



Local and Regional Democracy

**Pilot Study concerning the Degree Of
Conformity of Member States' Policy and
Practice with Council Of Europe Standards
For Local Finance**

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by

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**PILOT STUDY CONCERNING THE DEGREE OF CONFORMITY
OF MEMBER STATES' POLICY AND PRACTICE WITH COUNCIL OF EUROPE
STANDARDS FOR LOCAL FINANCE**

1. Background and methodology of the pilot study

1.1 The issues

This project relates to two of the items from local governments' budgets for which the Council of Europe acquis includes standards. One is the mix between earmarked and general grants from central to the local standards level, the other is the relative use of raising own local tax revenues.

Article 9 paragraph 7 of the European Charter of Local Self-Government (ECLSG) states that, "as far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction".

Article 9 paragraph 3 of the Charter furthermore states that "part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate".

Both these principles were confirmed by the Conference of European Ministers responsible for Local and Regional Government in Lisbon with their resolution on local government finances in October 1996, and further developed in Recommendation (2005)¹ of the Committee of Ministers to member States on the financial resources of local and regional authorities.

The European Committee on Local and regional Democracy has approved the report implying that the practices of the individual countries all have been within the interpretation of the two paragraphs of the Charter.

1.2 The methodology

The countries participating in the pilot study are: Albania, Belgium (Flemish region and Walloon region), Czech Republic, Croatia, Denmark, Estonia, Finland, Hungary, Iceland, the Netherlands, Norway, Slovenia, and Sweden. This gives all together 14 observations.

The pilot study employs two main methods of comparison. The first is to compare the situation in 2004 across. The second is to analyse the development over time, ideally from 1994 to 2004, in order to ascertain conformity of national policies with the guidelines. The study compares the results with recent results of work in the OECD¹.

¹ See OECD Network on Fiscal Relations across Levels of Government. Working Paper No. 2: "Fiscal Autonomy of Sub-central Governments" 2006. (www.oecd.org/dataoecd/48/26/37159974.pdf)

1.3 The Charter related to “freedom” for local authorities

During the discussions on the conformity of member States’ policy and practice with the Charter several issues were raised, some of them exploring whether the Charter is still a satisfactory guide for good decentralisation.

It was argued that the key message of the European Charter of Local Self-Government is that municipalities must have sufficient freedom and autonomy. When the Charter was drawn up this was basically interpreted to mean sufficient scope to levy local taxes and the right balance between general and earmarked grants. That seemed logical at the time but, the argument continues, today it is not enough to place emphasis on freedom to raise funds, it is more important to be free to spend them. In the Netherlands, for example, that is where the main emphasis lies.

It is clear that the coin of local freedom has two sides, as comes up in the discussion of the difference between narrow or broad-based earmarked grants in section 3.2 below. The ECLSG requires both: freedom to raise funds and freedom to spend them. The pilot study focuses on the revenue side.

Another issue that was raised was that the share of income tax common for all local authorities, the size of which is annually negotiated with the local authorities, has similarities to an own tax and gives local authorities similar freedom on the financing side. However, tax sharing does not promote local government accountability. Committee of Ministers Recommendation (2005)¹ does not regard such revenues as “own resources”. Also, the OECD classifies (section 3.3 below) cases where the revenue split can be changed only with the consent of the local government as a tax sharing arrangement. The pilot study therefore classifies the Estonian shared revenue as tax sharing.

2. What is “local government”?

2.1 Federal countries: The role of regions/states

A particular problem in meeting international definitions arises in some (constitutionally or *de facto*) federal countries where local (municipal) finances are controlled by the regional authorities. Where regions design their own rules for local finances the answers should describe the relationship between the regions and the municipalities. They will reveal the degree of conformity with the Charter for the regional policies towards local government. As concerns the countries participating in the survey, except for the case of Belgium, the responsibility for conformity with the Charter is placed at the level of central government but apart from Belgium no federal country volunteered to participate in the pilot study.

2.2 Unitary countries: the role of counties

Local government in unitary countries may have two tiers – a middle tier and “municipalities”. The middle tier is in some cases considered to be regional - also in *de facto* unitary countries (this may in some cases, like Ireland, be explained by the requirement to have a regional level in order to receive grants from the EU). But in other countries their functions are considered to be those of local government. The OECD tends to classify such cases of middle tier as local government.

However, this report attempts, in accordance with Council of Europe practice, to separate data for middle tiers so as to exclude their revenues from "local government" revenues. But the answers have not all followed the same definitions on this question: while for *Denmark* and *Sweden* it has been attempted to separate data for middle-tier authorities counties from municipalities (and hence reported data for taxes and grants that are different from the OECD classification), *Norway* and *Croatia* have included both tiers of local government in their answers.

The distinction also creates data problems in cases where large local authorities serve as a combined municipal and middle tier authority. For this reason an estimated division of accounts has been necessary in Sweden and Denmark. The magnitude of the difference in definitions is difficult to assess. But as a result of this difference the data submitted for this study will in some cases differ from OECD data on local finances

3. The Charter and the international definitions of "own" local tax revenues

The study is based on the international definition of local taxes as being either "own taxes" or "tax sharing receipts".

3.1 Difference between "local taxes" and local "fees and charges"

When discussing the definitional issues the question was raised of how to interpret the term "charges" in article 9.3 of the Charter. The solution chosen has been to define the term "charges" in best possible conformity with the usage in international statistics on public finances. This has the advantage of allowing available information on local finances to be used to illustrate the degree of conformity with the Council of Europe standards.

The way the terms "fees and charges" are used in local budgets is not well defined. Often local budgets contain revenue items called charges that upon closer examination are more of the nature of tax revenues than of payments for received services.

