AN ANALYSIS OF FISCAL DECENTRALIZATION AT THE LEVEL OF OECD COUNTRIES IN THE PERIOD 1999-2022

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Abstract: The tense international developments of recent years, although they focus on other topics of a regional nature, also lean towards the debate on improving the management of public financial resources and the optimal way of delivering services at the level of central or local administrations. In this context, public discussions focus on a rather federalist current, with a minimal, well-calibrated state, in which decentralization ensures a higher efficiency in the provision of public goods. Thus, the article aims to analyze for the period 1999-2022 certain aspects regarding subnational governance within public revenues and expenditures at the level of OECD countries, highlighting certain relevant differences between these countries worldwide. The analysis takes place from the perspective of two categories of countries, namely federal and unitary states. The article aims to contribute to the formulation of proposals for improving the fiscal-budgetary performance at the level of the analyzed OECD countries.

Keywords: fiscal decentralization, Countries revenues and expenditures comparison, subnational governments
JEL: H10, H72, R50

1. Introduction

Global economic growth is expected for the end of 2024 and 2025 to remain in the vicinity of 3% according to the World Economic Outlook (WEO) October 2024. The forecast revisions are based on the improved outlook for the United States of America and emerging Asia, amid the increase in demand for semiconductors and electronics, a process also supported by investments in artificial intelligence. On the negative side, the economic growth prospects are unfavourable for the advanced economies of Europe, against the background of more recent processes, but also of structural phenomena such as population aging and weak productivity, but also against the background of problems in the real estate sector in China, which may lead, through a long-lasting contraction, and to substantial imbalances in international trade.

On inflation, according to the WEO, stabilization appears to be proceeding relatively well globally, with global inflation projected to decline to an annual average of 5.8% in 2024 and to 4.3% in 2025, with issues still remaining around service prices in many regions of the world, but also regarding the prices of some goods due to persistent geopolitical tensions. All these risks and vulnerabilities could prevent central banks from easing monetary policy measures and lead to significant challenges to financial stability and fiscal policy.

Many countries still present major problems in reframing the public debt on the path of sustainability and restoring fiscal reserves, in the context of the persistence of pressures of a social nature, of economic fragmentation, but also the need to accelerate the transition to the green economy. Thus, according to WEO, advanced governments are expected to tighten their fiscal policies in 2024 and 2025, aiming to halve primary deficits by 2029, with a marginal revision in the US (in 2029, the fiscal deficit is expected to reach around 6% of GDP, and public debt 131.7% of GDP), while in the European Union and the euro zone the revision is expected at much lower levels. In this context, fiscal decentralization can be seen

as a mechanism for controlling the size and effectiveness of the public sector, increasing efficiency and budget performance.

2. Motivation, literature review and description of the problem

In measuring the fiscal dimension of subnational autonomy, the literature captures as relevant indicators such as the share of expenditures and revenues to determine the level of decentralization. While these indicators may provide a first impression of the extent to which subnational governments are decentralized or fiscally autonomous, they fail to fully capture the complexity of fiscal arrangements and the degree of autonomy that subnational governments actually enjoy (Blöchliger and King, 2007).

Thus, decentralization presents different ways of measurement, often starting from different definitions, but centred on increased freedom of local authorities. The definition proposed by Bahl and Bird (2018, in Bahl and Martinez-Vazquez, 2022) whereby the local population is empowered with the empowerment of local governments, is added to them a whole series of visions, most of them taking into account combinations of the political dimension, administrative and fiscal (Rodden, 2004; Voigt and Blume, 2012; Liu and al. 2013).

At the same time, the specialized literature highlights a number of important properties of fiscal decentralization. Fiscal decentralization is seen as a mechanism for improving the efficiency of public services, increasing the autonomy of subnational public authorities, limiting the coercive taxation power of the state, strengthening fiscal discipline and controlling the growth of the public sector, being proposed as an element important role of public sector reform in developing countries and supporting public areas such as health and education (Tanzi, 1996; Fukasaku & de Mello, 1997; Zhang & Zou, 1998; Brennan & Buchanan, 1980; Persson și Tabellini, 2000; Hindriks și Lockwood, 2005; Escolano et al.,2012; Sow and Razafimahefa, 2017; OECD, 1919; OECD, 2021; Nakatani et al. 2022).

Regarding the size of the state, in an econometric analysis using panel data from 32 industrial and developing countries for the period 1980–1994, Jin & Zou (2002) find that expenditure decentralization leads to smaller national governments, larger subnational governments and larger aggregate governments, and revenue decentralization increases subnational governments by less than it decreases national governments, but leads to smaller aggregate governments.

