

DECENTRALIZATION AND LOCAL ECONOMIC DEVELOPMENT IN THE KNOWLEDGE SOCIETY

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Abstract:

The sustainable development became a goal for knowledge society, but one of the main question in literature remains as how close is the relationship between economic development, knowledge society and local governments' level. Given the great diversity of situations and frameworks both across countries and within them in the European Union, I consider that each country must have own policies designed to implement process of decentralization with the commitment of "healthy" economy in a society dominated by the technology and innovation. In this context, the problem occurs in decentralization should be managed on two levels: on the one hand in terms of central-local budgets relations, and on the other hand, in the local public finance structural plan.

The paper will try to emphasize the connection between decentralization, local economic sustainable development and knowledge society, taking into account an overview of this three aspects and empirical evidences. In this regard, I will use the background offered by literature and the official statistical data for analysis to identify the variables which explain decentralization and local economic development in the knowledge society.

I estimate the analysis to confirm the hypothesis that there are good aspects, but also deficiencies that require solutions and budgetary policy options as part undisputed positioning local government finance as an engine of development of the whole nation.

I consider that the paper can be a useful viewpoint in understanding local public finances in decentralization, which allows researchers to include other sources of information for researching an in a much more complex approach.

Keywords: *decentralization, local economic development, local finance, local government, knowledge society*

JEL Classification: H7

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1. Introduction

From the 1970s onwards, the idea that local communities can serve their own needs through their proper economy has gained momentum globally. So that, today, local governments are essential contributors to economic and social community development, and an important employer which have played a fundamental constitutional role throughout the history of all European countries. Their role became complete when almost all the EU countries decided to be impacted by decentralization over the last fifty years, transferring responsibilities and means from central government to local administrative-territorial units which starting to have a certain independence of decision and action.

Simultaneously, starting with the beginning of 21st century, the global society realized beyond the importance of development, the sustainability of it. So, the sustainable development became a goal not only for central government, but also for local governments.

In this context, when we realized that society is governed by technology and so that it is considered developed, the local communities must face with the challenge to generate a sustainable development as the total autonomy they have in action and decision.

The paper will try to emphasize the connection between decentralization, local economic sustainable development and knowledge society, taking into account an overview of this three aspects and empirical evidences.

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2. An Overview of Decentralization Process and Features of Local Economic Development

Decentralization is viewed as an indispensable part of sustainable development efforts, particularly those focused on alleviating poverty (White, 2011). Several countries of Europe elaborated their first major decentralizing Acts starting with the end of the 1970s, such as: Spain with its 1978 Constitution, France with the 1982-1983 Acts, Belgium and Luxembourg in 1988, Italy in 1990, etc. These initial reforms determined a common framework for local autonomy in Europe, which were concretized by the European Charter of Local Self-Government, adopted in 1985 and which came into effect in 1988. The European Charter of Local Self-Government quickly became a reference, particularly for the new Central and Eastern European democracies that were in the process of implementing their own decentralization reforms, driven by a desire to both consolidate local institutions and capacities and the prospect of joining the European Union (Poland, Hungary in 1990; Slovenia, Latvia, Lithuania and Estonia in 1993 and 1994, etc.). Also, several West EU countries began territorial institutional reforms, such as: Belgium in 1993 with federalization, Greece in 1994 with creation of departments, Italy in 1997 with “Bassanini Reform” and the United Kingdom in 1998 with devolution Acts (Dexia – CEMR 2008). Starting with the year 2000, Romania and Bulgaria implemented a strong decentralization process; Czech Republic, Slovakia and Slovenia set up a regional level; France adopted Act II of the decentralization process; Spain initiated reform of autonomous communities; Italy adopted a constitutional reform and Germany reformed the federalism. So that, in the period 1990-2013 was consolidated the process of decentralization in all countries of the EU, the most striking reforms taking place in Belgium, Spain, Italy, the United Kingdom, France and Germany, as “old” EU countries. The tendency in Europe was to externalize the operation of local public services, choosing delegated management via sub-contracting, concession contracts with a private entity (i.e. an association or a company), public-private partnerships (PPP), and privatization of some public services. The high development of PPP and the wish for a better design of local development strategies have generated the implementation of a form of shared economic development which was not based only on directives from the public sector governed by decentralization or simply guided by the free market forces. So that, the local authorities and the market trying to find a link between them, has defined a new way of policy-making, and especially of economic development policy-making, thus promoting local development strategies.

