financing strongly depends on state budget has a considerable adverse impact on the autonomy of local government units.

## 3. Methodology and data

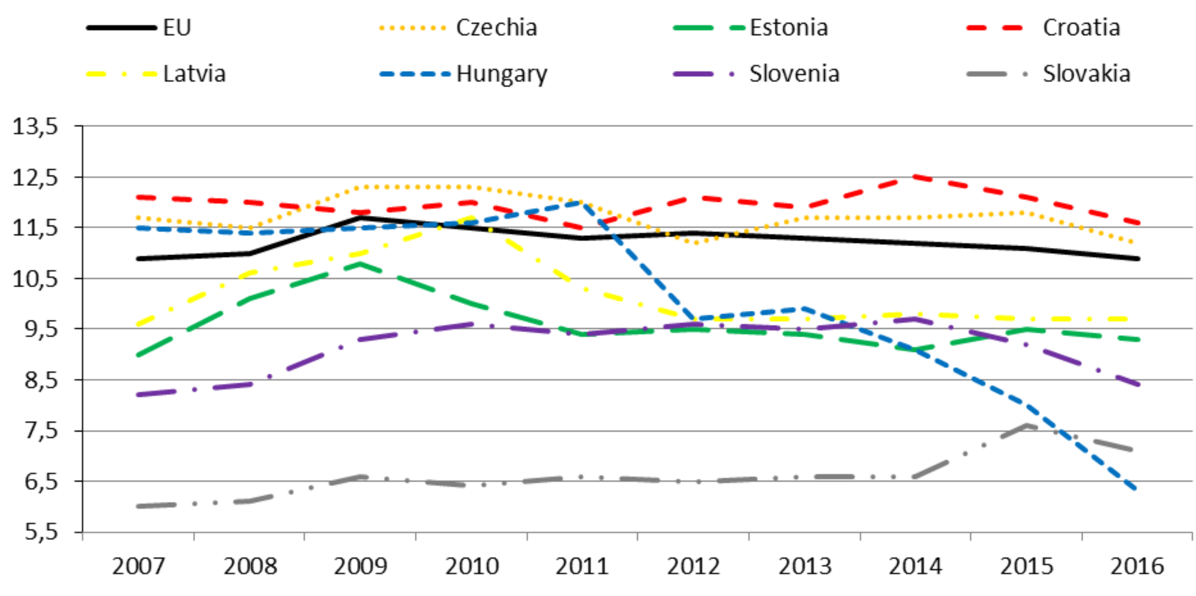
When considering the local fiscal autonomy, focus is generally placed on the local government unit's self-reliance in terms of revenue collection. As noted above, autonomy is defined as the discretion or freedom to determine its own expenditure. This aspect will be measured using measures used in the existing literature such as: the ratio of the local revenue to the national GDP, tax revenue as percentage of total national GDP and the ratio of the revenue from the taxes that local governments collect and the local budget spending. These indicators show us level and structure of local redistribution processes of the national economy, shortage of local tax revenue and how much transfers is needed from the central government to finance all the local spending. Tax autonomy is measured by the framework designed by OECD and it consists of five main categories of autonomy.

In this paper we do not analyze expenditure side of local fiscal autonomy. A higher level of fiscal autonomy allows to fulfil tasks which the local authorities believe to be the key drivers of development. In accordance with the decentralization principle, local authorities are best positioned to match the projects to local needs. A combination of above mentioned indicators need to be taken into account to be able to assess the real power of the different levels of government, as fiscal indicators can be misleading - as they in general tend to over-estimate the real degree of decentralization.
In the paper we will use OECD Fiscal Decentralization Database, Eurostat database and Ministry of Finance data of analyzed countries.

### *3.1. Measuring Fiscal autonomy of local government units*

It is understood that fiscal autonomy as a type of funding arrangement provides subnational governments with more discretion over the allocation of funds and, therefore, the choice of public policies. In the present state, fiscal autonomy is defined from a strict analysis of the norms regulating revenue generation, assuming that some types of funding arrangements— especially own-tax revenue—award subnational governments more autonomy to decide the allocation of public funds. On the other extreme, conditional grants are normally considered to be the only tool available to central governments to direct spending of member states to certain, specific policy areas (Gomes, 2012). From another direction, Ebohon et al., (2011) are telling us that autonomy has both an economic side, but also a political one. According to the authors, autonomy may involve the independence of the economic infrastructure of the lower level of government to higher level government. Also, autonomy can mean the independence of political structures and institutions from the lower level of government.
Sub-central governments rely on own tax revenue, shared taxes and intergovernmental grants. OECD countries have different levels of decentralisation measured by either the degree tax revenues perceived by subnational governments. Across the OECD, tax revenues represent 44.6% of subnational government revenues. Transfers have slightly increased their share over the last two decades and they now represent 37.2% of subnational government revenues (Allain - Dupré, 2018). Tax indicators can help to assess fiscal decentralization and its evolution over time. While this indicator can hardly capture the complexity and multidimensionality of fiscal arrangements, it can give a first impression of how much power sub-central governments enjoy. The following graph shows how significant is local revenue, and this indicator is the ratio of the local revenue to the national GDP and shows the significance of local redistribution processes for the national economy.