For this reason some items described as charges in local budgets should clearly be included as tax revenues. That includes cases:

- where the charge greatly exceeds the costs of providing the services;
- where the payer of the levy is not the receiver of the benefit (e.g. a slaughterhouse fee for the benefit for farmers);
- where government does not provide a specific service in return for the levy even though a license may be issued to the payer (e.g. fees for a license for hunting or fishing are examples of fees that should be classified as tax);
- where benefits are received only by those paying the levy but the benefits received by each individual are not necessarily in proportion to his payments.

Such charges meet the definition of taxes (compulsory, unrequired payments to general government, unrequired in the sense that benefits provided by the government to taxpayers are not normally in proportion to their payments²).

Thus, this report takes the view that the use of this kind of charges is to be equated to the use of own taxes in the sense of the Charter art. 9.3 and the *acquis*.

However, in the discussions of this question it was argued that other charges than those described above should also be counted as own local revenues. It was argued that for some charges (e.g. waste disposal charges) municipalities may be free to charge less than the cost price. The public sees the price tag and is free to submit complaints to the municipal council. Such charges, it was argued, are in the sense of the Charter equal to own taxes. However the consequences of following this argument would be that, for example, the existence of local cost-related charges for garbage removal would become a valid argument for denying local authorities the right to collect any other own taxes as part of their financial resources. This argument is therefore not followed.

3.2. Earmarked local taxes

During the discussion, also the notion of own earmarked local taxes was discussed from the perspective of the ECLSG. Are they to be avoided like earmarked grants (Article 9.7), or are they to be appreciated like own tax revenues (Article 9.3)?

When accepting in the preceding section that the term "charges" in art. 9.3 may in some cases include tax-like revenues, defined above as own earmarked tax revenues, the Charter can be said to favour own earmarked tax revenues like any other own tax revenues.

In conclusion, it strengthens the basic freedom of local authorities to exercise policy discretion within their own jurisdiction if they are enabled to collect some of their own tax revenue in the form of own earmarked taxes (even if they are described in the local budgets as charges)³.

3.3 OECD categories of tax autonomy

The categories of tax autonomy are based on a classification developed by the OECD and published for the first time in 1999 and again in 2006⁴.

² See OECD Yearbook of Revenue Statistics.

³ This conclusion may differ from the proposal by the OECD [See OECD Network on Fiscal Relations across Levels of Government. Working Paper No. 2: "Fiscal Autonomy of Sub-central Governments" 2006. (www.oecd.org/dataoecd/48/26/37159974.pdf)] arguing that all earmarked tax sharing revenues should be classified as grants.

⁴ See OECD Network on Fiscal Relations across Levels of Government. Working Paper No. 2: "Fiscal Autonomy of Sub-central Governments" 2006. (www.oecd.org/dataoecd/48/26/37159974.pdf).

The OECD classification of taxes comprehensively describes all possible kinds of local taxation as follows:

- a.1 SCG (Sub Central Government) sets tax rate and tax reliefs (base) without needing to consult a higher level government;
- a.2 SCG set the rate and reliefs after consulting a higher level government;
- b.1 SCG sets tax rate, and a higher government does not set upper or lower levels on the rate chosen;
- b.2 SCG sets tax rate, and a higher government does set upper or lower levels on the rate chosen;
- c.1. SCG sets tax reliefs - but it sets tax allowances only;
- c.2. SCG sets tax reliefs - but it sets tax credits only;
- c.3. SCG sets tax reliefs – and it sets both tax allowances and tax reliefs;
- d.1. There is a tax sharing arrangement in which the SCGs determine the revenue split (only one case is known to the OECD: Greece in 2002);
- 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, which may be changed unilaterally by a higher level of 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 of government;
- e. Other cases in which the central government sets the rate and base for the SCG tax;
- f. None of the above categories a, b, c, d or e applies.

3.4 The advantages of own local taxes

The advantage of having own local taxes is that they promote local accountability. It obliges local authorities to increase tax rates if they want to improve the level of local services. It could be argued that not all local taxes need to be “own” to ensure such accountability, but that accountability depends only on the need for the local councils to increase tax rates if they want to implement additional local spending. If there is only such a connection between spending and financing *on the margin* the electorate can react at the next election or move to another local authority (“voice” or “exit”) if they do not find the benefits from new spending worth their extra tax payments.

Thus, applying the OECD classification to the Charter means considering all items a-c as own taxes because they satisfy the provisions of the Charter “that they have the power to determine the rate” (Article 9(3)).

During the discussions of the pilot study some countries have described how a limited use of own local taxation need not to be the result of legal limitations. Local authorities may have the power to determine which local taxes to impose in their respective territory but exercising the right to impose local taxes has remained relatively unpopular. However, to make local accountability work it is necessary to convince local authorities of their role in taxation, for example by introducing stronger incentives and pressures on them to tax.

4. The Charter and the international definition of grants

On the basis of the Council of Europe's definitions the study is based on the distinction between grants to local government being either "non-earmarked" or "earmarked" grants.

4.1 Categories of grants

The categories of grants are based on the international classification originally designed by the Council of Europe and adopted by the OECD (see OECD 2006). The definitions are as follows:

A. Non-earmarked grants:

A1. Mandatory (A1a) general purpose or (A1b) block grants

A2. Discretionary grants.

B. Earmarked grants:

B1. Mandatory, (B1a) non-matching or (B1b) matching grants.

B2. Discretionary, (B2a) capital grants or (B2b) current grants.

Earmarked grants can be used only for a specific purpose, that is: to cover the costs of specific services. Non-earmarked grants can be spent as freely as the own (non-earmarked) tax revenue of sub-national government.

The decision how to apply this classification in relation to the Charter has been quite straightforward. The Charter holds that "The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction". This corresponds clearly to the distinction made in the international classification.

