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## Fiscal decentralization in Europe in the context of social protection development

**Abstract.** The authors analyze the European experience of fiscal decentralization in the context of the development of social protection. Based on the distribution of functional expenditures, countries that have prioritized organization and financial provision of social protection at the local level have been identified. The authors share the view that the effectiveness of social protection reforms is largely due to the interdependence of spending on social protection and the reduction of poverty in the country. The countries that use a relatively small share of GDP expenditure while having low poverty rates after social transfers are the Czech Republic and Ireland, while such countries as Italy and Greece track high share of GDP expenditure as social transfers and high poverty rates. The countries that spend much less on social protection in terms of GDP and have high levels of poverty are Estonia, Bulgaria, Latvia, Romania and Lithuania. An analytical study of the decentralization of incomes made it possible to find out the differences in the formation of municipal budgets through transferring powers and financial resources to the local level, as well as different approaches in determining sources of income and financial equalization. Some European countries still have high centralization of social protection expenditures, such as Bulgaria, Spain, Estonia, the Czech Republic, Portugal, Slovakia, Italy, Croatia, Cyprus, Malta, where the share of expenditures on social protection is less than 10% of the local level expenditures. At the same time, in Denmark, the UK, Germany, Ireland, Norway, Sweden, the Netherlands, Iceland, Austria, Poland, and Belgium the share of social protection expenditures in structure of the local level expenditures is more than 20%. The importance of the municipal level in financing social protection expenditures has been established, which confirms the assignment of the majority of financial resources to support the elderly, families with children and social inclusion.

**Keywords:** Fiscal Decentralization; Decentralization of Income; Decentralization of Expenditures; Municipal Budget; Social Protection

**JEL Classification:** H21; H55; H75

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### Фіскальна децентралізація в Європі в контексті розвитку соціального захисту

**Анотація.** У статті здійснено дослідження європейського досвіду фіскальної децентралізації в контексті розвитку соціального захисту. На основі розподілу функціональних видатків визначено країни, що надали пріоритетне значення в питаннях організації та фінансового забезпечення соціального захисту локальному рівню публічного управління. Аналітичне дослідження децентралізації доходів дозволило з'ясувати відмінності в формуванні муніципальних бюджетів, що полягають як у передачі повноважень і фінансових ресурсів на локальний рівень, так і в різниці підходів до визначення джерел надходжень і фінансового вирівнювання. Встановлено важливість локального рівня публічного управління при фінансуванні видатків соціального захисту, що підтверджує спрямування переважної частини фінансових ресурсів для підтримки людей похилого віку, сімей із дітьми та соціальної інклюзії.

**Ключові слова:** фіскальна децентралізація; децентралізація доходів; децентралізація видатків; муніципальний бюджет; соціальний захист.

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**Фискальная децентрализация в Европе в контексте развития социальной защиты**

**Аннотация.** В статье проведено исследование европейского опыта фискальной децентрализации в контексте развития социальной защиты. На основе распределения функциональных расходов определены страны, которые имеют приоритетное значение в вопросах организации и финансового обеспечения социальной защиты на муниципальном уровне. Аналитическое исследование децентрализации доходов позволило выявить различия в формировании муниципальных бюджетов, которые заключаются как в передаче полномочий и финансовых ресурсов на местный уровень, так и в различных подходах в определении источников доходов и финансового выравнивания. Установлено важность муниципального уровня в финансировании расходов социальной защиты, что подтверждается направлением большей части финансовых ресурсов для поддержки пожилых людей, семей с детьми и социальной инклюзии.

**Ключевые слова:** фискальная децентрализация; децентрализация доходов; децентрализация расходов; муниципальный бюджет; социальная защита.

**1. Introduction**

In the context of transformations, decentralization reform plays an important role in the provision of effective, high-quality and affordable services. At the present stage when the majority of European countries follow the policy of strengthening the local level in terms of exercising powers in many spheres and the transfer of relevant financial resources, it is important to study the positive experience of fiscal decentralization in the context of the development of social protection. At the same time, it should be noted that the implementation of best practices in the field of social protection at the local level is possible only if the similar processes of fiscal decentralization take place. This determines the need for a more in-depth study of the European experience of decentralization of income, decentralization of expenditures and financial provision of social protection at the local level.