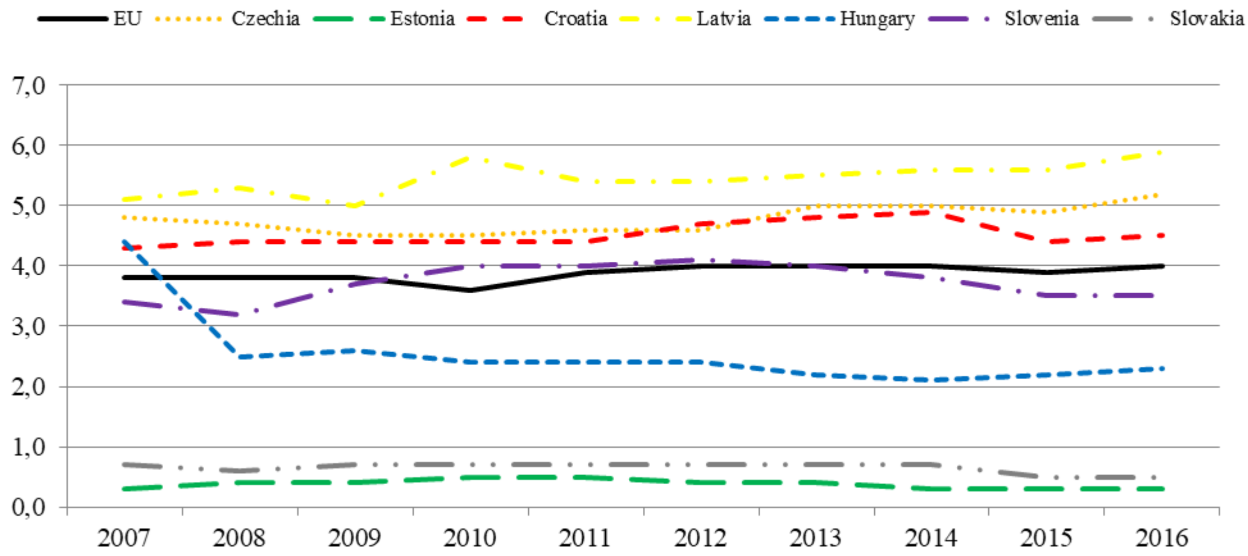
Graph 1: Local revenue as percentage of total national GDP in selected EU-13 member states




Source: Eurostat (2019a): http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_main&lang=en, author's calculations, Date: 07.04.2019.

Graph 1 shows that during the period (2007 – 2016) between 6% and 12.5 % of analysed countries GDP were redistributed via sub-central government budget. Values for all countries except Czech Republic and Croatia are lower than the EU average in the observed period (11,2 %). In the years after the economic recession, in the most of the countries the ratio of local revenue to GDP slightly decreased given that the central government took over the stabilization role during the crisis. Ratio of local revenue in the national GDP cannot be considered a reliable indicator for greater local autonomy because of the annual transfers from the central budget that were made in each country. To measure their local fiscal autonomy more accurately we need to disregard transfers from central government and take into account only the revenue from own sources. We will redefine the above indicator as significance of local tax revenue. Thus the indicator will show the significance of local budget revenues from local taxes for the redistribution processes. Higher values are indicative of a greater autonomy of local governments due to the larger amounts of own resources at the disposal of the local government units.

