

## Municipal governments' finances and investments

**Decentralisation in spending exceeds decentralisation in revenues. While municipal governments account for 19% of total public expenditure, they raise 13% of public revenues.**

Municipal governments in EU and OECD countries have an important role in public expenditures and revenues. However, there is very little comparative evidence on how their spending and investment responsibilities are set across countries. While municipalities are included in the set of SNGs, which also include regions and intermediary level governments, municipal finance rarely appears as an independent item in international comparisons. This section provides new indicators on municipal government finance for 26 EU and OECD countries.

Municipal governments have a relatively greater responsibility in spending than in raising revenues. In 2017, municipal governments accounted for 19% of total public expenditure among the countries analysed but they accounted for only 13% of public revenues. Since 2011, the municipal government share in public spending has increased by one percentage point (Figure 5.13).

While the relative share of municipal government spending appears to be stable across the OECD, significant differences across countries exist. Between 2011 and 2017, the municipal share of general government expenditure increased significantly in Lithuania, New Zealand, Poland and Korea, while it decreased in the Czech Republic, Finland, Ireland and the United Kingdom. Similar patterns hold for the share of municipal revenue, which increased significantly in Chile, the Czech Republic, Lithuania and South Korea and declined significantly in Japan, Latvia, the Slovak Republic and Slovenia. In the majority of countries analysed, the municipal expenditure share of total expenditure increased more than the revenue share.

Specific spending items are particularly important for municipal governments. Data for 18 EU and OECD countries disaggregated by 10 categories (COFOG classification) reveal that education, general public services and social protection represent the most important spending categories for municipal governments. The main exception to this is Finland, where healthcare is the most important municipal expenditure category, followed by social services (Figure 5.14).

In most countries analysed, transfer systems form an important component of municipal finances. In Estonia, central government transfers finance over 80% of municipal sector spending. Bulgaria and the Netherlands also have relatively high shares of transfers from the central government, above 70% of municipal finances. However, some countries differ significantly with respect to the importance of central government transfers. In the Czech Republic, New Zealand and Sweden, central government transfers fund less than 20% of municipal spending.

A composite measure based on different indicators of municipal finance can provide an overarching picture of differences in the degree of municipal decentralisation across countries. This measure rests on three sub-indicators: municipal share of general government spending, municipal own revenue share and the portion of non-shared municipal tax revenues (for a description of the methodology behind the composite indicator, please see Annex D) (Figure 5.15). According to the results, Denmark, Finland, Japan, Korea, Norway and Sweden have the highest degree of decentralisation at the municipal level. For the rest of the countries, the between-country differences are relatively small. In 16 out of 26 countries, decentralisation at the municipal level increased between 2011 and 2017. This trend was particularly visible in Chile and New Zealand, where decentralisation at the municipal level increased by more than 10%. On the other end, decentralisation decreased at the highest rates in Cyprus, the Czech Republic and Malta.

### Definition

Composite indicator on municipal decentralisation: In order to get an overview of the degree of decentralisation at the municipal level using several fiscal aspects, we constructed a composite indicator using three sub-indicators: municipal share of general government spending, municipal own revenue share and the portion of non-shared municipal tax revenues. Our methodology assumes that the degree of decentralisation at the municipal level is higher when: i) a large share of public expenditures is decentralised; AND ii) municipalities have a low dependency on central government transfers; AND iii) municipal tax revenues are mostly based on non-shared taxes. Using the following formula, we calculate the decentralisation indicator, for which the values range from 0 to 100:

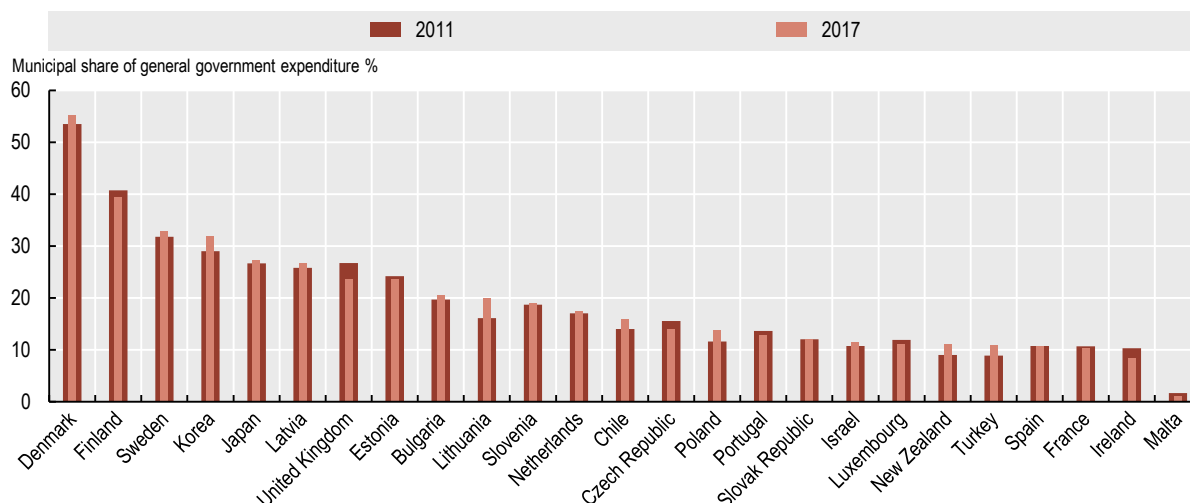
$$MDI = 100 \times MSS^{0.5} \times (1 - VFG)^{0.25} \times (1 - STR)^{0.25}$$

where MDI is the municipal decentralisation indicator, MSS is the municipal spending share, VFG is the vertical fiscal gap and STR is the portion of shared taxes in municipal incomes. The weighting of each term ensures that municipal spending share gets the biggest weight but that revenue side is also taken into account.