**2. Brief Literature Review**

The methodological basis of the study is the theory of fiscal decentralization, various aspects of which were justified by Musgrave's (1956) principle of subsidiarity in the distribution of public goods and services [1]; the Tiebout model (1956), which foresees competition between municipalities for the best provision of public goods and services at a certain level of taxes [2]; Oates's concept of fiscal federalism (1972), which gist is to look at the costs and benefits of decentralized provision of goods and services compared to centralized ones [3].

The European Charter of Local Self-Government [4] determines that local government authorities, in the first place, must have financial resources at their disposal, and secondly, their volume should be in line with the need for funding powers. As stated in the World Bank Report, these two conditions define local freedom and guarantee the ability of local authorities to finance the tasks assigned to them by law [5].

Consideration should be given to the potential risks that may accompany the process of fiscal decentralization in the context of the development of social protection. As L. Joshua and Y. Dzhygyr point out, decentralization of responsibility to local levels of government can, on the one hand, create a gap between the new spending needs and existing income opportunities at the local level [6].

Separate aspects of intergovernmental transfers to finance social protection expenditures are reflected in the studies of D. Bergvall, C. Charbit, D.-J. Kraan and O. Merk (2006). They confirm the importance of targeted transfers in terms of adequate financing of social protection at the municipal level [7].

**3. The purpose** is to identify the opportunities for fiscal decentralization in the context of the development of social protection based on the experience of European countries.

**4. Results**

The outline of the institutional, administrative, territorial principles of decentralization and the general parameters of financing social protection in foreign countries are the basis for defining the features of social protection implementation in conditions of decentralization with a focus on the municipal level. The general parameters of decentralized social protection system in European countries are accompanied by sectoral reforms, including social protection. At the same time, the most successful, in our opinion, are the reforms of deinstitutionalisation, long-term care of the elderly and the introduction of integrated medical and social services at the basic level of the administrative-territorial system. However, a successful implementation of the model may not be easy to integrate into the practice of another country, since financial support largely determines not only the nature of financial relations, but also the possibility of providing social services at each level of public administration.

In general, European countries are highly differentiated in terms of social protection expenditures, they spend different parts of GDP on social protection, and also use different instruments to reduce poverty. We share the view of M. Dodlova, A. Giolbas and J. Layb (2018) and A. Barrientos (2010) [8-9] that the effectiveness of social protection reforms is largely due to the interdependence of spending on social protection and the reduction of poverty in the country. It is worth mentioning the example of the countries that use a relatively small share of GDP expenditure while having low poverty rates after social transfers (the Czech Republic, Ireland) and vice versa, there are countries that track high expenditures and high poverty rates (Italy and Greece). Another group is formed by the countries that spend much less on social protection in terms of GDP and have high levels of poverty: Estonia, Bulgaria, Latvia, Romania and Lithuania (Figure 1).

It should be noted that the fundamentals of the social protection system, which have been historically formed in different countries due to institutional features, may differ significantly by the predominant part of the state funding (the Beveridge system) or the concept of social insurance (the Bismarck system). In support of this, based on the distribution of incomes between institutional sectors (Figure 2), we can state that the largest share of incomes of social insurance funds is observed in Germany (36.2%), France (45.6%), Finland (31, 1%), Poland (34.5%) and Luxembourg (35.5%). At the same time, the highest financial weight of subnational level in incomes of institutional sectors (more than 25%) is in Denmark, Sweden, Finland, Norway and Poland. In such federative countries as

Germany (36.2%), Spain (25.2%), Austria (25.8%), Belgium (29.3%), a significant proportion of subnational income is localized at the regional level as a whole.

In Table 1, based on the grouping of countries by sub-sectors of general government (sub-national level and social insurance funds), groups of countries that use different sources of financing of social protection are represented. For example, in Denmark, Sweden and Norway, despite the significant aggregate subnational income, there is virtually no income from social contributions in the public administration structure, which reflects the peculiarities of financing social protection systems mainly through taxes. A group of countries that have successfully used a mixed system of social security financing and have given greater weight to such expenditures at the subnational level are of the highest interest. These countries include France, Poland, the Netherlands, Finland and countries with a federal system - Germany, Austria and Belgium.

European countries have different approaches to the organization and use different mechanisms of social protection financing at local level. The process of decentralization plays a significant role in the issues of effective regulation and financing of social protection at different levels of government. Traditionally, three types of decentralization are distinguished: administrative (deconcentration, delegation, and devolution), political and financial (fiscal). Fiscal decentralization is the transfer of financial resources in the form of tax and

non-tax revenues, capital operations, as well as intergovernmental transfers to lower levels of government, in accordance with the powers conferred on each level of public administration [13].