Graph 2: Tax revenue as percentage of total national GDP in selected EU -13 member states

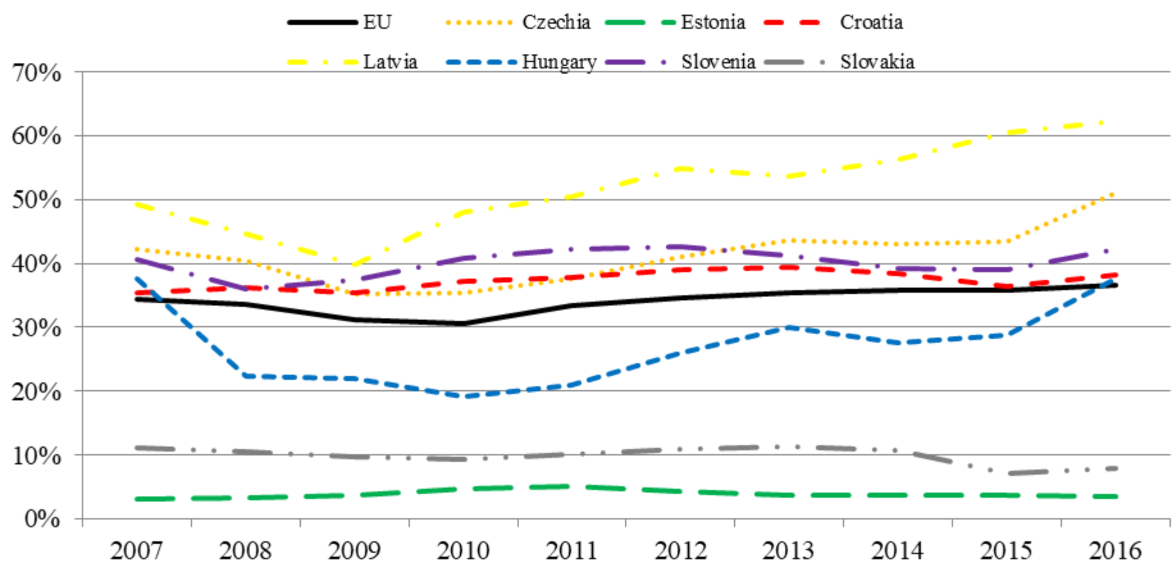



Source: Eurostat (2019b): http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_taxag&lang=en, author's calculations, Date: 07.04.2019.

The analysis of the Graph 2 reveals an important feature of the local governments in the surveyed countries – the low percentage of local tax revenue which is considered to be indicator of fiscal autonomy. Results in observed countries are approximately equal to average value of EU - 28 member states, with few exceptions (Slovakia and Estonia). When we compare two indicators it clearly shows that local governments are dependent on the central government and their transfers in observed countries. For example, the revenues of local governments in Slovakia in 2016 were 7,1% of total national GDP, while the value of the significance of local tax revenue indicator was only 0,5% (again compared to national GDP). In the same year, the local governments in Latvia (considered to be a positive example in the process of decentralization) had bigger tax autonomy than the Slovakian ones – 5,8% of national GDP was from local taxes, which is the most of all observed countries. The low share of GDP redistributed through local taxes shows not only that the effects of the fiscal decentralization in the selected countries are controversial, but also that local governments do not have sufficient fiscal capacity for autonomous provision of sufficient and adequate public services.

One aspect of local government's fiscal autonomy is the ability of local governments to have sufficient financial basis so they can spend independently on projects and activities without the financial support (intergovernmental transfers) of the central government. That kind of fiscal autonomy would widen the scope of local activities and secure more financial resources for financing the existing public services in local governments. The most suitable measure of the level of fiscal autonomy is the ratio of the revenue from the taxes that local governments collect and the local budget spending. That measure shows us the level of shortage of local tax revenue and how much transfers is needed from the central government to finance all the local spending.

Graph 3. Tax revenue to local expenditure ratio (%) in selected EU-13 member states




Source: Eurostat (2019c): http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_main&lang=en; http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_taxag&lang=en, author's calculations, Date: 07.04.2019.

Graph 3 shows the comparison of the selected countries and the average value of EU-28 members states, where the percentage of total local expenditure is covered with local tax revenue between 31% and 37%. Ratio of Estonia and Slovakia is far below the EU average varying between 3% and 5% in Estonia and 7% to 11% in Slovakia and are the lowest values among the seven observed countries. Latvia ranks first (40%-62%) in terms of fiscal autonomy - the lowest reported value was in 2009 (40%) and the highest was at the end of the survey period (62%). Apart from Latvia, all other countries have local expenditure covered by local tax revenue less than 50%. This means that local governments are strongly dependent on the central governments in terms of financial resource to cover their spending.

The share of local government spending has increased in almost all countries (with a few exceptions) while the revenue - raising power of local government units remained stable. In this context it should be emphasized that the share of tax revenues in total tax revenues cannot be seen as an indicator of tax autonomy since in most countries the determination of the tax rates, the coverage and the broadness of the tax base, the granting of tax incentives and tax reliefs and other characteristics of certain tax forms belong to central government, and local government units have the option of applying these tax regulations only with little modification.