However, the EU countries are still looking how to guarantee and consolidate local and regional autonomy, while at the same time rectifying, via solidarity mechanisms (equalization measures), the territorial imbalances such autonomy can generate. It is clear that there are many different interpretations of the concept of “decentralization” in Europe, making decentralization difficult to assess, given the multitude of criteria, whether in terms of the extent of local responsibilities, the leeway that local elected officials have over expenditure and revenues (particularly in terms of fiscal autonomy) as well as the way supervision and legal and financial control are carried out.

Economic development intervention requires a detailed analytical understanding of the strengths and weaknesses of the local economy, as well as the forces that are constraining or driving it. Local matters must be also placed in the context of external economies forces from around the globe. New technology, changing availability of natural resources, and trade and monetary policy, for example, all strongly influence local economic needs and opportunities. (Blakely, Green Leigh 2010, 143). Local governments are the most legitimate local public authorities responsible for calling together the different local actors and seeking areas of public-private consensus to further local economic development (Alburquerque 2004).

3. Empirical Evidences of Decentralization Supporting the Process of Sustainable Development

The European Union is comprised of 28 Member States, with a very heterogeneous territorial organization. Some countries include regions on only a part of the national territory, as Portugal with autonomous regions of Madeira and Azores, United Kingdom with the "devolved" nations Scotland, Wales and Northern Ireland and Finland with Kainuu and the autonomous island province of Åland. As a "regionalized" unitary State with regions that have "ordinary" as well as "special" status, Italy has a special place in the EU. Romania has eight development regions without juridical/legal personality. In the 28th landscape of EU, eleven countries have just one level of local authorities (i.e. municipalities), ten have two levels (municipalities and regions/counties) and seven, which include some of the biggest countries in the EU, have three levels (i.e. municipalities, regions/counties and intermediary entities as departments, provinces, counties, etc.). In present, there are approximately 90936 local governments in the EU.

The indicators which allow to quantify and characterize decentralization across the EU countries are as following: expenditure decentralization (% of local public expenditures in total expenditures of the general government); own revenue decentralization (% of own revenue in general government revenues); revenue decentralization (% of local public revenues in general government revenues; local autonomy (% of own revenues in total local public revenues); the percentage of transfers from the central government in total local revenues; local public expenditure coverage by own revenues (% of local public expenditures covered by local taxes and fees; transfer dependency (% of local public expenditures covered by transfers). Using both expenditures and revenues, we tap into the main aspects of fiscal decentralization.

