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Introduction

There are three territorial levels of government in the Netherlands: central government, provinces (12) and municipalities (418 in 2011). Each level covers the whole country. All provinces and all municipalities more or less face the same responsibilities and have the same tax options. Dutch municipalities, with 40,000 inhabitants on average, are relatively large compared to those in other countries. Municipalities, which spend about eleven percent of GDP, provide many of the services that are of daily importance to citizens: from sewers to refuse collection, from local roads to poverty relief. Provinces spend relatively little (1.4 percent of GDP). However, provinces have a number of tasks that do not require spending a lot of money, like spatial planning and coordinating regional public transport.

There is a third local government level in the Netherlands: the water boards (25 in 2011). These originate from the 12th century, and are responsible for keeping the country, an important part of which is below sea level, dry and safe from floods.

Water boards, municipalities, and provinces are each ruled by subnational governments controlled by parliaments which are elected every four years.

Municipalities

Revenues of municipalities

Dutch municipalities finance their spending through specific (18% in 2010) and general grants (34%) from the central government, municipal levies (14%) and income from property and market activities (33%).

Specific grants are received from different central government departments and are earmarked to finance local government tasks imposed by the central government, whereas general grants are used to finance the autonomous tasks of local governments. The number of specific grants, and the amounts involved, have decreased significantly in the first decade of this century. This reflects the insight that local governments should not depend too much on earmarked revenues. A good local trade-off between the costs and benefits of public services can only be made if municipalities have enough spending autonomy.

General grants are formula-based and independent of local spending and taxation. These are equalizing grants. The formula takes into account spending needs and tax capacity of municipalities. The aim is to enable all municipalities to finance equivalent service levels at equivalent tax rates. Municipalities are free to choose

higher service levels and tax rates, or lower ones. The Dutch grant allocation system, which consists of 60 criteria, may well be the most complicated in the world.

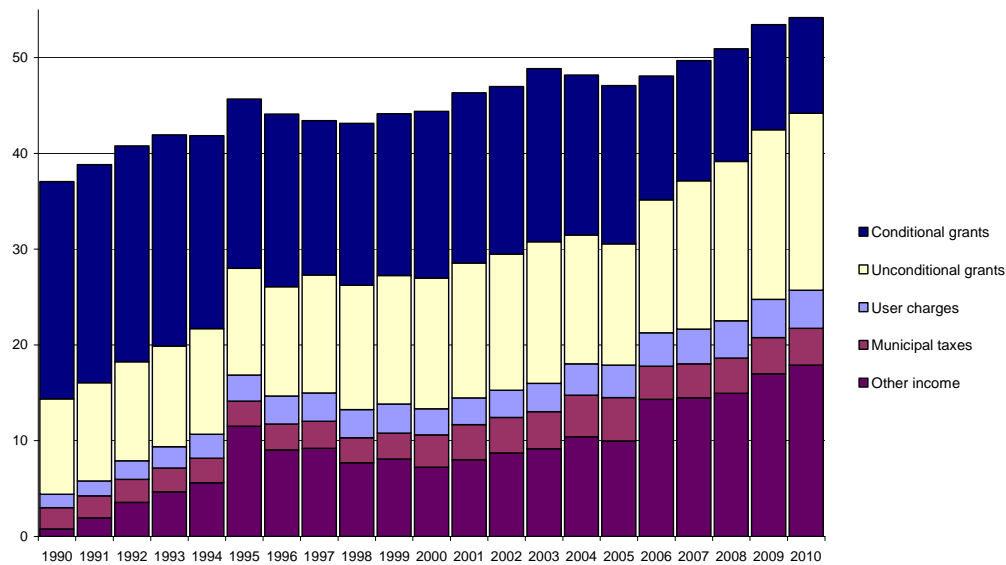
Municipal levies consist of user charges (7% of total revenue; mainly for sewerage and garbage collection) and local taxes (7%). Local tax revenue is dominated by the property tax. The only other local tax of any importance is the parking tax, which cannot be raised easily for fear of discouraging potential visitors of local businesses. Since user charges are not allowed to exceed (budgeted) costs and municipal budgets must be balanced, higher service levels can only be funded by raising taxes, i.e., by setting higher property tax rates.

Tax rates and expenditure levels are set by the municipal council, which is elected every four years through a system of proportional representation. The first proposals are circulated in the Spring of the preceding year. A provisional budget is presented to the council in September. In November, the council should approve the (modified) budget. During the fiscal year, the budget may be modified again, although tax rates cannot be raised any more.