### *3.2. Measuring Tax autonomy of local government units*

In economic literature there are various definitions of tax autonomy such as that tax autonomy is the ability of local authorities to have independent influence on the well-being of residents in local jurisdictions (Wolman and Goldsmith, 1990) or that tax autonomy is the ability of local jurisdictions to generate enough public revenue from the local economy and then determine how these revenues should be spent (Chapman, 2003). More generally, tax autonomy can be defined as the capacity of a local unit to establish tax rates and tax bases without external influence in order to independently determine how to spend that income and the ability to provide the level of services that citizens of some local units require.

For the purpose of this paper authors measure the share of local taxes on which local governments have some discretion over rate or relief, using information on local tax autonomy from the OECD Fiscal Decentralisation Database. OECD have designed the framework to measure tax autonomy and it consists of five main categories of autonomy (Table 1.). The categories listed in Table 1 are arranged in decreasing order of tax autonomy from highest to lowest taxing power. Category "a" represents full power over tax rates and bases, "b" power over tax rates, "c" power over the tax base, "d" tax sharing arrangements, and "e" no power over rates and bases at all.

Category “f” represents non-allocable taxes. In order to better capture the more refined institutional details the five categories were further divided into subcategories: two for the “a” and “b” categories, and three for the “c” category. Special attention was paid to tax sharing arrangements, where the four “d” subcategories are thought to represent the various rules and institutions for governments to determine and change their own share. Since category “f” or “non - allocable” was hardly used, the taxing power universe seems to be well reflected in this taxonomy. Altogether 13 categories were established to capture the various tax autonomy arrangements in OECD countries.

Table 1. Taxonomy of taxing power

| | |
|---|---|
| **a.1** | - The recipient SCG sets the tax rate and any tax reliefs without needing to consult a higher level government. |
| **a.2** | - The recipient SCG sets the rate and any reliefs after consulting a higher level government. |
| **b.1** | - The recipient SCG sets the tax rate, and a higher level government does not set upper or lower limits on the rate chosen. |
| **b.2** | - The recipient SCG sets the tax rate, and a higher level government does sets upper and/or lower limits on the rate chosen. |
| **c.1** | - The recipient SCG sets tax reliefs – but it sets tax allowances only |
| **c.2** | - The recipient SCG sets tax reliefs – but it sets tax credits only. |
| **c.3** | - The recipient SCG sets tax reliefs – and it sets both tax allowances and tax credits. |
| **d.1** | - There is a tax-sharing arrangement in which the SCGs determine the revenue split. |
| **d.2** | - There is a tax-sharing arrangement in which the revenue split can be changed only with the consent of SCGs. |
| **d.3** | - There is a tax-sharing arrangement in which the revenue split is determined in legislation, and where it may be changed unilaterally by a higher level government, but less frequently than once a year. |
| **d.4** | - There is a tax-sharing arrangement in which the revenue split is determined annually by a higher level government. |
| **e** | - Other cases in which the central government sets the rate and base of the SCG tax. |
| **f** | - None of the above categories a, b, c, d or e applies |

Source: OECD (2019a): Fiscal Decentralisation database, https://www.oecd.org/media/oecdorg/directorates/centrefortaxpolicyandadministration/A%20taxonomy%20of%20tax%20autonomy.doc , Date: 01.04.2019.

Table 2 present taxing powers of sub-central governments in selected EU-13 countries in 2014. Columns in the Table 2 report the proportion of the tax revenues of local governments that fall into each of the autonomy categories.