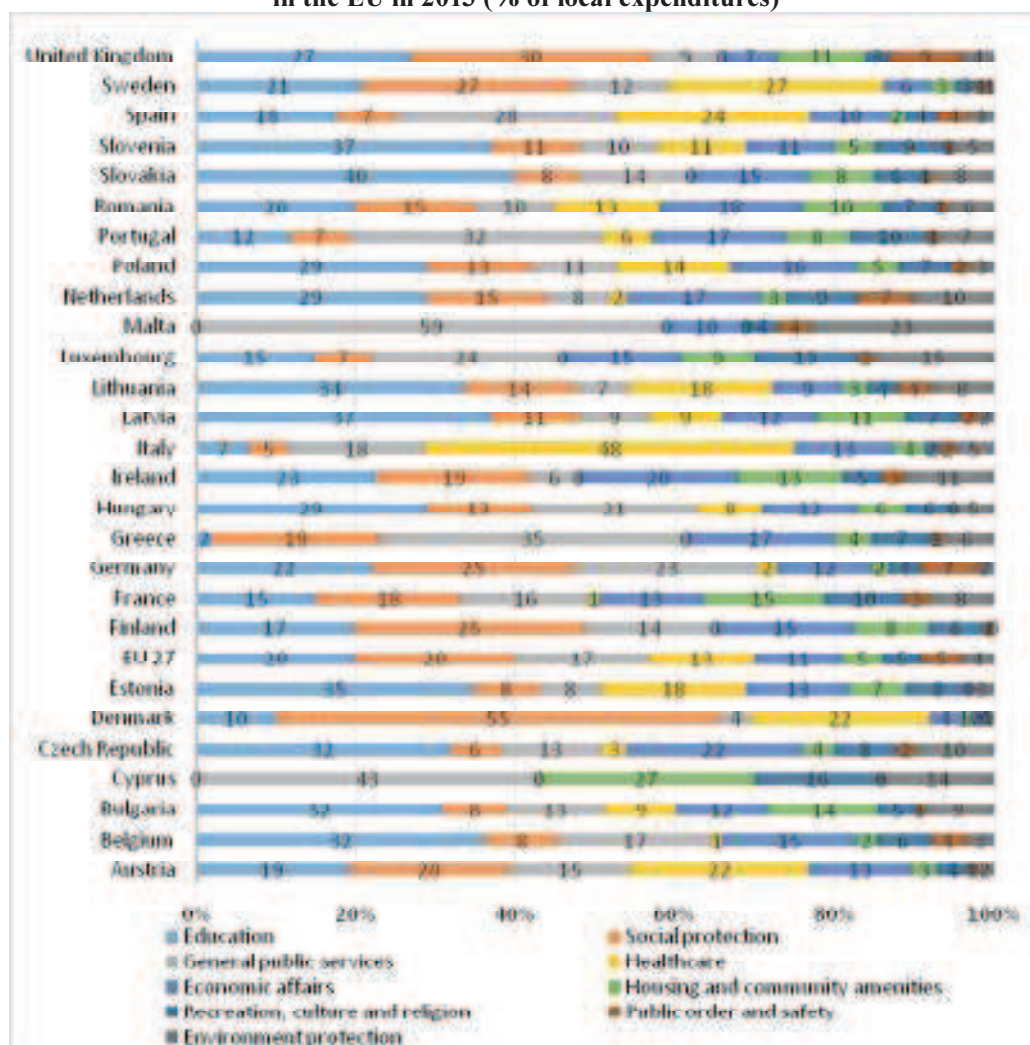
According to the literature review, the following areas were included into the categories of public expenditure supporting the process of sustainable development: education (Koehn 2012, 274–282; Kościelniak 2014, 114–119) – means to invest in human capital, environmental protection (Hoang 2006, 67–73), health and social protection (Seke, Petrovic, Jeremic, Vukmirovic, Kilibarda, Martic 2013, 1–7), recreation, culture and religion (Gough, Accordino 2013, 851– 887; Farmer, Chancellor, Gooding, Shubowitz, Bryant 2011, 11–23; Athichitskul 2011, 3–11). The amounts of the above mentioned categories of local public expenditure were analyzed as percentages of GDP, nominal values and dynamics indices, compared with the changes in total public spending.

Regarding local public expenditure by economic function (Fig. no. 1), expenditure on education increased by 3% per year, average in volume terms representing 20% of local budgets in the European Union countries. In Belgium, Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Slovakia and Slovenia, expenditure on education accounted for over 30% of total local expenditure, but no more than 40%. In countries as Cyprus and Malta, education is financed only by the state, being a centralized public service.

Social services expenditure, which refers to infrastructure and social benefits (e.g. sickness, disability, old age, survivors, family, youth, unemployment, housing, exclusion), account for 20% of local budgets in the EU. In Denmark, social services expenditure account for 55% of local expenditure and in Austria, Finland, Germany, Sweden and the United Kingdom the rate exceeds 20%. In Malta, social service expenditure are supported by the state budget.

Spending on general public services such as operating political bodies, general expenditure of administrations, interest charges on debt, etc., accounts for 17% of local public budgets. What is remarkable for this expenditure category is that local governments of Malta finance 59% of them, the biggest percent from the EU countries, while Denmark register only 4%.

Fig. no. 1. Categories of local public expenditure by economic function in the EU in 2013 (% of local expenditures)



Note: *not data available for Croatia

Source: computed by author using Eurostat data and Dexia-CEMR, 2012

Healthcare expenditure has an average of 13% of local budgets. In Austria, Denmark, Italy, Sweden and Spain, local authorities and regional authorities are responsible for indirect or direct management of public hospitals, specialized medical services and basic healthcare, the expenditure in budgets exceeding 20%. In Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Luxembourg, Malta, the Netherlands, Slovakia and the United Kingdom, these functions are provided by the central State and/or social security bodies. In Romania, until 1997 funding health care was based on a national health system, the amounts being allocated from state budget, local budgets and some funds set up for. Social health insurance system established by law in 1997 became operational in 1999. Starting with 2010, the process to decentralize hospital determined the heavy weight of healthcare expenditure in local budgets, in 2013 being 13%.

Economic affairs accounted for approximately 11% of local budgets. They account for more than 20% of local expenditure in the Czech Republic and Ireland. Cyprus established this category of expenditure in the authority of central government.