However, during the discussions on this issue a perceived growing international tendency over recent decades towards greater freedom within earmarked grants was brought up. Traditional statistics fail to register the increases in local spending freedom resulting from reductions in the degree of detail of earmarking, or from the introduction of more broad-based earmarked grants. This is a point worth developing further. No international statistics that permit comparisons of the levels or of the developments over time within grants are available at present.

Also the issue of the classification of systems of reimbursing VAT paid by local authorities was raised. This raised the issue whether such VAT arrangements really should count as grants. They are neutralised by a reverse payments of the same magnitude (i.e. the VAT paid by local authorities on their purchases) to the centre. The pilot study does not include these as earmarked grants and describes - for those countries with this kind of VAT reimbursement systems - only the financing of local spending net of VAT.

4.2 The advantages of non-earmarked grants

Earmarked grants have the undesirable effect of distorting local priorities and – when they are conditional – of giving incentives for increased local spending. The use of grants conditioned by local spending (or by local collection of fees and charges) weakens accountability and softens local authorities' budgetary constraint.

But several countries argued that the use of earmarked matching grants is a necessary by-product of more decentralisation because they are needed to compensate local authorities for the cost of new competences. This line of argument appears to take issue with the Charter and several countries have found ways more in conformity with the Charter to compensate local authorities for the costs of new mandates. These problems are taken up in a separate study⁵ CDLR(2008)48.

Finally, some countries, including Hungary, have argued that earmarked matching grants are necessary for development grants. This point is generally accepted and the explanatory report of the ECLSG says on this issue: "It would be unrealistic to expect all specific project grants to be replaced by general grants, particularly for major capital investments, but excessive recourse to such grants will severely restrict a local authority's freedom to exercise its discretion with regard to expenditure priorities." However, it is worth noting that the Flemish Region of Belgium in 2003 consolidated their earmarked Investment Fund into the general Municipal Fund.

5. Comparison of levels in 2004⁶

The data permit a comparison of levels of local taxes and grants between countries. Such comparisons may serve as a first indication of the size of the local government sector, of the relative importance of own taxes as opposed to tax sharing revenues, and the degree of success in avoiding the use of earmarked grants.

5.1 Size of local government sector

The sum of tax revenues and grants for local governments can be seen as an indication of the size of the decentralised public sector, see table 1 (*column 7*).

The Nordic countries (*Denmark⁷, Finland, Iceland, Norway and Sweden*) have a long tradition of decentralisation and the data confirm that in 2004 they still rank high in the size of the local government sector. *Albania, the Czech Republic, Croatia, Estonia, Slovenia and the Belgian regions* appear to have a smaller local government sector when measured this way.

5.2 Importance of own taxes

The OECD (2006) found that own taxes were at 40 per cent of local financing and thus a slightly less important source for sub central governments finances than the 45 per cent for grants. A similar pattern may be seen in table 1 (*column 9*), the average share for own taxes is 36 pct.

⁵ Member states' practices for the funding of new competences of local authorities", 2009.

⁶ Note that data were submitted sometimes in whole numbers and sometimes with one or more decimal places. Calculated data may because of rounding not add up.

⁷ *Denmark* notes that the 2005 data were before the recent reform increasing the role of municipalities in 2007.

Table 1 (column 9) suggests that a particularly low ranking is found for the *Czech Republic, Estonia, and Norway*. These countries also rank low looking at own taxes in per cent of GDP (column 1). This modest role of own taxes seems to suggest that the question of local financial accountability in these countries is given less importance than the desire of central control of overall tax policy.

Table 1. Comparison across countries of taxes, grants, and degree of decentralisation in 2004

	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Sum tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) in pct of (7)
Albania**	1.5	100	1.5	4.5	84	5.4	6.9	65	22
Austria									
Belgium- Walloon region \times .	3.1	100	3.1	2.1	59	3.6	6.7	31	46
Belgium - Flemish region \times ,	2.4	100	2.4	0.8	43	1.8	4.2	19	57
Czech Republic	0.4	10	3.5	3.5	100	3.5	7.0	50	6
Croatia	0.6	16	3	0.6	100	0.6	4.8 $\times\mathbf{x}$	17	14
Denmark**	10.6	96	11	2.3	46	5	16	14	69
Estonia	0.4	9	4.1	0.5	20	2.8	6.9	7	6
Finland*	10	95	10,5	0.5	10	5.2	15.7	2	64
Hungary	1.9	77	2.2	3.5	57	6.2	8.4	41	23
Iceland**	9.3	100	9.3	0.5	44	1,2	10.5	5	89
Netherlands	1.4	100	1.4	3.7	59	6.3	7.7	48	18
Norway*	0.3	5	5.6	2.2	47	4.7	10.3	21	3
Slovenia**	0.9	30	2.9	1.1	36	1.0	3.9	28	23
Sweden*	10.5	100	10.5	2.2	43	5	15.5	14	69

* 2006 **2005

\times Note that data for local government finances do not follow international definitions.

$\times\mathbf{x}$ Data based on 53 largest cities have been scaled up by increasing them with 33 per cent.

5.3 Earmarked grants

It seems reasonable to argue that the freedom of local authorities is best measured by the proportion of earmarked grants in relation to the sum of taxes and grants available for local government table 1 (column 8). Measured in this way *Albania, Czech Republic*, and perhaps the *Netherlands* have the highest proportion of earmarked grants. *Finland, Estonia* and *Iceland* have the lowest proportion of earmarked grants out of the sum of grants and taxes.

6. Comparisons of developments over time, the general trends

The data also permit to study changes in the composition of taxes and of grants, typically over the period 1994 to 2004 but, in some cases, over a different period, (see the annex table for 1994-data).