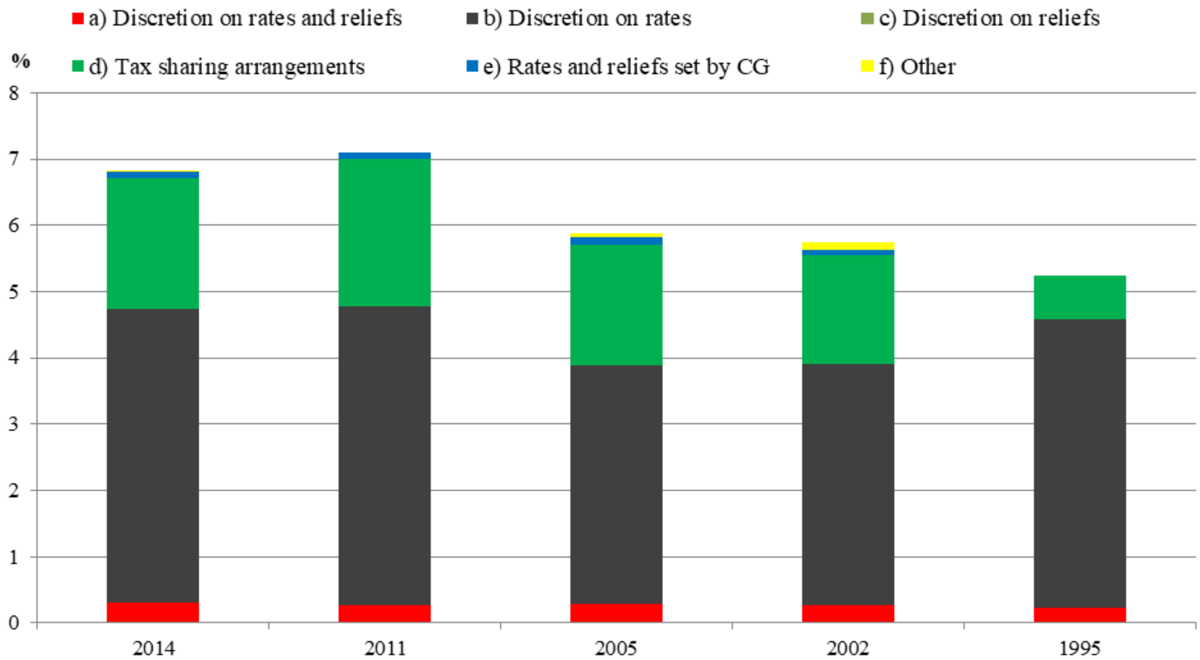
Table 2: Taxing power of sub-central governments in selected EU-13 member states (2014)

| Country | As % of sub-central tax revenues | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Discretion on rates and reliefs | | Discretion on rates | | Discretion on reliefs | Tax sharing arrangements | | | | Rates and reliefs set by CG | Other | Total |
| | Full | Restricted | Full | Restricted | | Revenue split set by SCG | Revenue split set with SCG consent | Revenue split set by CG, pluriannual | Revenue split set by CG, annual | | | |
| | (a1) | (a2) | (b1) | (b2) | (c) | (d1) | (d2) | (d3) | (d4) | (e) | (f) | |
| **Czech R.** | - | - | - | 100,0 | - | - | - | - | - | - | - | 100,0 |
| **Estonia** | 8,0 | 0,0 | 0,0 | 85,1 | 0,0 | 0,0 | 0,0 | 6,9 | 0,0 | 0,0 | 0,0 | 100,0 |
| **Hungary** | 0,0 | 0,0 | 0,0 | 95,7 | 0,0 | 0,0 | 0,0 | 0,0 | 4,1 | 0,2 | 0,1 | 100,0 |
| **Latvia** | 0,0 | 0,0 | 0,0 | 14,4 | 0,0 | 0,0 | 0,0 | 85,6 | 0,0 | 0,0 | 0,0 | 100,0 |
| **Slovak R.** | 4,0 | 0,0 | 0,0 | 95,7 | 0,2 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 100,0 |
| **Slovenia** | 15,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 77,2 | 7,6 | 0,3 | 100,0 |
| **Croatia** | 0,0 | 0,0 | 0,0 | 3,9 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 90,2 | 5,8 | 100,0 |

Source: OECD (2019b): Fiscal Decentralisation database, https://www.oecd.org/ctp/federalism/table1-taxpower-2017.xls and Ministry of Finance of the Republic of Croatia (2019): http://www.mfin.hr/hr/ostvarenje-proracuna-jlprs-za-period-2014-2017, author's calculations, Date: 07.04.2019.

