

# Local Finances and the Green Transition

Managing Emergencies and  
Boosting Local Investments  
for a Sustainable Recovery in  
CEMR member countries



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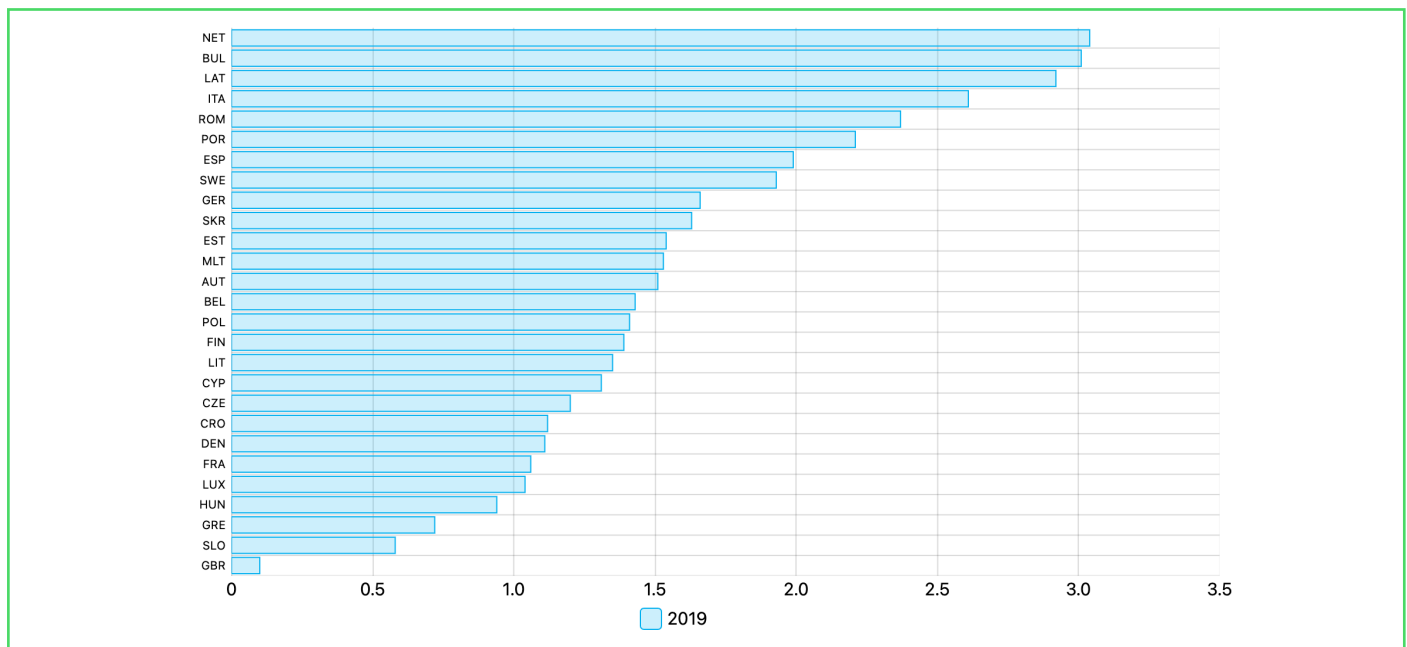
## 6. Public financial management

Over the past decade, there have been various changes in local public service provision and public financial management (PFM). Some aspects of this systemic transformation should also be considered when local finances are being evaluated. Municipal service management and PFM are rather overly broad areas for a thorough analysis, especially in the CEMR countries where there are huge variations across public administrations and differing levels of economic development. Many domestic factors can influence direction and pace of change as well.

Therefore, besides supplementing the previous analysis on local expenditure and revenue, the following assessment will focus on selected aspects of PFM. The indicators discussed will also round out the data analysis on the overall quality of fiscal rules, budget openness and accountability.

### *Fiscal rules*

**FIGURE 22 FISCAL RULES INDEX, EU COUNTRIES, 2019**



Following the 2008-2009 economic crisis, national fiscal policies were primarily concerned with the balancing of public budgets and maintaining control over local debt. During the past decade, the fiscal rules surrounding balanced budgets, borrowing limitations and procedures, control over local expenditure and taxes, monitoring and enforcement mechanisms have only grown in importance. They govern important areas of PFM and affect critical local finance conditions. The index on numerical fiscal rules in the EU countries measures this critical component of the local fiscal environment.