The OECD (2006) describes three forces shaping the evolution of *local tax revenues* and tax autonomy over time: political, fiscal, and economic cycles. From the point of view of the Charter the relevant factor is the role of policy reforms such as reassignment of taxes to another level, or changes in tax autonomy. Among the fiscal reasons are the relative changes in tax bases, in many countries the base for local property tax remains unchanged over long periods of time, while the base of central government taxes like income and consumption tax increase. Fiscal changes may thus affect the degree of conformity with the Charter without any action being taken by the government. Finally, the OECD considers that tax bases react differently to the business cycle.

Regarding the composition of *grants* the development in the share of earmarked grants may reflect "automatic" changes in conditional grants, but several countries report that also the need to fund new local functions or to control local government performance has played a role for the development in the use of earmarked grants (relative to general grants).

Table 2. Changes from 1994 to 2004. Taxes, grants, and degree of decentralisation

	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes pct of (7)
Albania	1.5	100	1.2	-1.5	-16	-0.3	0.9	-34	22
Belgium – Walloon region	-	-	-	-	2	-	-	-	-
Belgium- Flemish region	0.2	-	0.2	-0.1	-7	-	0.2	-3	2
Czech Republic (n.a)									
Croatia	-	-5	0.7	0.5	-	0.5	1.6 ^{xx}	13	-7
Denmark	-	1	-	0.5	-	1	1	2	-5
Estonia	-0.1	-0.5	-0.6	0.1	-4.2	1.2	0.6	0.9	-2.1
Finland	0.7	6	0.1	0.3	7	-1.0	-0.9	-1	8
Hungary	1.1	-	1.3	1.5	14	1.5	2.7	6	9
Iceland	2.8	-	2.8	0.4	16	0.8	3.6	4	-5
Netherlands	0.1	-	0.1	-1.6	-7	-1.7	-1.6	-9	5
Norway	-	-1	1	-	10	-1.3	-0.7	1	-
Slovenia	0.2	4	0.3	0.7	-64	-0.1	0.2	17	4
Sweden	1.5	-	1.8	-0.3	-20	1	2.8	-6	0

Source: Table 1 and annex table.

^{xx} Data based on 53 largest cities have been scaled up by increasing them with 33 per cent.

6.1 Development in the size of local government

The changes recorded in the size of the local government sector, measured as the sum of local tax revenues and grants in per cent of GDP, suggest (table 2 *col. 7*) that the period has seen a general trend toward more decentralisation. Most of the lower ranking countries in 2004 have moved towards more decentralisation. *Albania* reports that legislation enacted in 2000 has transferred many functions, competences, and fiscal responsibility to local government but in the *Netherlands*, already low ranking in 1994, decentralisation has been reduced. Also in two highly decentralised countries, *Norway* and *Finland*, show a small decline in the importance of local government. In *Norway* this results from the transfer of the hospitals from the counties (that were included in the 1994 data for local government) to the central government.

6.2 Development in tax composition

The pilot study attempts to reveal whether there has been a trend over time improving the conformity of local governments with the provision in the Charter that "part at least of the financial resources available for local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate".

The OECD 2006 study concluded that the taxing power of sub central governments increased from 1995 to 2002 but that states and regions gained more tax autonomy than local governments.

The data for local government accounts reported in the present study shows that one country, *Albania*, has made a complete shift from tax sharing to own taxes (table 2, *col. 2*) and that for three other countries there have been minor changes. In none of the four countries having the lowest proportion of own taxes (out of total local taxation) in 2004 (table 1, column 2) the proportion has increased, and it has declined in *Croatia*.

The strong performance of *Albania* was a result of legislation in 2002 "redefining" some previously national taxes as local taxes and creating new local taxes and fees (some of these fees with significant tax-like features). But also increases in taxable property values and improved tax collection help to explain the Albanian performance.

Hungary explains that though the local authorities have the right to impose a local business tax with an upper ceiling of 2 pct. of the tax base, some municipalities do not apply the local business tax. But in those municipalities where the local business tax has been introduced, the revenue has increased strongly because of the growth in business income.

6.3 Developments in composition of grants to local government

The countries with the lowest proportion of earmarked grants in 2004 were (table 1, *col. 8*) *Estonia, Croatia, Finland, Iceland, Denmark* and *Sweden*.

However, four out of these best performers in 2004 saw an increase in the importance of earmarked grants out of total financing, only in *Sweden* and in *Finland* did it decline.

The highest proportion of earmarked grants in 2004 is found in *Albania, the Czech Republic, the Netherlands* and *Hungary*. The proportion of earmarked grants in total financing has declined in *Albania* and in *the Netherlands*, the same seems to be the case more recently in the *Czech Republic* (see table 3c) but in *Hungary* the proportion of earmarked grants has increased. *Hungary* explains that this is necessary because their grants are directed at municipalities with low revenue potential in order to guarantee that they can provide public services in accordance with the requirements of mandatory tasks prescribed by law.

7. Summary of Conclusions

7.1 Conclusions on recent trends

The changes recorded in the *size of the local government sector*, measured as the sum of local tax revenues and grants in per cent of GDP, suggest (table 2, col. 7) that the period has seen a general trend toward more decentralisation.

The results regarding the *use of own local taxes* show that conformity with the guidelines has not deteriorated, but none of the countries ranking with the lowest proportion of own taxes in 2004 have reported improvements. Some countries report that the freedom to set own rates is there but that local authorities hesitate to make use of it.

As for *earmarked grants*, their use by countries taking part in the pilot study has often increased over the last decade. The argument advanced by participating countries has in many cases been that this is a result of the increasing decentralisation. It is argued that earmarked conditional grants have been needed to finance new local expenditure caused by decentralisation of functions.

7.2 Conclusions on country policies

The study suggests the following conclusions concerning the degree of conformity of the member states' policy and practice with Council of Europe standards for local finance. The conclusions are developed further in annex 2.