The processes of fiscal decentralization in European countries, as a part of the strengthening of the local level, are accompanied by the consolidation of incomes at the local level (local taxes and / or share of national taxes) and the distribution between different levels of public administration of transfers, which testifies to different degrees of fiscal decentralization of incomes.

The opportunities for fiscal decentralization in terms of further financing of social protection at the local level are largely determined by the type of taxes, the availability of other sources of own income and the nature of intergovernmental transfers (targeted or general). The assessment of sources of financial resources of the local level of public administration indicates that European countries use different sources of income at local level (Table 2).

The presence of a rather strong local level allows us to assume that adequate social protection funding can be provided at this institutional level. However, local self-government bodies, even in the presence of financial resources, are not always inclined to direct them to financing social protection. In addition, some European countries are characterized by a greater centralization of social protection expenditures. As a

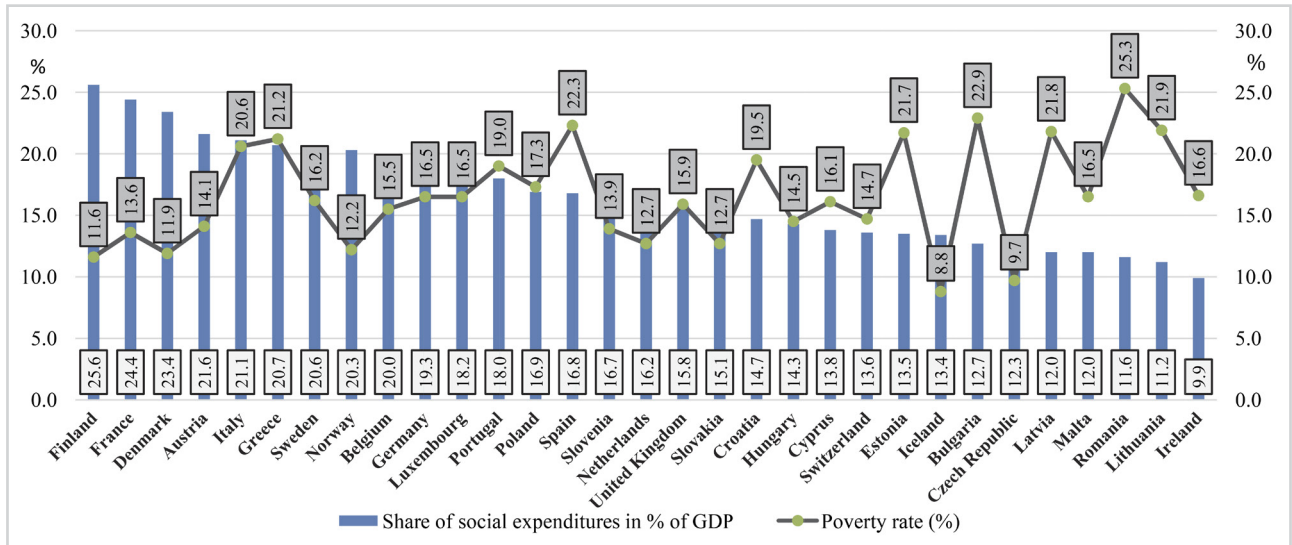


Fig. 1: Share of expenditures on social protection in GDP and poverty rate, as of January 1, 2017, %  
Source: Compiled by the authors based on [10-11]