The **Fiscal Rules Index**<sup>9</sup> takes into account several institutional aspects as well as fiscal weight of general government units. This composite index is a scaled measure of fiscal rules based on five dimensions: 1) legal base, 2) binding character, 3) bodies monitoring the compliance mechanism, 4) correction mechanisms, and 5) resilience to shocks. The Index characterises a very important element of fiscal policy making, which

<sup>9</sup> [https://ec.europa.eu/info/business-economy-euro/indicators-statistics/economic-databases/fiscal-governance-eu-member-states/numerical-fiscal-rules-eu-member-countries\\_en](https://ec.europa.eu/info/business-economy-euro/indicators-statistics/economic-databases/fiscal-governance-eu-member-states/numerical-fiscal-rules-eu-member-countries_en)

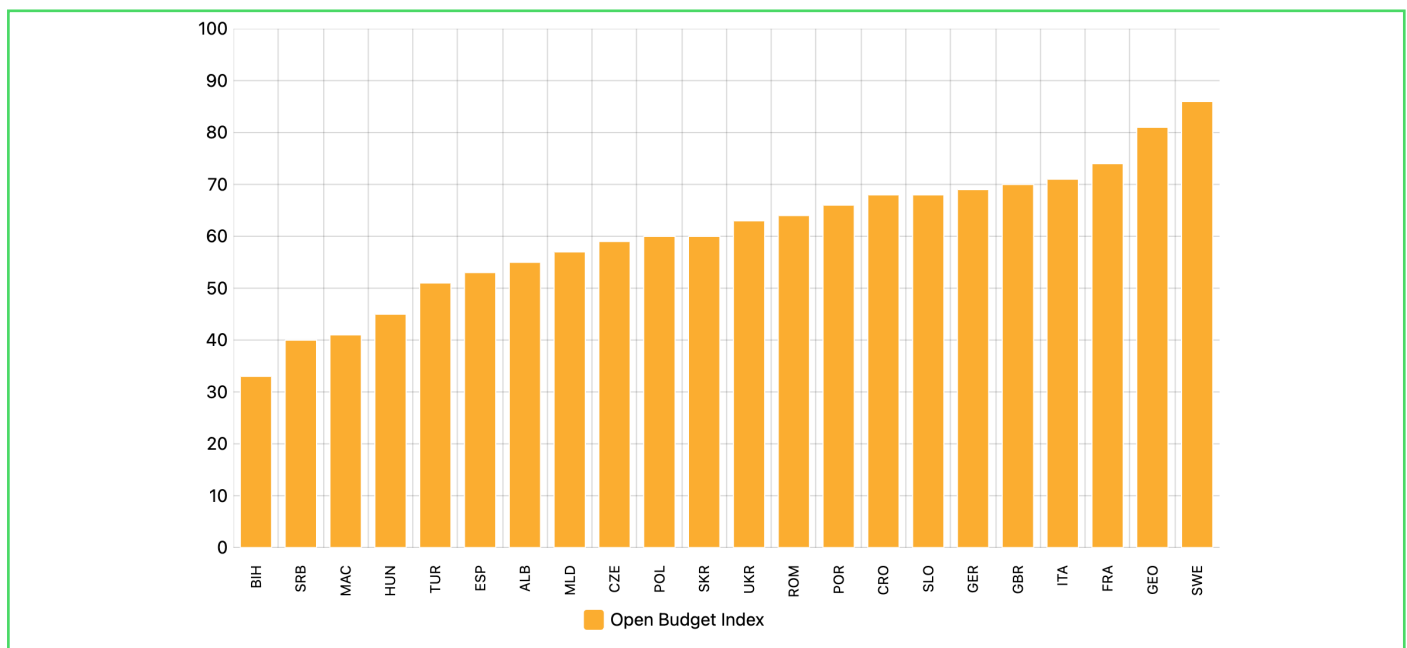


ultimately determines local budget design as well. As a unique measure of the strength of fiscal rules, it offers opportunities for benchmarking and the transfer of best practices on this critical area of PFM.

The Fiscal Rules Index shows significant differences among the EU countries (Figure 22). Countries with similar scores can diverge when it comes to the scope of decentralisation (the Netherlands vs. Bulgaria, Greece vs. Slovenia), population size or economic development. Consequently, the country ranking on the Fiscal Rules Index does not correlate to the level of decentralisation or economic development.

### Budget openness

**FIGURE 23 OPEN BUDGET INDEX, 2019**



**The efficiency of municipal service provision is greatly dependent on how governments respond to local needs.** In order to ensure that local financial decisions dovetail with the public demand for services, not to mention the acceptable form and size of taxation, local governments should develop its budget in an open manner.