If we refer to specific regional studies, such as an analysis of OECD countries, some studies confirm a positive impact of fiscal decentralization in the economy, such as Thiessen (2003), while others do not, such as studies by Thornton (2007) and Baskaran & Feld (2009). In this context, this article contributes to highlighting specific aspects of fiscal decentralization in OECD countries worldwide.

3. Methodology and data sources

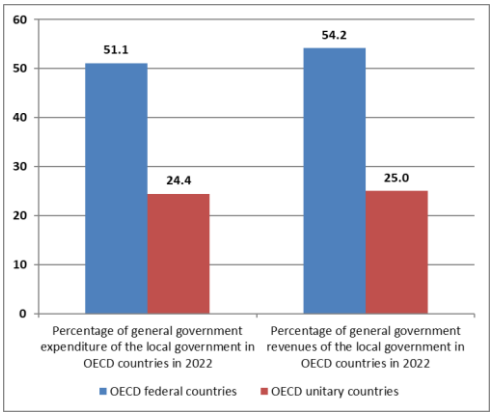
The study is based on a series of comparisons between, on the one hand, the elements of income and expenditure decentralization at the level of the Organization for Economic Cooperation and Development (OECD) countries, and on the other hand, on the systematization of OECD countries according to the quality of federal or unitary state. The analysis period is 1999-2022 and the main data sources are the OECD and International Monetary Fund (IMF) databases, as well as other international data sources e.g. World Bank, European Central Bank (ECB), etc. OECD data refer to the year 2022, the latest year available, and for a relatively long time series 1999-2022, the information is corroborated with IMF data, assuming relatively constant shares of local or state revenues and expenditures in total revenues and expenditures over time.

4. Results

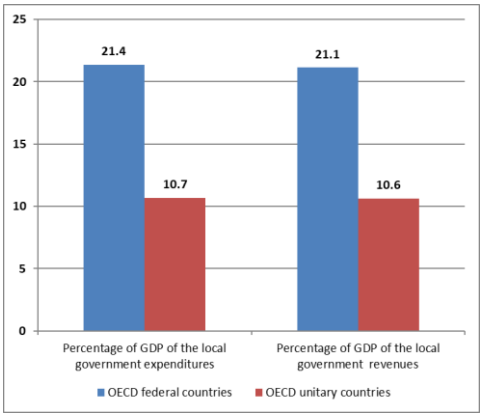
At the level of 2022, for the 38 OECD states, if we analyze the data expressed as a percentage of revenues and expenditures at the general government level, we notice that local revenues exceed by 3.1 percentage points (p.p.) expenditures in federal states and by only 0, 6 p.p. for the unitary states. However, this budget surplus is not reflected when we refer to the shares of local revenues and expenses expressed in GDP, so the deficit is 0.3 p.p. for OECD federal states compared to only 0.1 p.p. for the unitary states.

Figure 1 –The evolution of local revenues and expenditures for all OECD countries as percentage of general government and GDP in 2022

Local revenues and expenditures for all OECD counties as percentage of general government



Local revenues and expenditures for all OECD counties as percentage of GDP (%)



Source: OECD database

It should be noted that, both by reference to total government revenues and expenditures and by reference to GDP, the shares of local revenues and expenditures are substantially higher for federal states than for unitary ones. Thus, expressed as a weight in the general budget, the difference between the federal and unitary states at the level of local expenses is 26.7 p.p. and 29.2 p.p. for local revenues.

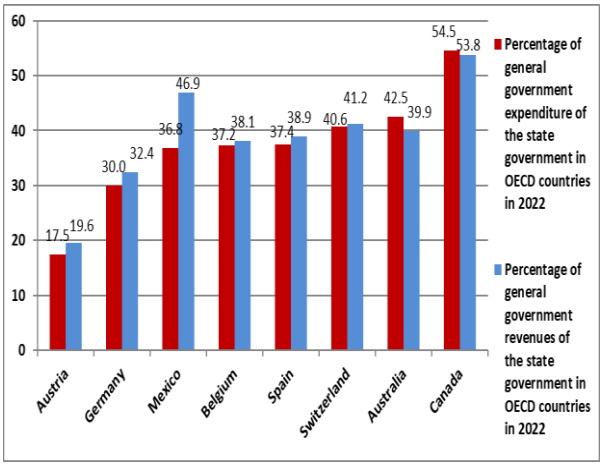
If we refer to the reporting to GDP, the share of local expenses for the federal states is higher by 10.7 p.p. compared to the unitary states and by 10.5 p.p. in respect of local revenues. This aspect is justified precisely through the lens of the definition of the federal state, which assumes a union of states with self-governing, autonomous, clearly defined constitutionally, strong at the local level, with decision-making power at the federal government level.