- *Albania* has moved in the right direction in relation to the recommendations of the Charter with a reform policy of creating more own local taxation. But in spite of strong moves in the right direction the use of earmarked grants is the highest recorded in the pilot study.
- The *Walloon Region of Belgium* lives up to the standards of the Charter, but the use of earmarked grant is relatively high.
- The *Flemish Region of Belgium* lives up to the standards of the Charter on own taxation as well as on earmarked grants, but the size of the local government sector is small.
- Data for the *Czech Republic* are not available for 1994. In 2004 the Czech Republic was the second highest user of earmarked grants in the pilot study and had a relatively insignificant share of own taxation.
- *Croatia* is moving towards more decentralisation, but the use of own taxation is low and has declined while the use of earmarked grants is increasing.
- *Denmark* seems, when looking at municipal finances, to be in accordance with the standards of the Charter.
- In *Estonia* legislation permits, in conformity with the Charter, local authorities to raise own taxes but they have shied away from doing so. In some other countries (see *Hungary* as one example) it has been possible to teach local authorities to tax. The use of earmarked grants is very limited.
- *Finland* seems to be in accordance with the standards of the Charter.

- *Hungary* has developed a relatively high degree of decentralisation and has implemented a successful policy of teaching local authorities to tax. But Hungary ranks among the highest in the use of earmarked grants and not high in the use of own local taxation.
- *Iceland* seems to be in accordance with the standards of the Charter.
- The local government sector in the *Netherlands* is of medium size. It seems to be in conformity with the standards with a modest but increasing role of own taxation (as per 2004), but with a relatively high level of earmarked grants. The level of the latter has declined markedly over the period.
- As for *Norway* the share of own local taxation is among the lowest in the pilot study.
- In *Slovenia* the degree of decentralisation is low. The use of own local taxation is not high. Slovenia has shown a strong performance by replacing all earmarked grants with general grants in 1999.
- *Sweden* seems to be in accordance with the standards of the Charter.

ANNEX 1

Comparison across countries of taxes, grants, and degree of decentralisation in 1994

	1. Own local tax pct of GDP	2. Own local tax pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear-marked grants pct of GDP	5. Ear-marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear-marked grants (4) in pct of (7)	9. Own tax (1) pct of (7)
Albania	0	0	0.3	5.7	100	5.7	6.0	95	0
Belgium – Walloon region \times	3.1	100	3.1	2.1	57	3.6	6.7	31	46
Belgium – Flemish region \times	2.2	100	2.2	0.9	50	1.8	4.0	23	55
Czech Republic n.a									
Croatia	0.5	21	2.3	0.1	100	0.1	(3.2)	4	21
Denmark*	10.7	97	11	1.8	46	4	15	12	73
Estonia	0.5	10	4.7	0.4	23	1.6	6.3	6.3	8
Finland*	9.3	89	10.4	0.2	3	6.2	16.6	1	56
Hungary	0.8	77	1.0	2.0	43	4.7	5.7	35	14
Iceland*	6.5	100	6.5	0.1	28	0.4	6.9	1	94
Netherlands	1,3	100	1.	5.3	67	8	9,3	57	14
Norway*	0.3	5	5	2.2	37	6	11	20	3
Slovenia	0.7	26	2.6	0.4	100	1.6	3.7	11	19
Sweden*	9	100	9	2.5	63	4	13	20	69

*1995

**1996

 \times 1998

ANNEX 2

Country profiles

Table A1. Albania: Taxes, grants, and size of local government.

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear-marked grants pct of GDP	5. Ear-marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear-marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1994	-	0	0.3	5.7	100	5.7	6.0	95	-
2005	1.5	100	1.5	4.5	84	5.4	6.9	65	22
Development	1.5	100	1.2	-1.5	-16	-0.3	0.9	-34	22

Albania is in the group of countries with a relatively limited degree of decentralisation (see table 1, col. 7) but the importance of local government has been increasing. Legislation enacted in 2000 has transferred a number of functions, competences, and fiscal responsibility to local government.

Albania has moved strongly to replace tax sharing with *own local taxation*. This was a result of legislation in 2002 "redefining" some previously national taxes as local taxes and creating new local taxes and fees – some of these fees seemingly with significant tax-like features. Albania reports that before 2002, 76 per cent of local budgets came from the centre, after 2002 this is reduced to only 35 per cent (this development is not clear in table A1, perhaps because much of the new local financing is in fees and charges). But also increases in the values of taxable property and improved tax collection explain part of the Albanian performance.

The use of *earmarked grants* is relatively high. Albania uses conditional grants for new delegated functions. Most of the earmarked grants are conditional grants for the financing of local educational and health care expenditure. The proportion of earmarked grants in total financing has declined. A new policy in *Albania* since 1999 has been to use unconditional grants to local authorities.

In conclusion Albania has moved in the right direction in relation to the standards of the Charter with a reform policy of creating more own local taxation. However, the use of earmarked grants is the highest recorded in the pilot study.

Table A2.a. Belgium, Walloon region: Taxes, grants, and size of local government⁸

Year	1. Own taxes pct of GDP*	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP*	4. Ear- marked grants pct of GDP*	5. Ear- marked grants pct of grants	6. Total grants pct of GDP*	7. (3+6) Total tax and grants pct of GDP*	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1998	3.1	100	3.1	2.1	57	3.6	6.7	31	46
2004	3.1	100	3.1	2.1	59	3.6	6.7	31	46
Development	-	-	-	-	2	-	-	-	-

*Relating to regional GDP

The regional data from Belgian regions follow local budget classifications that may differ from international definitions.

The *Walloon region* is less decentralised than the Nordic countries but is in line with other non-Nordic participants in the pilot study (see table 1, column 7).