The **Open Budget Index**<sup>10</sup> takes into account dozens of issues linked to budget preparation, design, approval and implementation and then presents an overall budgeting status. The budget openness index scores the major stages of the budgeting process and their outputs from a transparency standpoint. It primarily evaluates national budget procedures and documents. However, since these comprehensive government rules usually drive the local fiscal planning process, the country ranking also partly reflects the differences in the openness of subnational government budgeting practices (Figure 23).

**Budget openness is primarily determined by national policies and general governance practices, although it is connected in part to the scope of decentralisation.** Among the countries assessed by the Open Budget Survey, the more economically developed ones tend to score higher. These countries usually have more decentralised government systems: Sweden, France, Germany. However, seeing as some less decentralised countries also performed very well (e.g. Georgia, Slovenia), there are obviously exceptions. At the opposite end of the Open Budget Index's ranking (lower scores), the countries are unquestionably more centralised (Spain, as a quasi-federal country, being a special case).

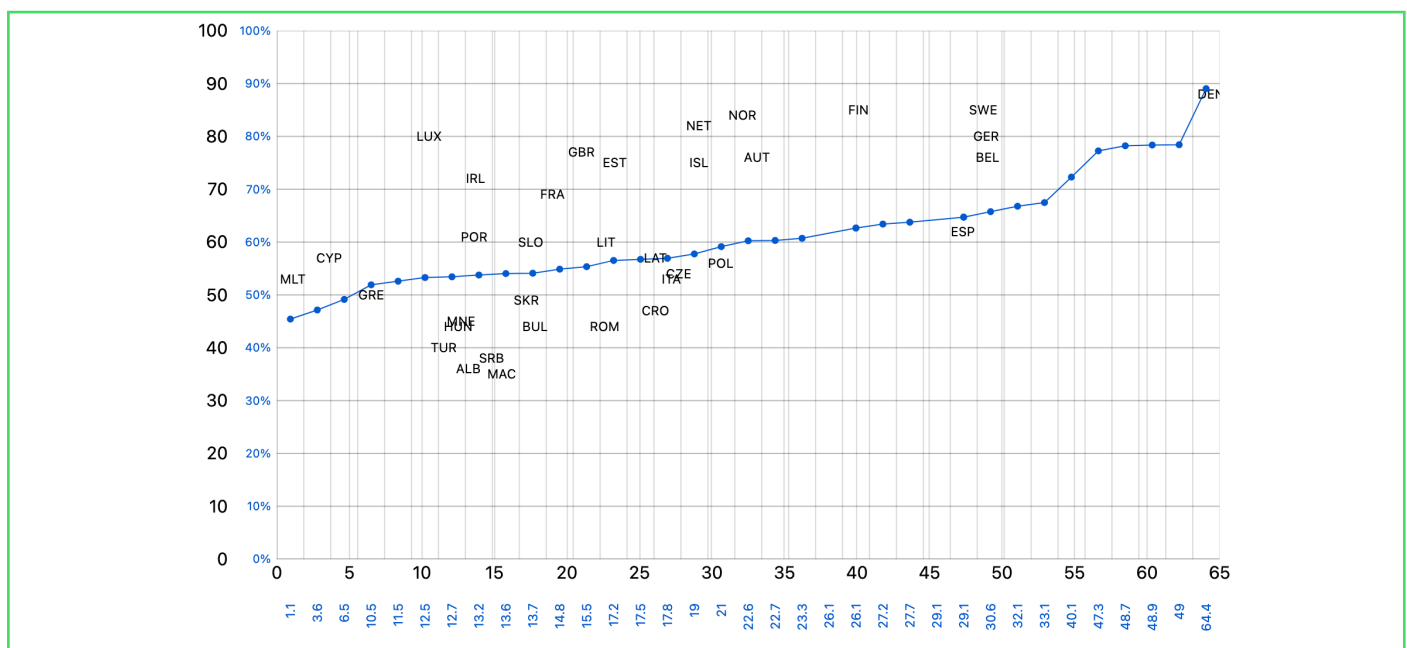
<sup>10</sup> The Index is only available for a limited number of countries, which are assessed by the International Budget Program: <http://survey.internationalbudget.org/#home>

### Transparency and accountability

Openness in local finances and financial management also helps to curb corruption. The **Corruption Perception Index (CPI)**<sup>11</sup> evaluates the overall status of a country. Given that local governments manage a major share of capital investments in the public sector, levels of corruption do affect local budgets. This reality is reflected in the CPI scores of the countries when they are ranked using a scope of decentralisation scale (Figure 24).

**The more decentralised countries have higher CPI scores.** The countries scoring the highest are more economically developed, as well as being less centralised, namely the decentralised Scandinavia countries and the federal countries. There are a few exceptions, such as Estonia and Israel, where corruption is successfully tackled under more unitary systems. The group with lower CPI scores is made up of countries that tend to be less economically developed and/or more centralised. Their ranking reflects higher levels of corruption and concerns many of the Balkan countries as well as Hungary and Turkey.

