Financial relation between central government and municipalities 2008

1. Introduction

The Netherlands are a decentralised unitary state. Some of the overall government responsibilities are delegated to provincial and municipal authorities. Central government, the provinces and the municipalities together form the three levels of government. Today (2008) the Netherlands at the regional level is divided into 12 provinces and into 443 municipalities. There is hierarchy between the three tiers of government. Central government sets national policy. A lower tier authority is free to take initiatives on any field as far as there are no restrictions by laws issued by a higher tier authority. Lower ties authorities perform only few duties on their own initiative; most duties are carried out under a system of joint authority.

The distribution of responsibilities between central government and the municipalities is of relevance to their financial relationship. Duties that are carried out autonomously are financed out of general funds, wherever possible. Work in which responsibility is shared is often in practise financed out of special purpose grants.

2. Structure of local government income

Local governments are imbedded in a hierarchical decision-making structure with central government on top. In the Netherlands, as in many other countries, the financial influence of central government manifests itself through the grants system. The distribution of responsibilities between central government and the municipalities is of a certain relevance to their financial relationship. Duties of municipalities that are carried out autonomously are financed out of general funds, wherever possible. Work in which responsibility is shared is often in practice financed out of special purpose grants, as these are made available when duties are assigned to lower tier authorities.

Municipalities obtain their income from three sources:

- own income from municipal taxation;
- general grant from the Municipalities Fund of the central government;
- special grants from various ministries.

Table 1. Dutch Municipal income (2008), in bln euro

	€ bln	%
Own income	21,9	44,6
of which taxes and user charges	*7,2*	*14,7*
of which other own income	*14,7*	*29,9*
General grant	15,9	32,4
Specific grants	11,3	23,0
Total	**49,1**	**100,0**

This table shows that Dutch municipal income for the most part depends on grants from central government. About 60% of municipal income is object of political decision-making by the central government. So developments in the national budget have great influence on municipal finances. Own municipal income stands for the other 40% of total municipal income. The own municipal income consists of municipal taxes and user charges (levies) and other non-fiscal income.

3. Own income: municipal taxation and other non-fiscal income

Municipal taxation

Municipal taxes consist of taxes in the narrow sense (not related to a specific municipal task and revenue is basically unlimited) and user charges or levies (directly related to a specific municipal task and revenue may not exceed the costs municipalities make in performing that task). Municipalities are not allowed to levy other taxes than the ones mentioned in the municipalities act and are not allowed to make allowance for income or wealth in their taxation.

Table 2. Estimated revenues from municipal taxation in 2008

	€ mln	**%**
Real estate tax	2739	76,8
Dog-license fees	56	1,6
Tourist tax	119	3,3
Parking fees	467	13,1
Other taxes	128	5,2
Total municipal taxes	**3509**	**100,0**

Of the municipal taxes the real estate tax –which is levied in all municipalities- is the most lucrative. All other taxes have a more marginal role as a source of income and often derive their value from the possibility to control unwelcome behaviour (for instance having too many dogs).

Table 3. Estimated revenues from user charges in 2008

	€ mln	%
Sewerage charges	1711	52,1
Refuse collection charges	1163	29,5
Building fees	482	12,1
Other user charges	371	6,3
Total	**3726**	**100,0**

Other non-fiscal income

Specific examples of other non fiscal municipal income are entry fees for museums, sport, outdoor recreation and for instance day nurseries. In addition to these sources one should mention revenues from assets, for instance long lease and from own capital (rents, dividends, interests). Also the profits of municipal enterprises make a considerable part of the own municipal income.

4. The Municipalities Fund

By 1929 the pronounced differences between municipalities were no longer deemed socially acceptable and the Allocation of Finances Act was passed. Under this new legislation a number of municipal taxes were abolished, including the important municipal income tax. In their place a Municipalities Fund was set up, out of which municipalities receive a general grant. The development of the Municipalities Fund is strongly linked to the developments of the national budget.