If we refer only to the OECD federal states (see Figure 2), their number is not significant (only 8 governments out of 38), but their budgetary governance in 2022 is substantially better compared to unitary states. Thus, only two of these federations: Australia and Canada recorded state budget deficits in 2022 (2.6p.p for Australia and 0.7p.p for Canada), while the rest of the OECD federal states recorded budget surpluses for the budget of state.

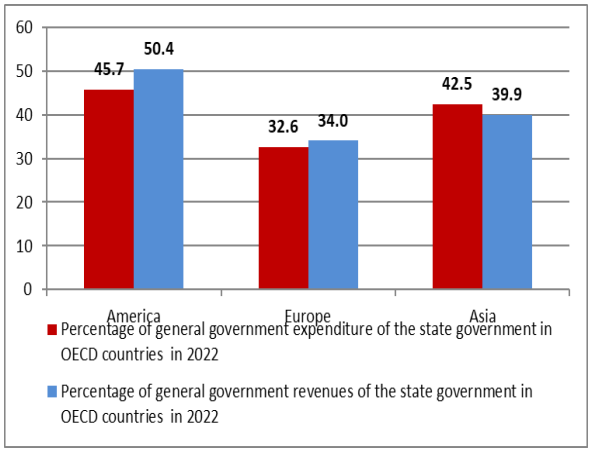
If we systematize by continent the information expressed as a share in the general government, having information only for three regions America, Europe and Asia, we notice that America and Europe present slight state budget surpluses and only Asia a deficit (2.6 p.p.). From the perspective of the consistency of decentralization, we observe that both America and Asia dominate the European continent, having higher weights in the general government budget both in terms of revenues and state expenditures.

Figure 2 – The evolution of state revenues and expenditures for OECD countries on continents and countries as percentage of general government in 2022

State expenditures and revenues as percentage of general government on countries in 2022



State expenditures and revenues on continents as percentage of general government in 2022

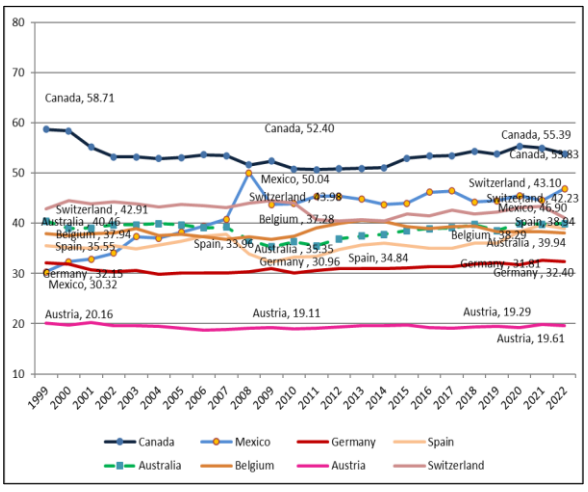


Source: OECD database

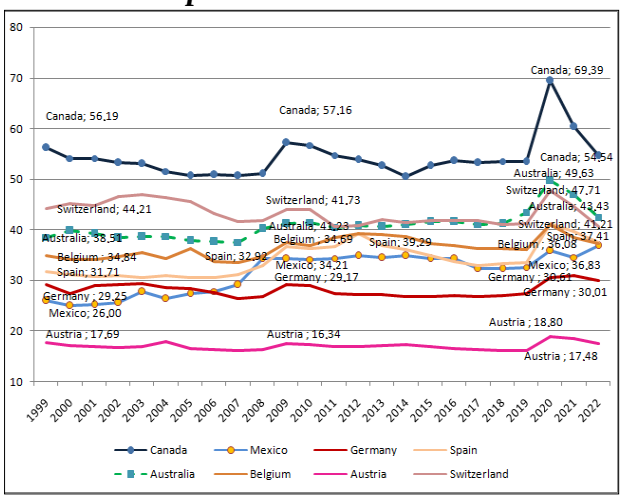
Regarding the analysis over time, for the period 1999-2022, we observe a relatively linear trend over time for both revenues and state expenditures (see figure no. 3), with the observation that the moment of the global crisis of 2008-2009 and the COVID pandemic -19 produced some increase in government spending in all analyzed OECD federations.