It is visible that tax autonomy varies across observed countries, and most sub-central governments have some, but limited discretion over their own taxes. The share of tax revenue over which local government units have full or partial discretion (when we summarize up categories a, b and c) amounts to more than 85% for local government in Czech Republic, Hungary, Estonia and Slovakia, while in Slovenia, Croatia and Latvia there is much less discretion. Most of the countries have restricted influence on setting the tax rate. A category (which is representing control over both the tax rate and the tax base) has a very small role in selected countries. The C category (which is representing control only over the tax base for local government) has no role in selected countries. In tax sharing arrangements a single sub-central government cannot set tax bases and rates, but mostly sub-central governments together may have the ability and opportunity to negotiate their share in a certain tax. In Latvia and Slovenia, a significant amount of tax revenues comes from tax-sharing arrangement in which the revenue split is determined in legislation and is changed unilaterally by central government annually or less frequently than once a year. In some literature, local revenue from tax sharing is completely excluded and is classified as transfers from central government. However, in many countries and in our example Latvia and Slovenia, local governments are significantly dependent on the revenue from tax sharing between local and central government. More pronounced tax autonomy was measured in Czech Republic while the lowest tax autonomy is measured in Croatia.
The low amount of revenue accumulated from local taxes (own revenues) which we present in Graph 2 and Graph 3, has a substantial impact on the one of the fiscal decentralization coefficients, share of sub-central tax revenue in total tax revenue of the country. It is also one of the indicators of fiscal autonomy. It fluctuates between 0.8% and 19.6% in the analysed countries from the 1995-2014. Below, from the Graph 4 we can see that there was a positive trend in increase of fiscal and tax autonomy from 1995-2011. In 1995 share of local tax revenue in total tax revenue was 5,2%, while in 2011 it was 6,8%. Within this share, the ratio of tax revenues over which local governments has both tax base- and tax-rate-setting power stayed on low values, while both the significance of tax sharing arrangements and of tax rate setting power minimally increased. By analysing the observed period, we can conclude that tax autonomy of local governments remained largely stable and at low levels. The outlined trends regarding the rate of tax decentralization imply that in countries included in the survey the tax revenues are highly centralized, which makes the local governments in these countries highly dependent on the central governments in terms of their budget spending objectives and casts doubt on the success of the fiscal decentralization with regard to their tax autonomy.

Graph 4.: Evolution of tax autonomy of local governments in selected EU-13 member states, 1995-2014




Source: OECD (2019c): Fiscal Decentralisation database, https://www.oecd.org/ctp/federalism/table1-taxpower-2017.xls, author's calculations; Date: 08.04.2019.
*Note: Croatia is not taken into account because there is no data for 1995*

Changes to the relative share of each tax autonomy category can be either attributed to a) policy changes or to b) cyclical factors. Policy changes means that autonomy may change after policy reforms such as a reassignment of taxes to another government level, the expansion or reduction of local control over their own taxes or a swap between sub-central taxes and intergovernmental grants. On the other hand, cyclical factor imply that taxes react differently to the business cycle or economic development, and this may affect the tax revenue and tax autonomy of different government levels (Blöchliger and Nettley, 2015).

## 4. Tax policy recommendations for decision makers

The structure of subnational government revenues has an important impact on the results of the fiscal decentralization process. The inability of the central government to control consumption of subnational government due to inadequately shaped revenue systems, can result in inefficient spending and accumulation of local government fiscal deficits, thus endangering the macroeconomic stability of the whole country. Therefore, the key to the successful implementation of decentralization is the formation of a multilevel public finance system that will enable effective and efficient delivery of public services while maintaining macroeconomic stability. The ability of lower levels of government to decide on the size of their own revenue by controlling the marginal rates is an important feature of a revenue system that encourages careful borrowing and wise management of expenditures at those levels of government. Namely, in order for lower levels of government to be fully responsible for their expenditures and public debt, it is necessary that they decide on the size of their income and have access to significant tax sources that they control to a significant extent.
One of the key conclusions and suggestions in both theory and practice is that fiscal decentralization can produce sustainable net benefits, only if subnational governments have real taxing power. Involving subnational governments more directly in taxation can increase revenue mobilization and a greater share of national GDP can be reached by the tax system. If the intergovernmental transfer system is properly designed, subnational governments have the potential to reach tax bases much more efficient than the central government. It has been proven that higher tax revenues that subnational government collect due to greater autonomy, will not cause a reduction in central government tax revenues. Moreover, increased mobilization of revenues at the local level will reduce the need for intergovernmental transfers allocated by the central government. If the subnational governments rely more on own-source taxes it can also impose much higher fiscal discipline.

Local government units which have higher degree of fiscal and tax autonomy will have the resources and ability to satisfy the needs of local communities and improve the local living conditions, which is indicator of a high level of local development. In this paper we emphasize that without local fiscal and tax autonomy, local authorities will not have the resources to secure the efficiency of the local administration process, which will reverse the development of local community.

## 5. Conclusion

The issues of fiscal decentralization, its forms and the analysis of its effects on economic growth in the narrow sense and on overall economic performance, in the broad sense, are a complex process since it is the basis for achieving allocation efficiency. In economic literature, other aspects of fiscal decentralization (e.g. effects of decentralizing fiscal resources on fiscal responsibility, producing of national coordinated policies, types of fiscal funding arrangements) increasingly gaining in importance, which make this process even more complex. The comparison of the tax autonomy indicators shows that local governments are mostly dependent on the central government in selected EU member states and the low amount of revenue is accumulated from local taxes. Changes regarding the various dimensions of local autonomy have not been equally strong in all parts of Europe. For subnational governments to be autonomous in any meaningful sense they should have both the right and the responsibility to raise their own revenues at least to the extent that it is appropriate for them to do so. The level of tax autonomy is one of these effects, it affects all of the above-mentioned effects.
The strong centralization of tax revenues, the growing spending responsibilities of local government and the limited opportunities for self-financing make local governments strongly dependent on the central government to cover their public expenditure. This requires a reorganization of current fiscal system and central funding policy. Also, the results of the analysis showed that there is, however, a limited number of countries in which local government has the possibility to set rate and base of a major tax without any restrictions from higher levels of government.