The policy regarding *own taxation* is outstanding. A reform in 2001 reduced the local tax sharing revenues, and this was compensated by an increase in the ceiling for the local surcharge on the personal income tax. The new taxation powers were tempered by a "plan de paix fiscale" that ensures that the level of taxation as a whole does not increase.

The Walloon Region uses *earmarked grants* relatively much and this situation did not change during the period 1998-2004. The earmarked grants are used in particular for local spending on employment, economic development, urban renewal, and housing. These grants are seen as promoting decentralisation because they allow local authorities in certain cases to develop new services. Following the elections in 2004 new policies have been introduced to strengthen the role of general grants.

In conclusion the data reported for the pilot study suggest that the Walloon Region lives up to the standards of the Charter, but that the use of earmarked grant is relatively high.

⁸ At the time of ratification of the European Charter on Local Self-Government the Walloon Region of Belgium did not declare itself bound by Article 9(7).

Table A2.b. Belgium, Flemish region: Taxes, grants, and size of local government⁹
¹⁰

Year	1. Own taxes pct of GDP*	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP*	4. Ear- marked grants pct of GDP*	5. Ear- marked grants pct of grants	6. Total grants pct of GDP*	7. (3+6) Total tax and grants pct of GDP*	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1998	2.2	100	2.2	0.9	50	1.8	4.0	23	55
2004	2.4	100	2.4	0.8	43	1.8	4.2	19	57
Development	0.2	-	0.2	-0.1	-7	-	0.2	-3	2

*Relating to regional GDP

The regional data from the Flemish region follows local budget classifications that are reported to be "very different" from international definitions.

The *degree of decentralisation* in the Flemish region is low when compared to the other pilot study countries (see table 1, col. 7). But decentralisation seems to have increased.

The Flemish region ranks relatively high in the use of *own taxes*. These are mostly the "additional taxes" based on central legislation but with the right for individual local authorities to set the rate. The increase in own tax revenues is explained in part by the need to finance otherwise un-financed new mandates or revenue shortfalls caused by changes in central legislation.

The use of *earmarked grants* is relatively low and has been slightly decreasing in favour of non-earmarked grants and own local taxes. The decline is related to the reform in 2003 incorporating the formerly earmarked Investment Fund and Social Incentives Fund into the general Municipal Fund.

In conclusion the data reported for the pilot study suggest that the Flemish Region lives up to the standards of the Charter on own taxation as well as on earmarked grants, but that the size of the local government sector is small.

⁹ At the time of ratification of the European Charter on Local Self-Government the Flemish region of Belgium did not declare itself bound by Article 9(7).

¹⁰ Include municipalities and provinces.

Table A3. Czech Republic¹¹: Taxes, grants, and size of local government

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes pct of (7)
1994 n.a.									
2004	0.4	10	3.5	3.5	100	3.5	7.0	50	6
Development									

The Czech Republic has not reported data to allow analysis of the 10-years trends.

In 2004 decentralisation is in line with the other non-Nordic countries (see table 1, column 7).

The use of *own taxation* is in 2004 relatively limited.

The use of *earmarked grants* is among the highest in the study and was increased by a reform in 2001. This would appear to be on the borderline of the standards on the Charter. The Czech Republic defends earmarked grants stressing the: "directness of earmarked grants and support of higher efficiency of local government." The reason why the relative share of earmarked grants has increased has not been that they have been increased but rather that the 2000-reform reduced the need for the non-earmarked equalisation grant.

In conclusion the Czech Republic was in 2004 the second highest user of earmarked grants in the pilot study and had a relatively insignificant share of own taxation.

¹¹ At the time of ratification of the European Charter on Local Self-Government Czech Republic did not declare itself bound by Article 9(7).

Table A4. Croatia¹²: Taxes, grants, and size of local government

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1994	0.5	21	2.3	0.1	100	0.1	(3.2)*	4	21
2004	0.6	16	3	0.6	100	0.6	(4.8)*	17	14
Development	-	-5	0.7	0.5	-	0.5	(1.6)*	13	-7

* The data includes about 75 percent of all local authorities. The total is increased by 33 percent to cover the whole country. Column 8 is calculated on the not adjusted sum.

The degree of decentralization in Croatia is relatively speaking very low (see table 1, column 7) but has been increasing.

The use of *own local taxation* is relatively low. The revenue from own taxation has through the period been a constant share of GDP, all the growth in the share of local tax revenues in GDP have been in tax sharing revenues. Towns and municipalities can levy surtaxes on the income tax within maximum rates depending on type and size of local government. In 2001, a reform of the system of local financing was introduced and the functions of education, health care, welfare and fire protection were partially decentralised. The local authorities were, following the Croatian rules, compensated for the extra costs of new delegated functions by a combination of an increased share of the income tax and grants from the central government.

All grants are *earmarked* and the use of such grants has increased quite strongly. Croatia explains this as "arising from the decentralisation process". However, compensation for new local mandates is provided by changes in the distribution of the 100 per cent shared income tax and this revenue is not earmarked.

In conclusion Croatia is moving towards more decentralisation but the use of own taxation is low and has declined while the use of earmarked grants is increasing.

¹² At the time of ratification of the European Charter on Local Self-Government Croatia did not declare itself bound by Article 9(7).

Table A5. Denmark: Taxes, grants, and size of local government

	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
Year									
1995	11	97	11	1.8	46	4	15	12	73
2005	11	96	11	2.3	46	5	16	14	69
Development	-	1	-	0.5	-	1	1	2	-5

Denmark is among the most decentralised countries (see table 1, column 7).

The use of *own local taxation* is high though there seems to be a slight decline in their role (column 9). Denmark explains this by a recent surge in revenue from the shared revenue from certain capital income taxes pushing down somewhat the per cent share of own taxes. This effect is not necessarily seen as a lasting one.