Figure 3 –The evolution of state revenues and expenditures for OECD countries for the period 1999-2022

State revenues as percentage of general government revenues on countries in the period 1999-2022



State expenditures as percentage of general government revenues on countries in the period 1999-2022



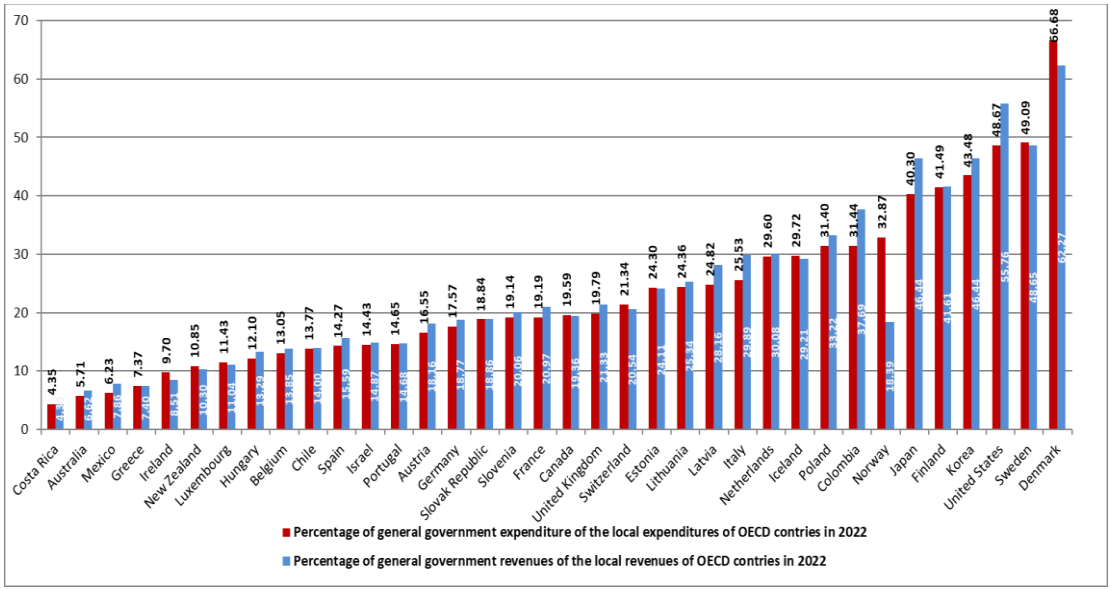
Source: OECD and IMF databases

The aspect reinforces the general belief that at the time of a crisis, a firm position is necessary, prompt to restore the initial economic and social conditions, a fact that really calls for significantly higher general, state or local budget expenditures than in periods of calm or economic well-being. In general, at the level of the OECD countries, federations such as

Canada, Mexico, Switzerland, Belgium and Spain are at the top of the revenues and respectively of state expenditures as a share of revenues and respectively of government expenditures, marking values of state fiscal decentralization significantly higher compared to countries such as Austria and Germany.

If we analyze all OECD countries at the level of local budgets in 2022 (see Figure no. 4), we notice that the lowest shares of fiscal decentralization, both for revenues and expenditures, are registered by Costa Rica, Australia, Mexico, Greece and Ireland, while countries with consistent fiscal decentralization are Denmark, Sweden, the United States, South Korea and Finland. At the level of 2022, if we also look at the budget balance, we notice that out of 36 analyzed OECD countries (we excluded Turkey and the Czech Republic, because there is no data for local revenues in 2022) 25 present local budget surpluses, and the remaining 11 present deficit, so the number of budget surpluses exceeds at least 2 times the number of deficits, suggesting good and very good fiscal performance at the local level of all OECD states.

Figure 4 –The evolution of local revenues and expenditures for OECD on countries as percentage of general government in 2022



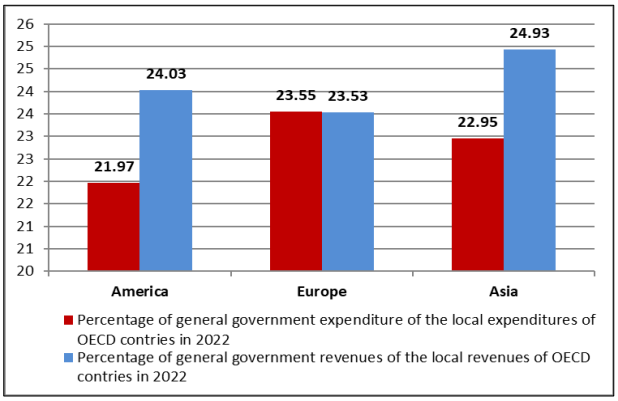
Source: OECD and IMF databases

Analyzing by continent, based on OECD countries, the share of local spending as a percentage of government spending, that is, fiscal decentralization of local spending is dominant in Europe, and less significant in America, while the importance of local revenue as a share of government spending, or decentralization of local income is highest in Asia and lowest in Europe.