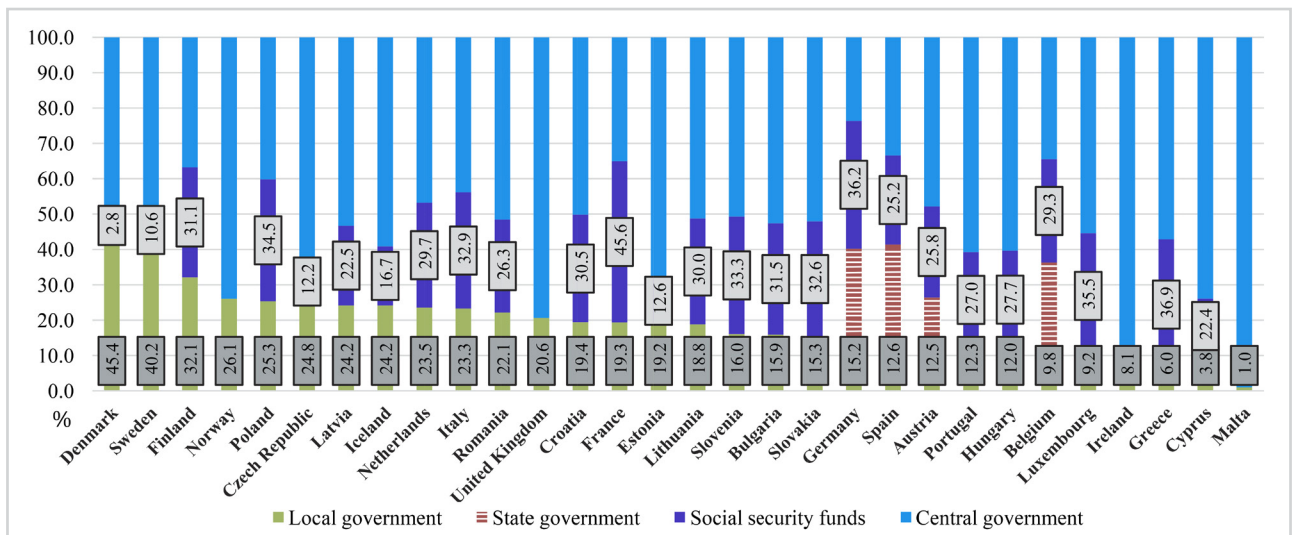


Fig. 2: Distribution of total incomes by the subsector of general government in European countries, as of January 1, 2017, %  
Source: Compiled by the authors based on [12]

result, in a number of European countries (Bulgaria, Spain, Estonia, the Czech Republic, Portugal, Slovakia, Italy, Croatia, Cyprus, Malta), the share of the expenditures on social protection is less than 10% of the local level expenditures (Figure 3).

An analysis of the expenditure distribution at the local level indicates a higher priority of social protection expenditures in Denmark, the UK, Germany, Ireland, Norway, Sweden, the Netherlands, Iceland, Austria, Poland, and Belgium. The share of social protection expenditures in these countries is more than 20% in the structure of the local level expenditures. At the same time, in Germany, Ireland, Norway, Sweden, Iceland, and Belgium more than a half of these expenditures are provided at the expense of own revenues of sub-national budgets. Conversely, in Denmark, the UK, the Netherlands, Austria, and Poland, the predominant way of social protection financing is the transfers from other levels of public administration.

An analysis of local level expenditures on functions allows us to conclude that countries spend the financial resources allocated to social protection differently (Figure 4).

Thus, the support for the elderly and social exclusion is traditionally characteristic for the Scandinavian countries. Post-socialist countries (such as Latvia, Estonia) are more diversified in the financing of social protection at the municipal level; the priority areas of municipal expenditures of such countries are support for the elderly, social inclusion and support for families with children. Somewhat different from the general context is Poland, which, at the municipal level, spends the majority of social protection expenditures on support for children and families.

**5. Conclusions**

Thus, the experience of European countries suggests that, in the face of obvious differences in existing approaches to financing of social protection at the local level, it is important to

Tab. 1: Grouping of countries by share of individual sub-sectors in European countries, as of January 1, 2017,%

		Subnational level			
		[1-11.3]	[11.4-22.7]	[22.8-34.1]	[34.2-45.5]
Social security funds	[0-11.3]	<b>Ireland, Malta</b>	<b>United Kingdom</b>	Czech Republic, <b>Norway</b>	<b>Denmark, Sweden</b>
	[11.4-22.7]	-	Estonia	<b>Iceland, Latvia</b>	-
	[22.8-34.1]	Cyprus	Hungary, Portugal, Slovakia, Bulgaria, Slovenia, Lithuania, Croatia, Romania	Italy, <b>Netherlands, Finland, Austria</b>	<b>Belgium, Spain</b>
	[34.2-45.6]	Greece, Luxembourg	<b>France</b>	<b>Poland</b>	<b>Germany</b>

Note: The countries that belong to the group with the highest share of social protection expenditures at the municipal level are marked with bold black

Source: Compiled by the authors based on [12]