The importance of *earmarked grants* is low but has been slightly on the increase. Local authorities are compensated for new mandates by general grants.

In conclusion Denmark seems, when looking at municipal finances, to be in accordance with the standards of the Charter.

Table A6. Estonia: Taxes, grants, and size of local government

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1996	0.5	9.8	4.7	0.4	23.1	1.6	6.3	6.3	7.9
2004	0.4	9.3	4.1	0.5	19.9	2.8	6.9	7.2	5.8
Development	-0.1	-0.5	-0.6	0.1	-4.2	1.2	0.6	0.9	-2.1

Estonia is among the least decentralised countries in the sample (see table 1, column 7).

It is among the very low ranking in the sample as regards the relative importance of *own taxes* (table 1), but Estonia does consider itself to be in conformity with the Charter.

Firstly, the low revenue from own local taxation is a result of local unwillingness to tax. Local authorities have the power to determine which local taxes to impose on their respective territory as well as the rate of state land tax (within the limits of statute). However, local authorities see it as an unpopular decision, which they are unwilling to make for political reasons. Examples: on 2004, sales tax, and motor vehicle tax were imposed in 2 local authorities, parking charge in 7, road and street closure tax in 14 local authorities. The most popular tax is advertisement tax – 50 local authorities.

Secondly, the fixed rate designated to local authorities on state personal income tax is annually adjusted after consultations between the two levels of government. Estonia argues that the definition of “own taxes” is too narrow if it does not accept this as own tax revenues. This argument seems difficult to accept, see section 3.4.

Only a limited share of the local financing in Estonia is *earmarked grants*, though the share of earmarked grants has increased slightly.

In conclusion Estonian legislation permits, in accordance with the Charter, local authorities to raise own taxes but they have shied away from doing so. In some other countries (see Hungary as one example) it has been possible to teach local authorities to tax. The use of earmarked grants is very limited.

Table A7. Finland: Taxes, grants, and size of local government

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear-marked grants pct of GDP	5. Ear-marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear-marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1995	9.3	89	10.4	0.2	3	6.2	16.6	1	56
2006	10.0	95	10.5	0.5	10.2	5.2	15.7	2	64
Development	0.7	6	0.1	0.3	7	-1.0	-0.9	-1	8

Finland is among the most decentralised countries (see table 1, column 7).

The role of *own taxation* is high. Finland explains the slight decline in tax sharing revenues as a result of government tax policy. There has been a reduction in the municipal share of the company tax as well as a structural increase over the years of personal income that is the base for the local income tax.

Also for Finland there has been a trend towards using more *earmarked grants*. Finland offers two explanations for the increase. One is a complete reform of the grant system, and that some cuts in the grants have been necessary because of the general economic recession. The other is the need to finance newly delegated functions. The Finish development is partly caused by the inclusion of a new system reimbursing VAT paid by local authorities among earmarked grants (see discussion of this in section 4.1). This system has meanwhile been abolished.

In conclusion Finland seems to be in accordance with the standards of the Charter.

Table A8. Hungary: Taxes, grants, and size of local government¹³

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear-marked grants pct of GDP	5. Ear-marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear-marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1994	0.8	76.7	1.0	2.0	43.4	4.7	5.7	35	14
2004	1.9	77.1	2.2	3.5	56.9	6.2	8.4	41	23
Development	1.1	-	1.3	1.5	14	1.5	2.7	6	9

The relative size of the local government sector in *Hungary* ranks average among Non-Nordic countries (see table 1, column 7) and the importance of local government has been increasing quite strongly.

The role of *own local taxation* in Hungary ranks in the medium range and has increased. For those municipalities that introduced the local business tax revenue has increased strongly because of the growth in business income. But Hungary has moved in the right direction also because of a successful process of local "learning to tax". As a result there has been an increase in the importance of local taxes in pct. of GDP and a growing number of municipalities who have introduced local taxes (the number increased from 1578 municipalities in 1994 to 3091 in 2004). There is still some way to go, Hungary reports, because although local governments have the right to impose a local business tax, some municipalities still do not do so.

Hungary ranks relatively high in the use of *earmarked grants* and the trend has been on the increase. However, Hungary states that the financing system is in compliance with the provisions (art. 9.7) of the Charter. Hungary describes its decentralised system as very fragmented and with a wide range of functions delegated to the local level. Considering this, the increase in the already high share of earmarked grants is a minor point and, seen as a whole, argues Hungary, local freedom in Hungary is not limited. The use of earmarking is necessary because the allocation of grants in Hungary is directed at local authorities with low revenue potential in order to guarantee that they provide public services in accordance with the requirements of mandatory tasks prescribed by the law. This latter argument could, if accepted, be used by many members. However, no necessary connection between the degree of decentralisation and the use of earmarked grants has been demonstrated.

Earmarked matching grants have, Hungary argues, in particular been increasing in order to fund new local mandates in the field of social policy, employment and education (some examples are mentioned of new matching grants like a 90 pct. reimbursement – up from 50 pct. in 1994 – for the prescribed costs of protection of children, a proportion of the costs of employing unemployed for public works, for running the local fire service, and for local health services.

¹³ At the time of ratification of the European Charter on Local Self-Government Hungary did not declare itself bound by Article 9(3) in respect of the counties.

Among examples of recently introduced earmarked grants is one aimed at promoting micro-regional cooperation and one for local public transport in the cities). But many countries have managed to fund new mandates with general grants or increases in tax sharing revenues.

Hungary also argues that most matching grants are development grants and that operational grants typically are distributed according to objective criteria. It is recognised by the ECLSG that development grants may tend to be earmarked, but the ECLSG anyway maintains that "excessive recourse to such grants will severely restrict a local authority's freedom".