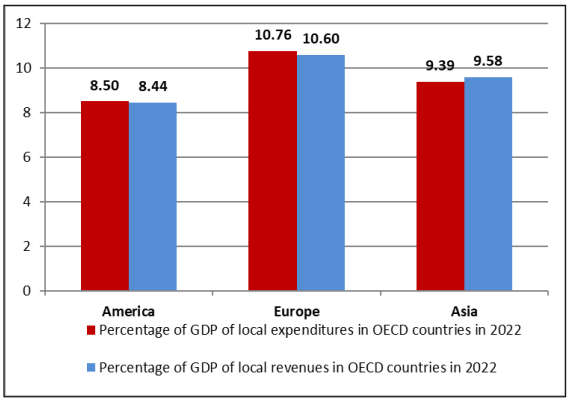
If we look at local expenditures and revenues as a percentage of GDP, of all the OECD countries, the countries of Europe dominate the other two continents, Asia and America, with the American continent presenting the lowest weights and against the background of much more significant budgetary resources at the state and federal level. If we look at the situation from the perspective of the budget balance, only the Asian continent seems to have a more consistent budget discipline, registering a slight 0.19 p.p. budget surplus.

Figure 5 –Local governments' expenditures and revenues as percentage of general government and GDP on OECD countries in 2022

Local governments expenditures and revenues as percentage of general government on OECD countries on continents



Local governments expenditures and revenues as percentage of GDP on OECD countries on continents



Source: OECD and IMF databases

5. Conclusions

Fiscal decentralization is a topic of interest in the context of the economic and financial crises that have been unfolding more and more frequently in recent decades, putting considerable pressure on state budgets worldwide. The discussions aim not only at significant budget savings, but also at optimality in the provision of public services, in finding the best fiscal system, the best practices, in the way the decision must be made and run a city, a county, a country or a region. In general, geographically large countries tend to approach the problem from a federative perspective precisely through the prism of an extremely extensive area that is difficult to control and administer from the central level.

However, although decentralization presents certain advantages especially for large economic systems, it also presents numerous disadvantages, taking into account the level of political, economic and social maturity of a country. Issues such as the existence of insufficiently clear legislation, corruption, interest groups, a totalitarian or anti-democratic regime, an economic regime in transition with serious social problems, a precarious tax system with a high level of tax evasion And so on they can make fiscal decentralization a real failure. That is why fiscal decentralization is and must be seen as an integrated element in other types and forms of centralization and decentralization (economic, political). In this context, worldwide, analyzing the local or state decentralization structures of the OECD countries, the article tries to highlight a series of elements regarding the decentralization of budget revenues and expenditures.

Thus, both by reference to total government revenues and expenditures, as well as by reference to GDP, the shares of local revenues and expenditures are substantially higher (even higher than twice) for federal states than for unitary ones. If we refer to the reporting to GDP, the share of local expenses for the federal states is higher compared to the unitary states, a situation that is also confirmed for local revenues.

If we refer only to the federal states, although their number is not significant in the total number of OECD states, nevertheless their budgetary governance in 2022 is substantially better compared to the unitary states. Thus, only two federations: Australia and Canada recorded state budget deficits in 2022. From the perspective of the consistency of decentralization, regarding revenues and state expenditures as weights in the general budget, we observe that both America and Asia dominate the European continent, having higher weights. At the same time, at the level of the OECD states, the moments of economic and

social crisis (2008-2009, 2020-2022) demonstrate the ability of state expenditures to react much faster than other budget expenditures and certainly much faster than revenues to changes in global economic paradigms.

Analyzing fiscal decentralization at the level of local budgets for OECD countries, we observe that in 2022 the southern part of America and Europe presents a higher degree of decentralization, while northern areas such as the United States, South Korea and countries such as Denmark, Sweden and Finland has high fiscal decentralization. At the same time, with regard to local budget balances, more than half of the OECD countries show very good budgetary developments, often showing budget surpluses.

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