Municipalities and provinces use accrual accounting. This means that capital expenditures are normally not budgeted in the year they are incurred. Instead, interest and depreciation appear in the budget during the economic life of the assets. Municipalities are obliged to present a balanced budget. Borrowing is allowed to finance investments, as long as interest and depreciation can be financed by the budget.

Figure 1 describes local government revenues since 1990. Unfortunately, this Figure supplies an incomplete picture. All data are based on budgets, not realizations. Moreover, a reliable source for "other income" is not available. This income source is calculated by subtracting the other revenue categories from total revenues. Other income consists of revenues from selling land for building projects, dividends from utility companies, interest on savings, etcetera.

Figure 1 Revenues of municipalities, 1990–2010 (billion euro, prices of 2010)



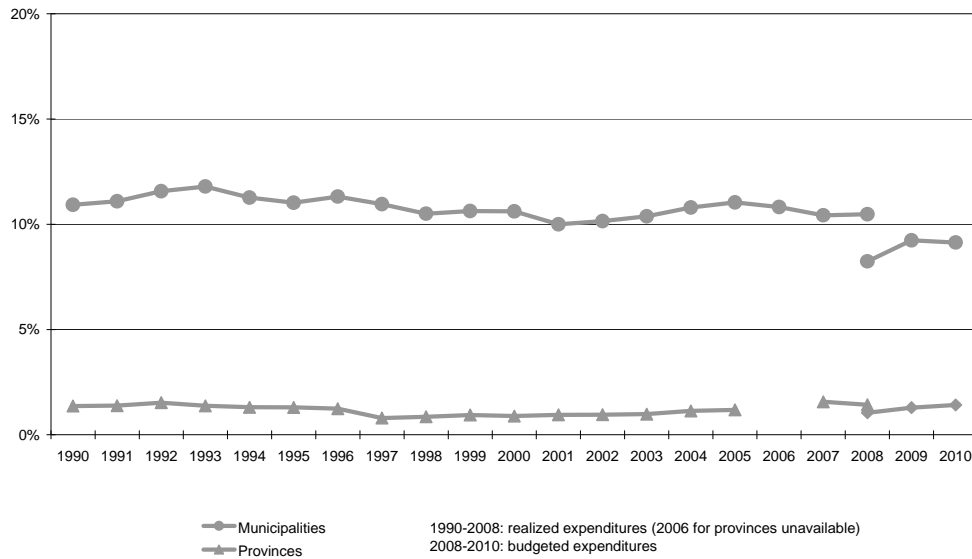
Source: author's calculations based on data from Statistics Netherlands, the Netherlands Bureau for Economic Policy Analysis, the central government's Budget Memorandum and annual reports on conditional grants.

The share of taxes and levies grew from 10 percent in 1990 to 14 percent in 2010. The share of unconditional grants has risen as well, from 27 percent in 1990 to 35 percent in 2010. The share of conditional grants fell dramatically, from 61 percent in 1990 to 18 percent in 2010. This is the result of the ongoing transformation of conditional grants to the municipal fund, from which the unconditional grants are financed.

Expenditures of municipalities

According to their budgets, municipalities spent 54 billion euro in 2010, 9.2 percent of GDP. In practice, actual spending turns out to be systematically higher than budgeted spending. That is because municipalities (and provinces) tend to budget conservatively. For the period 1990-2008, actual spending data are available. Actual spending of municipalities has increased by 60 percent since 1990 (corrected for inflation), which reflects an annual growth of 2.6 percent. In this period, the share of municipal spending in GDP varied around 11 percent. See Figure 2.

Figure 2 Expenditures of municipalities and provinces, 1990–2010 (percentage of GDP)



Source: author's calculation based on data from Statistics Netherlands and the Netherlands Bureau for Economic Policy Analysis.

Figure 3 describes municipal spending on the main service sectors. Welfare and social services form the most important spending category in the entire period since 1990. In 2010, one third of municipal spending is directed towards welfare and social services. This consists mostly of welfare payments to unemployed, but also of local means-tested poverty relieve programs and social services.

The Dutch welfare system may be interesting to study for other countries (Allers and Toolsema, 2010). In many countries, welfare is administered locally, but financed by the central government. Decentralization allows public services to be tailored to local preferences. Decentralization may also be more efficient, as knowledge of local circumstances is needed to successfully run a welfare program. However, decentralized finance of redistributive programs is likely to break down as a result of the migration patterns it brings about. Therefore, income redistribution is generally considered the responsibility of the central government. As a result, welfare is usually administered locally, but financed centrally. This raises the question as to how the center can induce local administrators to administer welfare efficiently.

