

## **A note on the Council of Europe findings on why earmarked grants often have been on the rise.**

**(Note for the 2009 Copenhagen Workshop on grants policies 17.-18. September 2009.)**

### **The guidelines of the Council of Europe on earmarked grants.**

The CoE differs from other organisations by having a normative basis, they not only want to describe and understand what happens, they need to see how their guidelines for good decentralisation are followed by the member states.

The guidelines of the Council of Europe on local finances are agreed upon by the member governments in the “Charter on Local Government Self-determination” and have as such become not only an economic but also a political and legal issue.

The Council of Europe guidelines on grant design reads:

“A substantial part of state assistance in funding local authorities’ current expenditure should take the form of block grants to be used freely by local authorities; earmarked state grants should be confined to significant capital expenditure and certain current expenditure”

### **Does the trend reflect the CoE guidelines?**

OECD paper for this workshop (Bloechiger and Vammelle. 2009) finds that only in 4 out of the 14 countries, for which such information was available, had there been an increase in the use of earmarking of grants to local government for current spending. But it also confirms that earmarked grants are still about half of all grants to local authorities.

So, though the trend seems in conformity with its guidelines, it caused some concern in the Council of Europe that, in spite of their guidelines, there had been so little reduction of the large proportion of earmarked grants out of the total. And in particular, why did some members of the Council of Europe go against the guidelines?

During the discussions of these findings some CoE member countries argued that earmarked conditional grants were necessary for compensating local authorities for new competences. So the increasing use of earmarking was a result of an increasing decentralisation – and in praiseworthy conformity with and not in conflict with the spirit of the Charter.

Is there such an inconsistency in the European Charter? The Council of Europe was not fully satisfied with this argument and initiated a report on this.

### **The CoE report on compensation for new local competences.**

This report (Lotz. 2008) examines the reasons why decentralisation should lead to increased grant financing (against the spirit of the Council of Europe guidelines fa-

vouring the use own taxation), and in particular why this should take the form of conditional earmarked grants (also against the CoE guidelines).

The study was based on a survey covering 23 European member countries.

The results were that

- 21 out of 23 countries have a policy to fund local authorities for new competences.
- the compensation was done by increasing grants, in spite of the information from 17 countries that the local authorities had taxation powers to finance the new competences themselves.
- 17 countries compensates using earmarked grants, only 6 use general grants.
- half of the matching grants, used by most countries, were matching grants (not in accordance with the Charter) and half were investment grants for capital spending(permissible under the Charter).
- 20 countries said that they negotiate the size and the distribution of the compensation with the local authority associations.

In conclusion the report confirmed the argument made by member countries that earmarked grants are seen as needed for mandating new competences to local authorities. The report explains one reason for this, namely that earmarked conditional grants compensates more exactly than general grants those authorities who feel the burden of the new competences most. This way conditionality facilitates the local acceptance of new functions.

But this does not answer the question (also raised by Bird and Smart. 2009 p. 23) why do central governments do it?

In 17 out of 23 countries it was estimated that the local authorities had revenue potential to finance the new functions themselves, it was not necessary to finance the local costs of new competences by grants.

Perhaps it could contribute to an answer that 20 out of 23 governments answered, that they followed procedures so that compensation questions are negotiated with the local government level (associations).

### **Concluding remark on the CoE findings.**

The survey demonstrates how negotiated compensations and the concern over equal treatment of all authorities have led to the use of earmarked grants in surprisingly many countries.

There is something about the role of the state to learn from this.

Is it an argument for shifting analytical emphasis from the Musgrave/Oates/Tiebout model to what Rattsø called the European administrative federalism model where decentralisation of redistributive spending combined with mandated and centralised

financing is seen more as an administrative convenience than an instrument for better allocation?<sup>1</sup>

It will be interesting to learn whether the CoE findings on these forces driving the use of earmarked grants is also in play in non-European countries?

### **References:**

Bird and Smart (2009): Earmarked grants and accountability in government. Paper for the 2009 Copenhagen Workshop.

HansJoerg Bloechliger and David King (2006): Fiscal Autonomy of Sub-Central Governments. OECD Network on Fiscal Relations Across levels of Government Working paper No. 2.

HansJoerg Bloechliger and Camila Vammalle (2009): Intergovernmental grants in OECD countries: trends and some policy issues. Paper for the Copenhagen Workshop 2009.

Jorgen Lotz (2008): Draft report on the member states' practices for funding of new local competences of local authorities. Council of Europe. CDLR(2008)48.

Jørn Rattsøe (2002) in Bernard Dafflon (ed): Local Public Finances in Europe. Edgar Elgard. 2002.

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<sup>1</sup> Rattsø (2002). He argues that the conditions for of the Musgrave-Oates-Tiebout model are not met in the present day European reality. Rather than the result of local population organising a club to solve common problems, local governments are established as part of the "public sector". Decentralisation of redistributive spending combined with mandated and centralised financing is an administrative convenience. European fiscal federalism can, he says, consequently be called administrative federalism.