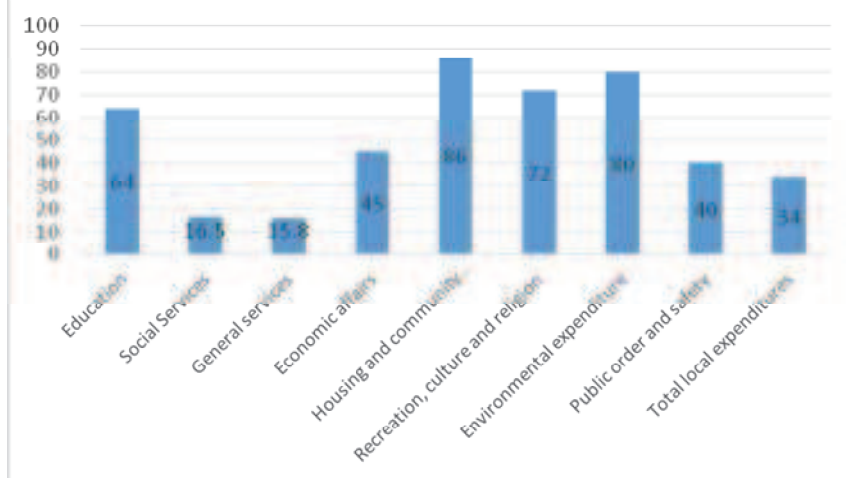
Three category of expenditure, respectively housing and community amenities, recreation, culture and religion, and expenditure on public order and safety accounts for

5% of local budgets. Regarding housing and community amenities expenditures, Cyprus is the country with more than 20% of total local budget.

Environmental expenditure (waste collection and treatment, parks, environmental protection) accounts for 4% of local budgets. The amount of local environmental expenditure in all EU countries is not significant in local budgets. The only country which register more than 20% of local budget expenditure is Malta with 23%.

According to fiscal federalism theories, viewing local expenditures as a percentage of total expenditures is the most appropriate way to gauge fiscal decentralization (Fig. no. 2). Expenditure on education represent 64% of public spending on education in the European Union countries. Social services account approximately for 16,5% of the entire public sector's social expenditure. General services accounts for 15,8% of the entire public sector expenditure. Economic affairs accounted for approximately 45% of public economic intervention spending (transport, communications, development of companies active in industry, agriculture, fishing, mining, energy, construction, etc.). Expenditure in housing and community amenities (water distribution network, public lighting, and building of housing) accounts for nearly 86% of public spending in this area. Recreation, culture and religion (sporting equipment and activities, libraries, museums, up-keep of heritage sites, municipal culture centres and theatres, etc.) accounts for 72% of public spending in these areas. Environmental expenditure (waste collection and treatment, parks, environmental protection) accounts for 80% of public spending in these areas. Public order and safety (regional and municipal police, fire brigades and emergency responders) accounts 40% of public spending in this sector.

Fig. no. 2. Local public expenditure as % central public expenditure in 2011



Source: computed by author using Eurostat data

Trying to implement decentralization, the center of gravity of public expenditures in the EU countries moved to local budgets, where local public expenditures grew at an average rate of 2,8% a year in real terms. Correlating with GDP (Fig. no. 3), local public expenditure of the EU countries fluctuated around an average of under 11,68% of GDP in the last ten years. In 2011, local government spending averaged 11,8% of GDP and 11,6% of GDP in 2013.