The distribution of the Municipalities Fund over the 443 municipalities is regulated by a system that consists of a set of indicators like the number of inhabitants, the number of houses, the area of land and water, soil-condition, built-up area, etcetera. The redistribution of the Fund is cost-oriented and aware of the differences equally sized municipalities having totally different social structures. It boils down to municipalities with a weak social structure (a lot of unemployed people within the municipality) and municipalities with a centre function (providing facilities also beneficiary to citizens of neighbouring municipalities) getting more money than municipalities with a strong social structure and municipalities without a centre function.

A very important factor in the distribution of the Municipalities Fund is the capacity of a municipality to levy property taxes. Every municipality is forced to use its tax capacity to a legally defined level. There will be a deduction in the calculation of the grant a municipality receives to the extent of the legally defined level of taxation.

Control of the fund is in the hands of the Minister of Finance and the Minister for Home Affairs. The Minister of Finance is involved because of his responsibility for the distribution of resources among the different sectors of the national economy and for the fact that the growth of Municipalities Fund is directly linked to the growth of total government expenditure. The Minister for Home Affairs has overall responsibility for local government and is thus involved in expenditure on administration. For this reason he is also connected with the Fund. The Ministers are assisted in their task by the Council for Municipal Finance, an independent body which advises on the Fund's budget, the distribution of the grant between the different municipalities and any other matters related to municipal finance.

Supplementary allowance
Should a municipality be unable to finance all necessary expenditure it may apply for a supplementary allowance. A condition for receiving this is that its own income (from real estate taxes and rates for sewage, sanitation and cleansing services) is already at a reasonably high level. The deficit must be caused by factors over which the municipality has little or no control. An example would be a municipality with a small population which was required to maintain an extensive road network.

5. Specific grants

Apart from their own income and the general grant municipalities receive special purpose grants from various ministries. These grants must be used for purposes designated by the ministries in question. The distribution of responsibilities between central government and the municipalities is of a certain relevance to their financial relationship. Duties of municipalities that are carried out autonomously are financed out of general funds, wherever possible. Work in which responsibility is shared is often in practice financed out of special purpose grants, as these are made available when duties are assigned to lower tier authorities. The reason behind the provision of the grant is a ministerial policy aimed at promoting the relevant service or activity. The lower tier authorities have a role to play in realising this policy and require funds in order to fulfil this function.

Funding by means of the general grant has the advantage that very little expense is involved in the allocation of the money. Funding through special purpose grants, on the other hand, leads to additional indirect (bureaucratic / administrative) costs.

Specific allocations exist because:
- Costs are unevenly distributed over municipalities. For example, in some municipalities there may be no state schools or the number of unemployed may be extremely high;
- Objective distribution criteria do not exist;
- Costs are unequally distributed in time;
- Municipalities face temporary expenses. For example for the stimulation of a certain policy, such as child day-care or an environmental policy.

The disadvantages of specific allocations are evident:
- detailed regulations; the money has to be spent in a certain way on a certain task. This involves high bureaucratic costs;

- introducing a plan, accounting for the budget and the expense, audit certificates and often national supervision; all this results in decreasing possibilities for flexible financial policy because a large part of the expenses is fixed.

Quantitatively the specific allocations were by far the most important municipal source of income. In 1983 there were more than 500 different types of specific allocations for municipalities, in 2008 there are 101 specific grants left. This reduction is the result of an aimed policy by the central government. The ultimate goal is to reduce specific grants to an amount of around 37. This reduction has been made able by (i) transferring specific funds to the Municipality Fund; (ii) combining different specific allocations into one, broader grant or (iii) ending the activity which was financed by specific allocations. Apart from the reduction of the amount of specific grants there are also bureaucratic and administrative simplifications made.

Transferring specific purpose grants to a general fund offers more opportunities to municipalities for self-governance. It fits in the principle for the order of preference for the several methods of financing the activities of the local government. Secondly, all kinds of new acitivities have been funded by transferring budgets to the Municipality Fund. An important argument for central government for this method of financing is again allocation-theory. Funding activities of municipalities by means of the Municipalities Fund gives more incentives to economize.