Until 2001, each municipality financed 10 percent of welfare benefits it paid out from its own coffers, while 90 percent was reimbursed by the central government through an open-ended matching grant. Clearly, this did not provide a strong incentive to limit welfare payments by helping recipients find work or by clamping down on fraud. In order to improve this incentive, the match rate was reduced from 90 to 75 percent in 2002. As from 2004, no reimbursement takes place any more. Matching grants have been replaced by block grants. If a municipality spends more than its block grant, it bears the extra expenditures itself. If it spends less, it may use the balance as it sees fit. Block grants are allocated in such a way that municipalities which operate reasonably efficiently will not need to use own resources to finance welfare expenditures. The allocation formula is based on a sophisticated econometric model.

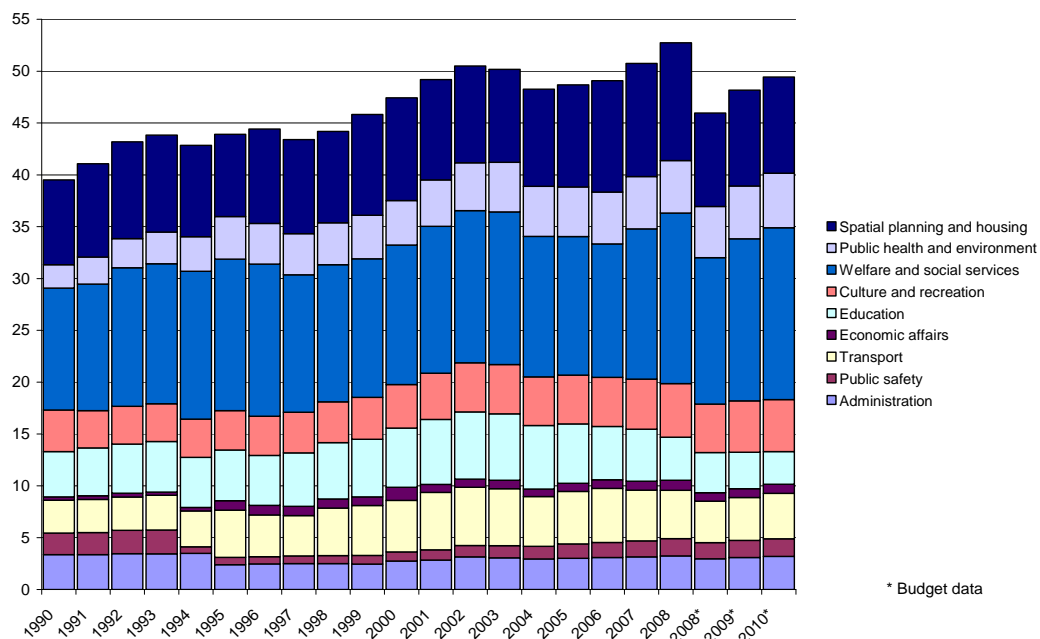
At the same time, total grants add up to no more than forecasted aggregated welfare expenditures. The introduction of the new financing system in 2002-2004 was followed by a significant fall in welfare dependency.

The second most important spending category of municipalities is spatial planning and housing (19 percent of budgeted spending in 2010). Most of these expenditures are aimed at developing land for new building projects. Because of the economic recession, this activity has come to a virtual standstill, which is not yet reflected in the budgetary data for 2010.

Eleven percent of local spending is directed at public health and environment. This spending category consists mainly of refuse collection and processing, and of sewer management. Both activities are financed mainly by user fees. Municipalities may collect garbage themselves, or contract this activity out to private operators, other municipalities or intercommunal organizations.

About ten percent of municipal expenditures are directed at Culture and recreation. Most important financially are public parks and greenery, and sport facilities. Public libraries and the arts are also included in this spending category.

Figure 3 Municipal expenditures, 1990–2010 (billion euro, prices of 2010)



Source: author's calculation based on data from Statistics Netherlands and the Netherlands Bureau for Economic Policy Analysis.