## References:


1. Akai, Nobuo, Yukihiro Nishimura and Masayo Sakata. 2004. Fiscal Decentralisation, Economic Growth and Economic Volatility – Theory and Evidence from State – level Cross – section Data for the United States, *Yokohama National University: The Centre for International Trade Studies, Faculty of Economics*
2. Allain-Dupré, Dorothée. 2018. Assigning responsibilities across levels of government: Trends, challenges and guidelines for policy-makers, OECD Working Papers on Fiscal Federalism, No. 24, OECD Publishing, Paris, https://www.oecd-ilibrary.org/docserver/f0944eae-en.pdf?expires=1554836645&id=id&accname=guest&checksum=65873ABA1BE0B1DFA12EB31A006BB32F (accessed March 15, 2019)
3. Bahl, Roy W. and Richard M. Bird. 2008. Subnational taxes in developing countries: The way forward, *Public Budgeting and Finance*, Vol. 28., No. 4: 1–25.
4. Bahl, Roy W. and Johannes F. Linn. 1992. Urban public finance in developing countries, New York, Oxford University Press
5. Bird, Richard M. 2011. Are There Trends in Local Finance? A Cautionary Note on Comparative Studies and Normative Models of Local Government Finance," IMFG Papers on Municipal Finance and Governance, No. 1, Institute of Municipal Finance and Governance, Munk School of Global Affairs, University of Toronto, https://tspace.library.utoronto.ca/bitstream/1807/81272/1/imfg_paper_1_bird_2011-11-25.pdf (accessed April 2, 2019)
6. Blöchliger, Hansjörg and David King. 2006. Fiscal Autonomy of Sub-Central Governments, OECD Working Papers on Fiscal Federalism, No. 2, OECD Publishing, Paris. https://www.oecd-ilibrary.org/docserver/5k97b127pc0t-en.pdf?expires=1554837206&id=id&accname=guest&checksum=B21FE1BD19162A00DCCA863BEF2C892E (accessed March 15, 2019)
7. Blöchliger, Hansjörg and Josette Rabesona. 2009. The Fiscal Autonomy of Sub-Central Governments: An Update, OECD Working Papers on Fiscal Federalism, No. 9, OECD Publishing, Paris. https://www.oecd-ilibrary.org/docserver/5k97b111wb0t-en.pdf?expires=1554837300&id=id&accname=guest&checksum=0E3F50190D45A7EC23953FBE78ADEAC5 (accessed March 15, 2019)