Tab. 2: Sources of local income in certain European countries

	Grants / transfers		Tax revenue	
	Earmarked	General	Shared	Own-sources
1 Social grants (Nordic countries, Netherlands)		Local government funds (France, Belgium, Denmark, Italy, Portugal, UK, Netherlands, and Norway etc.)	PIT, VAT (Belgium)	Local business taxes (Germany, Luxembourg, Italy, Spain, Austria, France, etc.)
2 Healthcare grants (Spain, Italy, Sweden)		Equalization Funds (Iceland, Sweden, Finland, etc.)	PIT (Norway, Italy)	Business property rates (Australia, UK)
3 Social housing (Ireland, Hungary)		Shared taxes considered as grants (Austria, Slovak Republic, Estonia)	PIT and CIT (Poland, Switzerland)	Property tax (in almost all countries)
4 Infrastructures (Estonia, Ireland)			PIT, CIT and VAT (Germany and Czech Republic)	Local income tax (Finland, Denmark, Sweden, Iceland)

Source: Compiled by the authors based on [14-15]

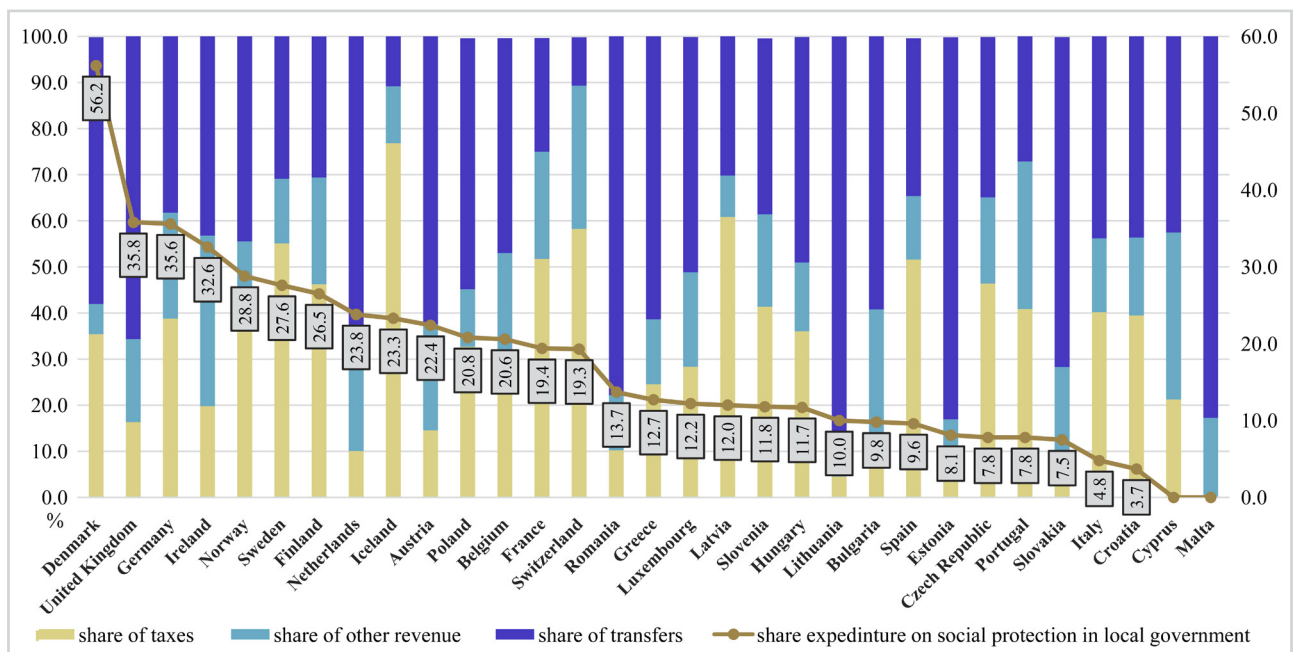


Fig. 3: The structure of incomes and the share of expenditures on social protection of the local level in European countries as of 01.01.2017

Source: Compiled by the authors based on [10; 16]

identify the features of income generation and distribution of expenditures at this level of public administration. Summing up the above, it should be noted:

1. The differentiation of European countries by the level of expenditures on social protection is accompanied by the interdependence of the social protection expenditures and the reduction of poverty in the country. With the use of

different funding models and tools to reduce poverty, the most interesting is the experience of the countries with the lowest or acceptable levels of poverty.