### Reference years and sources

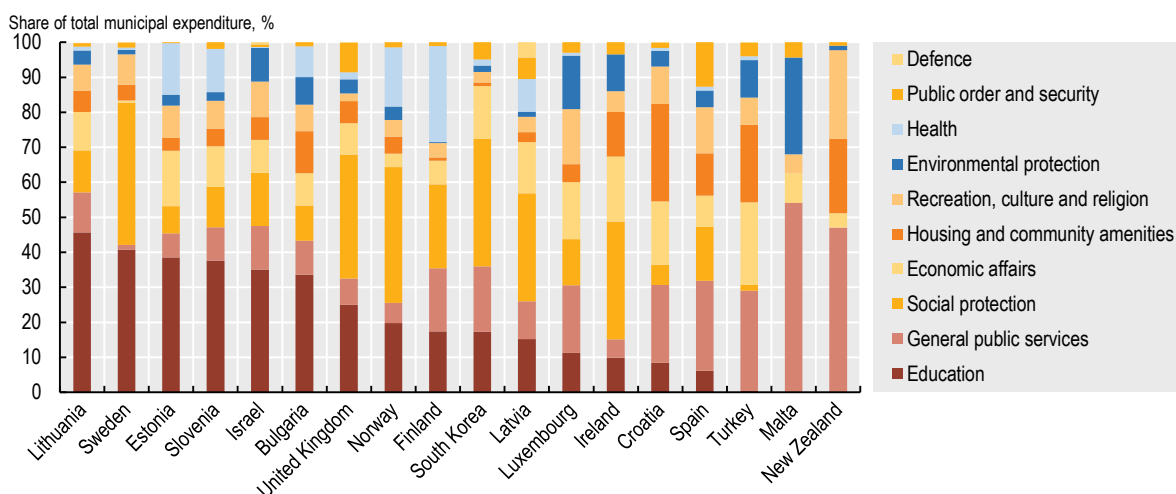
This analysis refers to a period before the pandemic COVID-19. Significant variations in subnational government finance are expected because of the impacts of the pandemic. See more definitions in Annex D.

### 5.13. Municipal share of general government expenditure in a sample of EU and OECD countries, 2011 and 2017



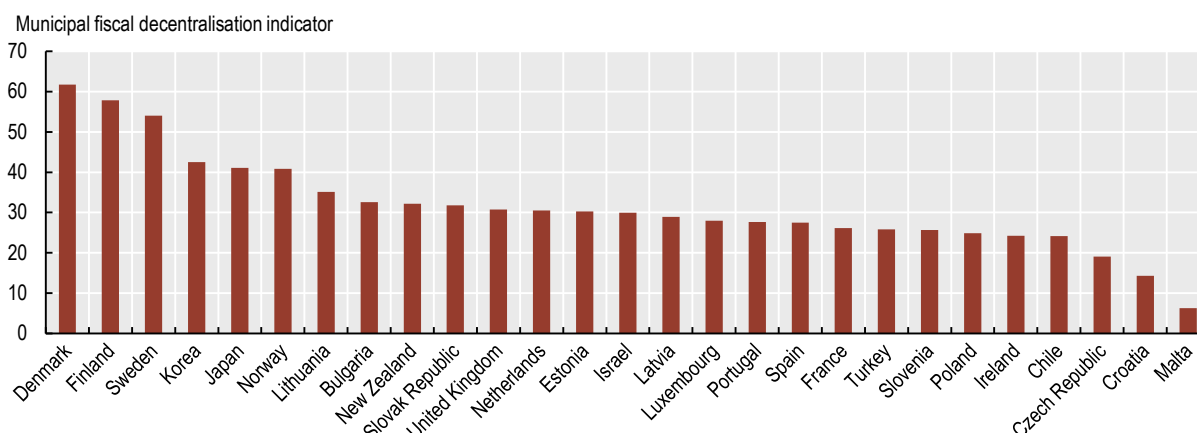
StatLink <https://doi.org/10.1787/888934191141>

### 5.14. The structure of municipal spending by COFOG expenditure groups in countries, 2017

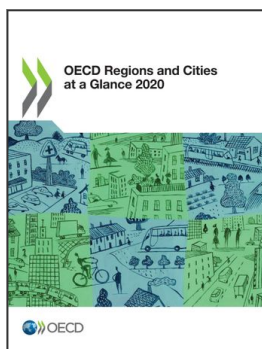


StatLink <https://doi.org/10.1787/888934191160>

### 5.15. Composite indicator for fiscal decentralisation at the municipal level, 2017



StatLink <https://doi.org/10.1787/888934191179>



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