8. Blöchliger, Hansjörg and Maurice Nettley. 2015. Sub-central Tax Autonomy: 2011 Update, OECD Working Papers on Fiscal Federalism, No. 20, OECD Publishing, Paris, https://www.oecd-ilibrary.org/docserver/5js4t79sbshd-en.pdf?expires=1554837401&id=id&accname=guest&checksum=A5BCA5E5ABF919FCFC970DAD91C05752 (accessed March 15, 2019)
9. Boetti, Lorenzo, Massimiliano Piacenza and Gilberto Turati. 2012. Decentralization and Local Governments' Performance: How Does Fiscal Autonomy Affect Spending Efficiency? *FinanzArchiv: Public Finance Analysis*, Vol. 68, No. 3. 269-302(34).
10. Brezovnik, Boštjan and Žan Oplotnik. 2012. An analysis of the applicable system of financing the municipalities in Slovenia, *Lex Localis – Journal of Local Self-Government*, Vol. 10, No. 3. 277-295.
11. Chapman, Jeffrey I. 2003. Local Government. Fiscal Autonomy and Fiscal Stress: The Case of California, *State & Local Government Review,* Vol. 35, No. 1. 15-25.
12. Ebel, Robert D. and Serdar Yilmaz. 2002. On the Measurement and Impact of Fiscal Decentralization. World Bank Policy Research Working Paper 2809. Washington, DC: World Bank. http://documents.worldbank.org/curated/en/309771468764353136/pdf/multi0page.pdf (accessed March 10, 2019)
13. Ebohon, Sylvanus I., Osa Osemwota and Phillip Agbebaku. 2011. Autonomy and Local Capacity: An Analysis of the Performance Profile of EDO State Local Govenrment Councils, *The Social Sciences* Vol. 6, No. 3. 235-236.
14. Eurostat. 2019a. http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_main&lang=en (accessed April 7, 2019)
15. Eurostat. 2019b. http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_taxag&lang=en (accessed April 7, 2019)
16. Eurostat. 2019c. http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_main&lang=en; http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_taxag&lang=en (accessed April 7, 2019)
17. Gemmell, Norman, Richard Kneller and Ismael Sanz. 2013. Fiscal decentralization and economic growth: Spending versus revenue decentralization, *Economic Inquiry*, Vol. 51, No. 4. 1915–1931.
18. Gomes, Sandra. 2012. Fiscal Powers to Subnational Governments: Reassessing the Concept of Fiscal Autonomy, *Regional & Federal Studies*, Vol. 22, No. 4. 387-406.
19. Iimi, Atsushi. 2005. Decentralization and economic growth revisited: An empirical note, *Journal of Urban Economics*, Vol. 57, No. 3. 449-461.
20. Ivanyna, Maksym and Anwar Shah. 2014. How Close Is Your Government to Its People? Worldwide Indicators on Localization and Decentralization, *Economics: The Open-Access, Open-Assessment E-Journal*, Vol. 8, No. 3. 1- 61. http://dx.doi.org/10.5018/economics-ejournal.ja.2014-3 (accessed February 25, 2019)
21. Martinez-Vazquez, Jorge, Santiago Lago-Peñas Agnese Sacchi. 2017. The Impact of Fiscal Decentralization: A Survey, *Journal of Economic Surveys*, Vol.31, No. 4. 1095-1129.
22. Ministry of Finance of the Republic of Croatia. 2019. http://www.mfin.hr/hr/ostvarenje-proracuna-jlprs-za-period-2014-2017, (accessed April 7, 2019)
23. Musgrave, Richard. 1959. The Theory of Public Finance: A Study in Public Economy, New York: McGraw-Hill
24. Oates, Wallace. 1972. Fiscal Federalism, New York: Harcourt Brace Jovanovich
25. OECD. 1999. Taxing powers of state and local government, Tax policy studies, No. 1, OECD Publishing, Paris, https://read.oecd-ilibrary.org/taxation/taxing-powers-of-state-and-local-government_9789264174030-en#page1 (accessed February 10, 2019)
26. OECD. 2002. Fiscal Design Surveys across Levels of Government, OECD Tax Policy Studies, No. 7, OECD Publishing, Paris, https://read.oecd-ilibrary.org/taxation/fiscal-design-surveys-across-levels-of-government_9789264195530-en#page1 (accessed February 26, 2019)
27. OECD. 2019a. Fiscal Decentralisation database, https://www.oecd.org/media/oecdorg/directorates/centrefortaxpolicyandadministration/A%20taxonomy%20of%20tax%20autonomy.doc, (accessed April 1, 2019)
28. OECD. 2019b. Fiscal Decentralisation database, https://www.oecd.org/ctp/federalism/table1-taxpower-2017.xls, (accessed April 7, 2019)
29. OECD. 2019c. Fiscal Decentralisation database, https://www.oecd.org/ctp/federalism/table1-taxpower-2017.xls, (accessed April 8, 2019)
30. Pratchett, Lawrence. 2004. Local autonomy, local democracy and the "New Localism", *Political Studies*, Vol. 52, No.2. 358-375.
31. Rondinelli, Dennis. 2000. What is decentralization? in Jennie Litvack and Jessica Seddon (ed.), Decentralization briefing notes. World Bank Institute Working papers in collaboration with PREM

network, https://www.academia.edu/6589441/WORLD_BANK_INSTITUTE_WBI_Working_Papers_in_collaboration_with_PREM_network_Decentralization_Briefing_Notes (accessed April 5, 2019)

32. Tiebout, Charles M. 1956. A pure theory of local expenditures, *The Journal of Political Economy*, Vol. 64, No.5. 416–424.
33. Vetter, Angelika. 2007. Local Politics: a resource for democracy in Western Europe? Local autonomy, local integrative capacity, and citizens' attitudes towards politics, Lexington Books
34. Wolman, Harold and Michael Goldsmith. 1990. Local Autonomy as a Meaningful Analytic Concept. Comparing Local Government in the United States and in the United Kingdom, *Urban Affairs Quarterly*, Vol. 26, No. 1. 3-27.