Furthermore, the local functions described by Hungary, at least as far as local operational functions are concerned, are performed in other countries by using general equalisation grants in well designed equalisation systems based on objective criteria. In Hungary other grants exist that equalise differences in tax capacity.

In conclusion Hungary has developed a relatively high degree of decentralisation and has implemented a successful policy of teaching local authorities to tax. But Hungary ranks among the highest in the use of earmarked grants and not high in the use of own local taxation.

Table A9. Iceland: Taxes, grants, and size of local government

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1995	6.5	100	6.5	0.1	28	0.4	6.9	1	94
2005	9.3	100	9.3	0.5	44	1.2	10.5	5	89
Development	2.8	-	2.8	0.4	16	0.8	3.6	4	-5

Decentralisation is not as high as in the other Nordic countries (see table 1, column 7) but the importance of local government has been increasing.

The use of *own taxation* is at the same high level as the other Nordic countries and has increased over the period.

Iceland has a very low proportion of *earmarked grants* but the share has increased. This is explained by the desire to fund the local costs of new mandates.

In conclusion Iceland seems to be in accordance with the standards of the Charter.

Table A10. The Netherlands: Taxes, grants, and size of local government

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1994	1.3	100	1.3	5.3	67	8	9.3	57	14
2004	1.4	100	1.4	3.7	59	6.3	7.7	48	18
Development	0.1	-	0.1	-1.6	-7	-1.7	-1.6	-9	5

The *degree of decentralisation* in the Netherlands as measured by column 7 is in the medium range but has declined sharply during the period. The drop is located in the importance of earmarked grants but no explanation of this decline has been offered.

Netherlands ranks in the low end of the use of *own taxation*. The relative importance of own taxation has increased but column 1 indicates that the increase is small.

The relative importance of earmarked grants is high in the Netherlands but it has – as said – declined.

In *conclusion* the local government sector in the Netherlands is of medium size. It seems to be in conformity with the standards with a modest but increasing role of own taxation (as per 2004), but with a relatively high level of earmarked grants. The level of the latter has for unknown reasons declined markedly over the period.

Table A11. Norway: Taxes, grants, and size of local government

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1995 (estimates)	0.3	5	5	2.2	37	6	11	20	3
2006	0.3	4.5	5.6	2.2	47	4.7	10.3	21	3
Development	-	-0.5	0.6	-	10	-1.3	-0.7	1	-

Decentralisation in Norway is below that of Denmark and Sweden but is still relatively high (see table 1, column 7). It has declined a little which is explained by the transfer of the hospitals from the counties (included in the data for local government) to the central government.

The share of own taxes places Norway among the very low ranking countries. The local PIT rate is not fixed by law, a maximum rate is set, but the local authorities have the right to reduce their tax rate. However, since 1979 all local authorities have applied the maximum rate and the Norwegian authorities describe the system as being one of tax sharing. The PIT is collected by the municipalities and they forward the proper share of the revenue to the central government. Norway finds that the fact that the municipality collects that tax creates expectations of good quality of public service and this way can be said to result in some accountability.

The use of earmarked grants is in line with the international average and has not declined.

In conclusion the share of own local taxation is among the lowest in the pilot study.

Table A12. Slovenia: Taxes, grants, and size of local government

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1995	0.7	26	2.6	0.4	100	1.1	3.7	11	19
2005	0.9	30	2.9	1.1	36	1.0	3.9	28	23
Development	0.2	4	0.3	0.7	-64	-0.1	0.2	17	4

Taking the sum of local tax revenues and grants as an indication of the *decentralisation* of the public sector Slovenia ranks among the lowest (see table 1, column 7) though the share of local government has been slightly increasing.

The weight of *own taxes* in Slovenia is low when compared to that of other countries. Most local tax revenues are tax sharing revenues. The proportion of own taxes has increased slightly but no steps have been taken or are planned to increase the share of own taxation. Recent changes have increased the local share of the PIT.

As to the share of *earmarked grants*, Slovenia appears among the highest ranking countries. In 1995 all grants were matching earmarked grants, but in a reform in 1999 it was decided to replace matching grants with general grants according to objective criteria.

In *conclusion* Slovenia has a low degree of decentralisation. The use of own local taxation is not high. Slovenia has shown a strong performance by replacing all earmarked grants with general grants in 1999.

Table A13. Sweden: Taxes, grants, and size of local government

Year	1. Own taxes pct of GDP	2. Own taxes pct of local taxes	3. Total local tax revenue pct of GDP	4. Ear- marked grants pct of GDP	5. Ear- marked grants pct of grants	6. Total grants pct of GDP	7. (3+6) Total tax and grants pct of GDP	8. Ear- marked grants (4) in pct of (7)	9. Own taxes (1) pct of (7)
1995	9	100	9	2.5	63	4	13	20	69
2006	11	100	11	2.2	43	5	16	14	69
Development	2	-	2	-0.3	-20	1	3	-6	-

Sweden is among the most decentralised countries (see table 1, column 7) and the importance of the local government sector is increasing.

Sweden ranks in the top of the use of own taxes and the trend over time has been an increase. This performance is to some extent related to the strong development in the taxable personal incomes.

The use of earmarked grants was in 1995 in line with the international average and has been declining. Central government grants and the equalisation system were reformed in the 1990s. In 1993 a larger number of earmarked state grants were replaced with a single non-earmarked grant distributed between local authorities on the basis of differences in tax capacity and spending needs. Another step was taken in 1996 with the introduction of a new non-earmarked grant distributed among municipalities and county councils as a uniform sum per inhabitant. There are still earmarked grants – they are used to compensate for newly delegated functions – but such earmarked grants are usually transformed to non-earmarked grants after some years.

In conclusion Sweden seems to be in accordance with the standards of the Charter.