Fig. no. 3. Local public expenditures in the EU countries

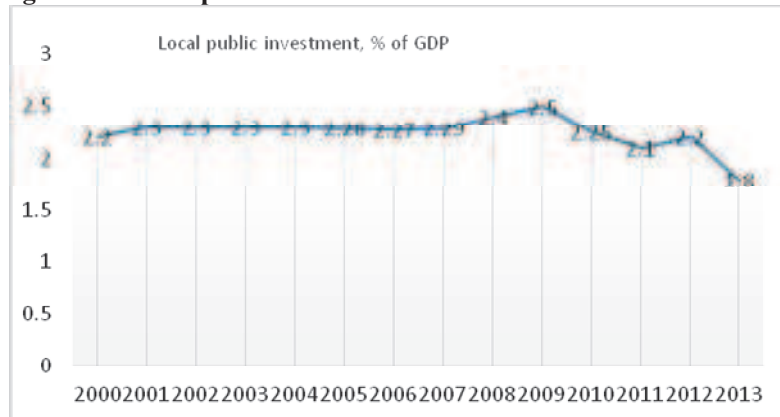


*Excluding capital payments on borrowings

Source: computed by author using Eurostat data and Dexia-CEMR

Great importance should be given to capital expenditure (Fig. no. 4), which in 2013 around 55% of total public investment was carried out by local authorities. The highest rate were met in Germany, Belgium, Finland and France, where local budgets sustain over 65% of public investment. Local public investment accounted for 2.3% of GDP for the period 2002 – 2007, reached to 2.5% in 2009, partly as a result of stimulus measures. For the period 2010-2013, it declined to 1.8% of GDP. In real terms, local public investment in the EU fell by 7.2% in 2010, 6.6% in 2011, 3.3% in 2012 and 8.6% in 2013.

Fig. no. 4. Local public investment in the EU countries as % of GDP



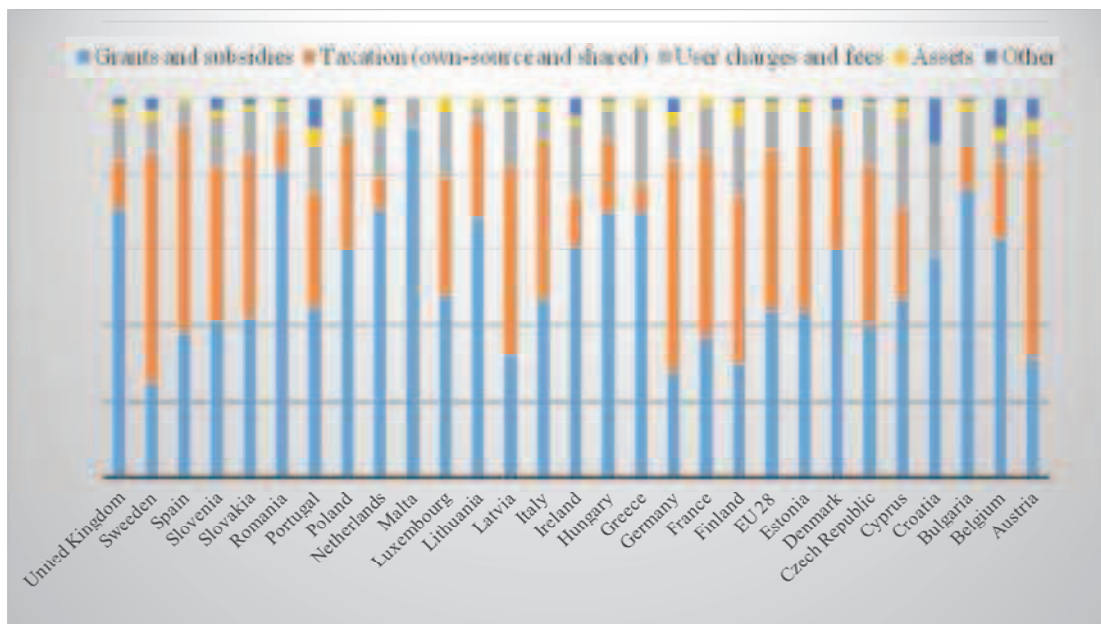
Source: Eurostat

As a reaction of implementing sustainable development in a knowledge society, local direct investment was robust over the decade 2000-2010, particularly in the CEE countries where it financed decentralization and urbanization as well as the development of metropolises, including renovation, construction and efforts to upgrade infrastructure and public equipment (transport, water, waste, etc.) to EU standards. It was also boosted by looser lending conditions for local authorities as well as by European Cohesion policy. In fact, European Structural and Cohesion funds, alongside domestic co-financing, had a powerful leverage effect on local investment in many EU countries.

An important issue encountered in the analysis of public sector decentralization is the appropriate measurement framework for fiscal decentralization and fiscal autonomy. The commonly used main indicators for fiscal decentralization are local revenues (% of total central government revenue); tax revenues (% of total local revenue or total tax revenue); non-tax revenues (% of total local revenue); grants from other levels of government (% of total local revenues and % of their total expenditure expressing vertical imbalance).

The local public revenue of the EU countries comes from a wider variety of sources (the creation of local taxes, the implementation of national tax revenue-sharing schemes, the creation of grant systems, the use of alternative sources, the implementation and modification of equalization instruments, etc), but the considering of existing strong tax revenue system supposes a financial management based in all improvement in economic activity (Fig. no. 5).