Provinces

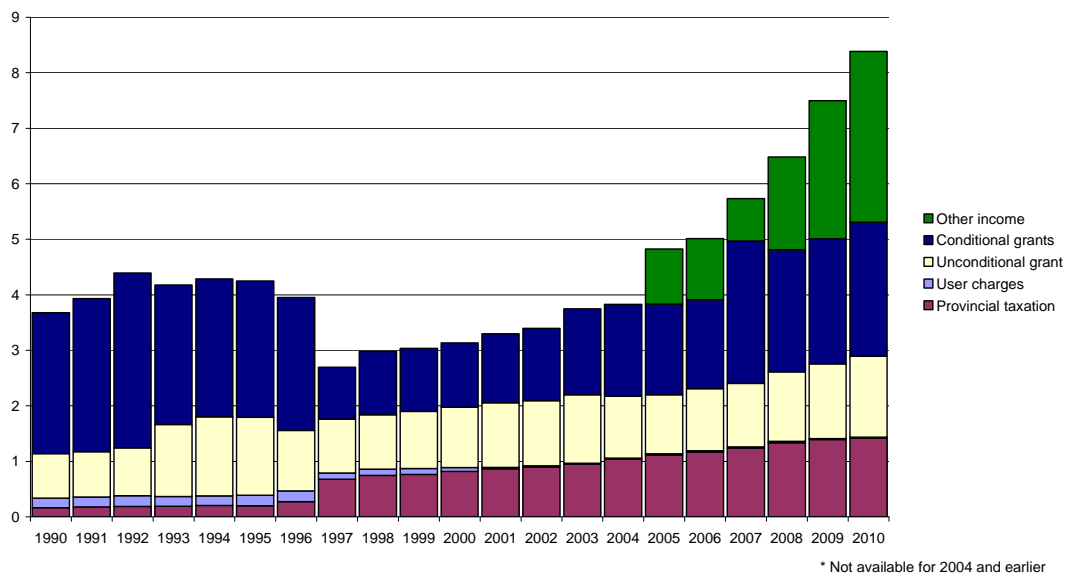
Revenues of provinces

Figure 4 gives an overview of the revenues of provinces since 1990. As is the case with municipalities, for provinces, a reliable source for “other income” is not available. From 2005 onward, this income source is calculated by subtracting the other revenue categories from total revenues. For earlier years, total revenues are not available, strangely enough.

Other income of provinces consists mainly of dividends from utility companies, mostly power companies. These dividends grew rapidly as a result of the introduction of tradable emission rights for CO₂. These emission rights were distributed for free, but the power companies included them in their consumer prices. The ensuing profits were partly paid out as dividends. Because share holdings vary greatly among provinces, some provinces receive large amounts of “other income”, while others don’t.

Provinces receive an equalizing unconditional grant from the central government. The allocation is based on spending need and tax capacity, but less complicated than the formula which is used to allocate unconditional grants to municipalities. The steep fall in conditional grants in 1997 is the result of the discontinuation of a grant which financed homes for the elderly. In 1997, provincial tax revenues triple as a result of a new law which gave provinces more power to tax. Compared with municipalities, provinces rely rather heavily on own tax revenue.

Figure 4 Budgeted revenues of provinces, 1990–2010 (billion euro, prices of 2010)



Source: author’s calculations based on data from Statistics Netherlands, the Netherlands Bureau for Economic Policy Analysis, the central government’s Budget Memorandum and annual reports on conditional grants.

Expenditures of provinces

Figure 5 breaks down provincial spending in the main categories. Transport is the most important spending category (31 percent of expenditures). Provinces are responsible for regional roads. They also play a role in public transport, which is contracted out to private operators.

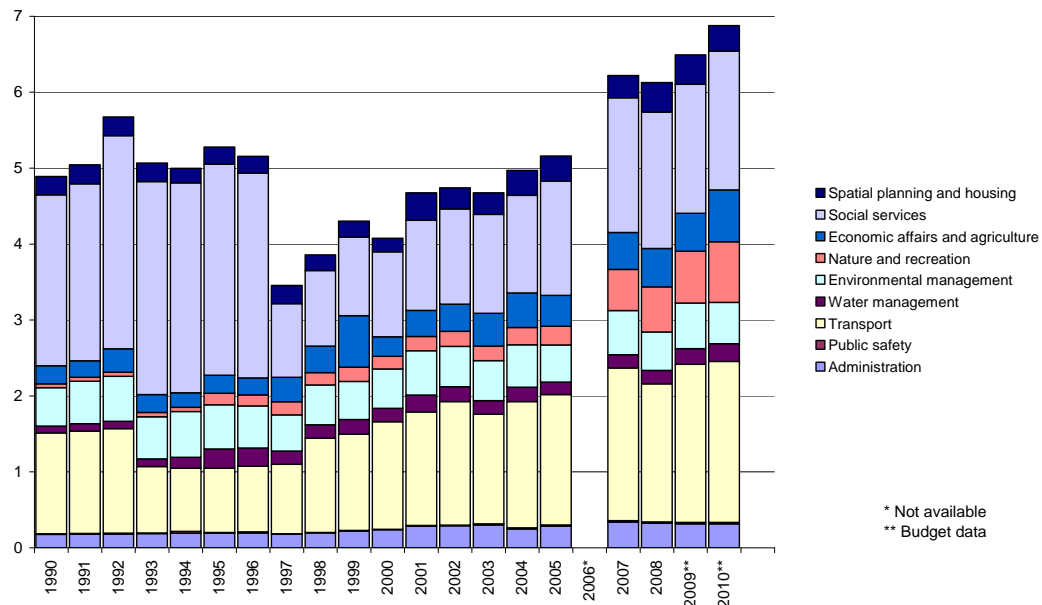
The second most important spending category is social services (27 percent of spending). Most importantly, provinces play a large role in helping parents and children with serious problems (problems at school ,abuse, etcetera). However, the new central government which came to office in 2010 has announced that this