2. Based on the analysis of institutional sector incomes, it can be concluded that many European countries succeeded in building a mixed system of social protection financing. It is established that the differences of the chosen model of financing essentially determine the parameters of financial provision of social protection at the local level. So, firstly, a higher proportion of sub-national level in institutional sector income positively correlates with expenditures of local governments on social protection, and secondly, in the countries that use the model of social protection budget provision, there are also higher social protection expenditures at the local level.
3. Under conditions of fiscal decentralization, not all European countries have given a dominant role in the organization and financing of social protection to the local level. In the countries characterized by a higher level of distribution of expenditures for social protection at the local level, their provision takes place with a predominance of both tax revenues and transfers. Diversification of social protection expenditures at the local level in European countries is accompanied by greater support for families with children, the elderly and people at risk of social exclusion.

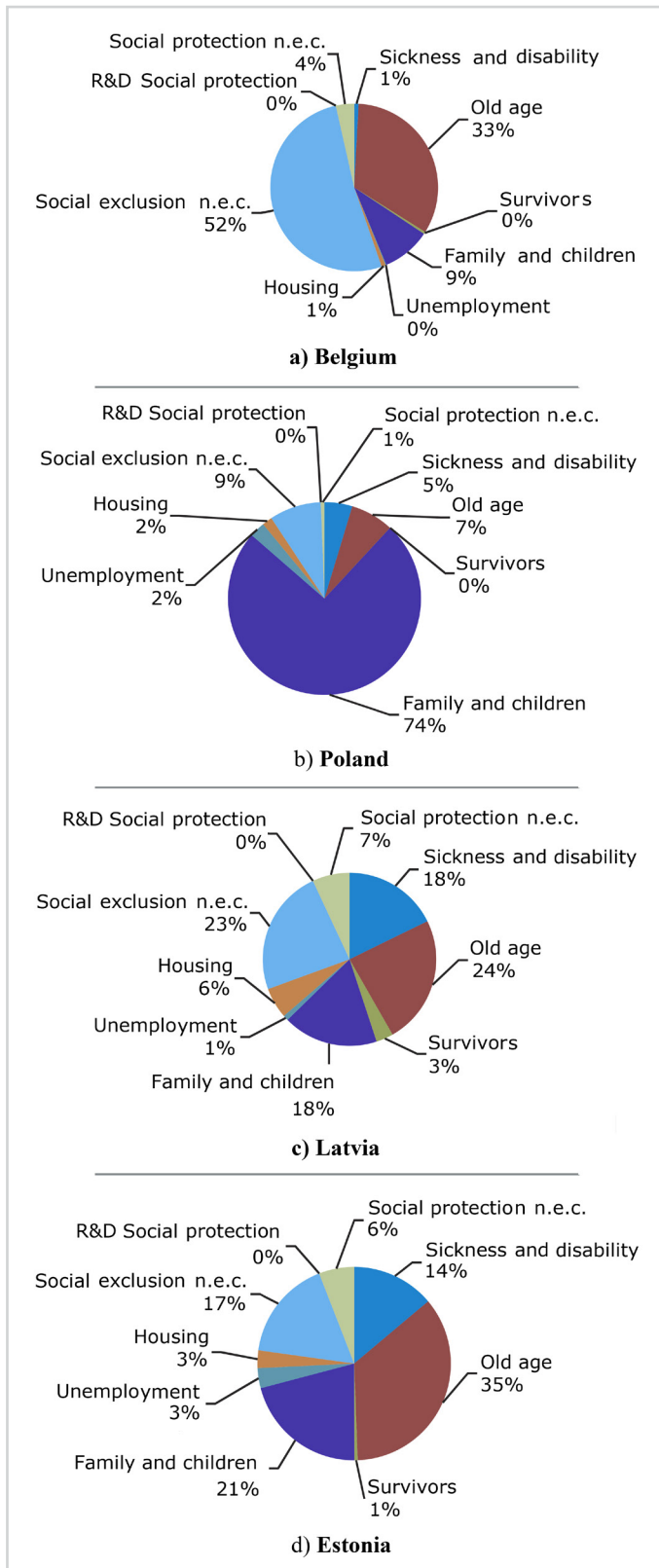


Fig. 4: Structure of expenditures of social protection at the local level in some European countries as of January 1, 2017, %  
Source: Compiled by the authors based on [10]

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