Fig. no 5. Categories of local public revenue in the EU in 2013 (% of total revenue)



Source: computed by author using Eurostat data and Dexia-CEMR

Even the decentralization was reformed permanently, grants and subsidies are still the main source of European local public sector revenue, in some countries accounted for over 70% of revenue (Greece, Malta, Bulgaria, etc.). Over the crises period, grants and subsidies dropped in volume terms in general, but investment grant growth remained strong, primarily in CEE countries (Hungary, Romania, Bulgaria, Estonia, Poland, etc.).

Shared taxation, in the sense of collecting a tax at the national level and then sharing the revenue between central budget and local budget, and own tax revenue account almost 42% of local budget revenue, with differences between most decentralized countries (Finland, Denmark, France, Germany, or Sweden – more than 46%) and less decentralized countries (Greece, Bulgaria – under 15%) . Local tax are not applied in Malta, because of the small size of the national territory.

Fees and user charges represent approximately 11% of local budget. Revenue from the sale and the operation of physical assets (e.g. income from land) and financial assets (dividends, interest from deposits and investments, etc.) provided approximately 2% of local revenue.

Local tax revenue accounted for 11.6% of GDP and around 36% of public revenue in 2013 (Fig. no. 6).

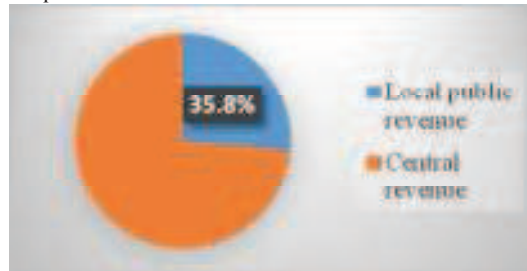
Fig. no. 6. Local public revenue in the EU

Local public revenue as % of GDP in 2013

Local Tax revenue (own-source and shared) as % of GDP in 2013



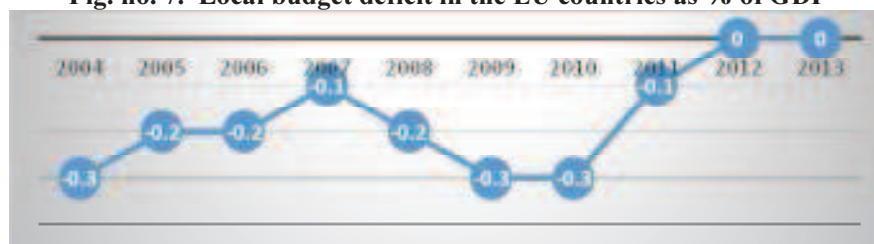
Local public revenue as % of total central revenue in 2013



Source: computed by author using Eurostat data

The EU countries registered a local budget deficit of 0.3% in 2004, recovering to 0.1% of GDP in 2007 (Fig. no. 7). Due to a fall in revenue in 2008 and 2009, stemming mainly from the reduction of transfers from the central government, the local budget deficit registered 0.3% of GDP in 2009 and 2010. Fiscal consolidation measures then began to have an effect and the deficit was progressively reduced from 0.1% of GDP in 2011 to 0% by 2012 and 2013. However, the practice of local budgetary deficit does not necessarily mean that the financial situation of local governments is imbalanced, and the use of local debt, necessary because of the deficit, is allocated to the local investments, without it posing a macro-economic risk.

Fig. no. 7. Local budget deficit in the EU countries as % of GDP



Source: computed by author using Eurostat data

4. Conclusion

Local financial stability is an important objective of each government because creates the premises for sustainable local economic development. In this context, the reality demonstrates that the rise in local public debt is controlled in the most vulnerable countries. At the same time, taking into account that public services provided by the local authorities are likewise linked with local economic competitiveness, since the quality of those services increases the attractiveness of the area for private investment, an important issue of local governments in decentralization is to create the necessary conditions in terms

of basic infrastructure and urban development services for the private business sector to take on its role as a producer of goods and services and a motor of the local economy.

However, some challenges and vulnerabilities remain and require continued monitoring and policy action at local level in decentralization, which means that local economic development must be incorporated in the programmes for the strengthening of local governments, to improve the capacity for the efficient management of the resources transferred to local governments and modernizing municipal management.

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