responsibility for youth care will be decentralized to municipalities. In 1997, expenditures on social services fell as a result of the fact that provinces were no longer responsible for homes for the elderly. This also impacted on provincial revenues (see Figure 4).

Twelve percent of the expenditures of provinces are directed at Nature and recreation. Most of this money is used to create and manage regional parks and other areas where nature is protected.

Since 1997, when provinces lost their responsibility for the care for the elderly, provincial expenditures have increased rapidly (recall that the data in Figure 5 are corrected for inflation). According to the Advisory Council on Financial Relations (Rfv, 2009), this is the result of fast growing revenues, especially tax revenues and dividends. The Council suspects that provinces spend more than is necessary, and has advised to curb the unconditional grant accordingly. Consequently, the central government has decided to cut the grant by 300 million euro in 2011.

Figure 5 Expenditures of provinces, 1990–2010 (billion euro, prices of 2010)



Source: author's calculation based on data from Statistics Netherlands and the Netherlands Bureau for Economic Policy Analysis

Water boards

Water boards have three main tasks. The first is dike maintenance. Because a large part of the Netherlands lies below sea level, dikes are essential to the country's safety. The country also has a number of big rivers flowing through it, which must be prevented from flooding. The second main task is water level management. Water in low lying parts in the country must be pumped out. The third main task of water boards is the treatment of sewer water. Municipalities are responsible for the sewers. Before sewer water is allowed to flow into open water, it is treated by the water boards. Apart from these main tasks, some water boards manage country roads and waterways.

Water boards finance their expenditures mostly from own tax revenues. Apart from that, they receive some grants from other governments for specific purposes. Water board taxation is aimed to burden households and firms according to the extent to which they profit from the activities of the boards. This is operationalized by using general guidelines determining which part of the total burden should be borne by each group of taxpayers.

Trends in subnational government

Decentralization

Dutch law prescribes that the national government must stimulate decentralization. In the last decade, several large tasks have been decentralized to municipalities. The present government, which came to office in 2010, is set to continue this policy. In the recent past, large scale decentralizations occurred in welfare and social services. In the next few years, youth care will be decentralized from (mainly) the provinces to the municipalities, along with some other social services. Moreover, welfare is to be merged with entitlement programs for disabled workers.

Decentralization is promoted because it is thought to give citizens more control over public services which they need in daily life. Municipalities can tailor services to local preferences and needs. That should result in higher welfare than uniform service levels across the country.

Another reason to decentralize is that municipalities are supposed to be more efficient. The decentralization of welfare has been rather successful (see above). However, the central government systematically allocates less funds to municipalities than was used for the services involved before they were decentralized. This puts pressure on the local governments' budgets.

Another problem is that small municipalities find it hard to cope with the continuing stream of new responsibilities. Often, they do not have enough staff to allow specialization. Many observers question the ability of small local governments to absorb new tasks.

Amalgamation

As a result, small municipalities merge and amalgamate at an alarming rate. In 1980, there were 811 municipalities. In 2011, there are 418 left, and the end of this process is not in sight. Both Denmark and Belgium applied a big bang approach to amalgamation, in 2007 and 1976, respectively. In the Netherlands, however, amalgamation is an ad hoc process. There is no grand design which guides the amalgamation process. Hardly a year goes by without some municipalities being merged. No end goal has been defined, e.g., a desired number of municipalities or an desired minimum size.

There is a paradox here. Decentralization is partly driven by the desire to move decision making to the lowest possible level of government, in order to allow optimal citizens' control. But because decentralization leads to ever growing municipalities, decision making is moved steadily to larger units at greater distance from the citizen.

References

- Allers, M.A., Toolsema, L.A. (2010), *Welfare financing: Grant allocation and efficiency*, paper available on <http://www.rug.nl/staff/m.a.allers/research>.
Rfv (2009), *Naar een herijking van de financiële verhouding tussen Rijk en provincies*, The Hague: Raad voor de financiële verhoudingen.