**FIGURE 24 LOWER CORRUPTION COINCIDES WITH HIGHER DECENTRALISATION (SUBNATIONAL EXPENDITURE AS % OF GENERAL GOVERNMENT EXPENDITURE)**



$R^2 = 0.375$

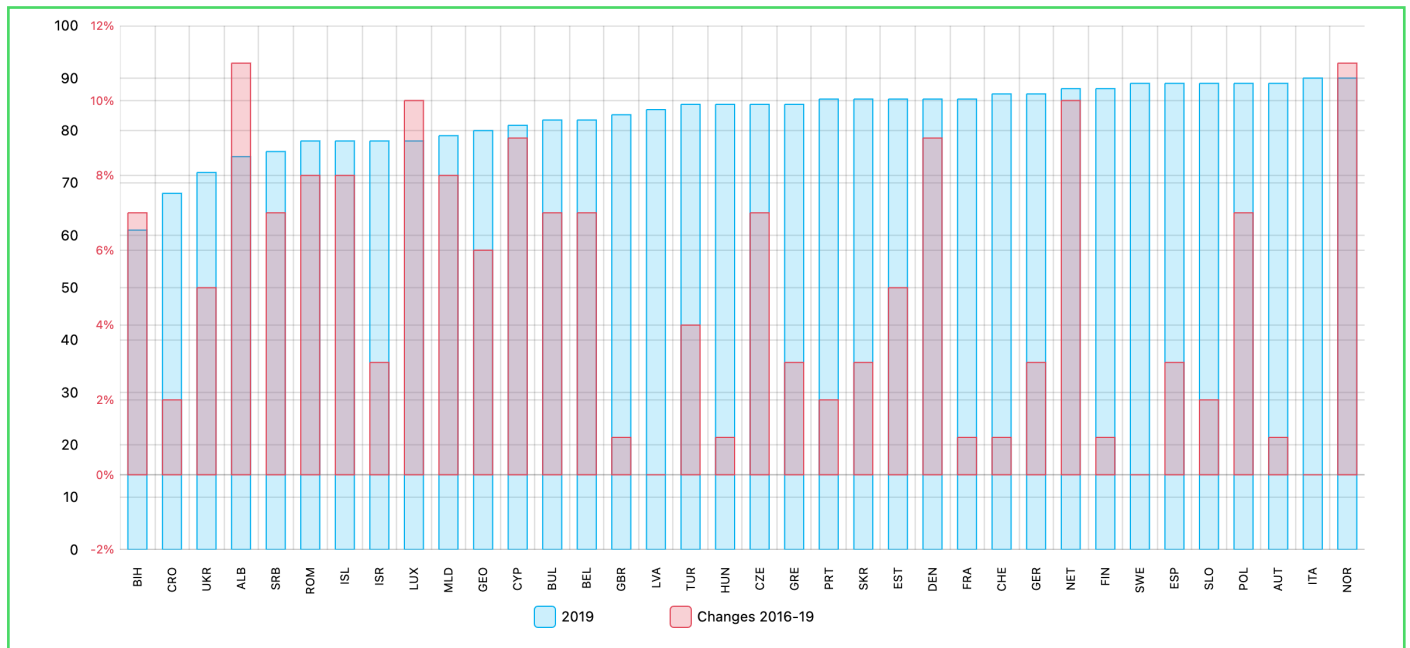
The type of information and statistical data available on government activities is an important measure of transparency and accountability. The comprehensive **Statistical Performance Indicator (SPI)**<sup>12</sup> provides a general assessment on the state of maturity of these statistical practices. Reporting on the Sustainable Development Goals has been an additional challenge for national statistical systems. Since SDG implementation is measured by detailed performance indicators, the same data represents important products (topics) that are also assessed by the Statistical Performance Indicator.

**CEMR member countries usually score high on the Statistical Performance Indicator** (Figure 25). The more economically developed countries usually rank the highest on the list. The scope of decentralisation is another aspect that can be correlated to the quality of statistical systems. For example, Albania's investing in the strengthening of its statistical systems seemed to follow local government reforms (with a high increase in scores since 2016). Some decentralised countries are constantly working to improve their internal information systems (Norway, Poland, Netherlands, Denmark).

11 <https://www.transparency.org/en/cpi/2020/table/nzl>

12 <https://www.worldbank.org/en/programs/statistical-performance-indicators>



**FIGURE 25 STATISTICAL PERFORMANCE INDICATOR, 2019**












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