



FINANCING LOCAL PUBLIC SERVICES IN ESTONIA: CHALLENGES AND WAYS FORWARD

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February 18th 2022

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Outline

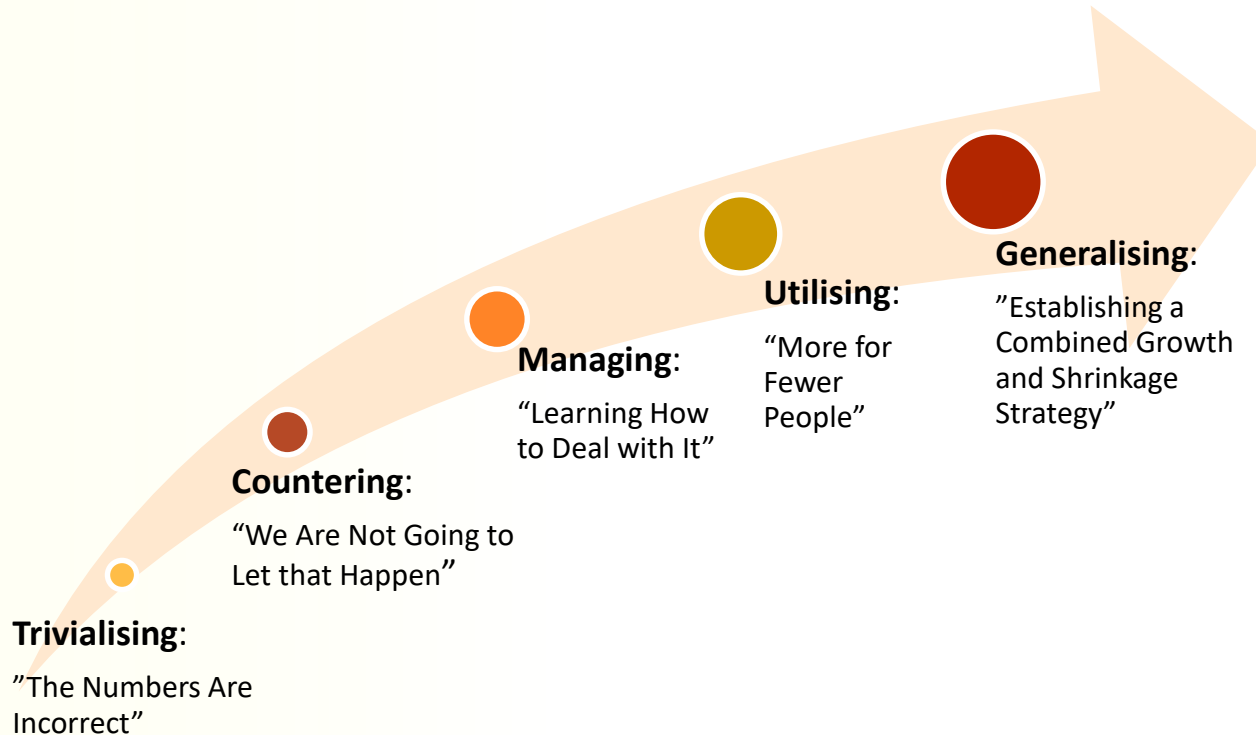
- Shrinking population: overview of policy responses and fiscal impacts
- Population change in Estonia from municipal perspective
- Assessment of Estonia's multi-level governance model and municipal financing model
- Recommendations

A photograph of several white paper cutouts of human figures holding hands in a line, set against a green background. The figures are arranged in a slightly curved line, and the focus is on the central figures. A large, dark red diagonal shape overlaps the bottom left corner of the image, containing white text.

**Shrinking population at
subnational government
level: impacts and
potential policy responses**



Five approaches to deal with population shrinkage



Source: adapted and modified from Hospers and Reverda (2015)



Potential fiscal impacts of shrinkage at subnational government level

- Shrinking own revenue base
 - Pressure to increase local tax rates
 - Risk for deficit budgeting (depending on fiscal rules)
 - Risk for debt accumulation
 - Increasing role of transfers
- Increasing per capita costs
 - Cuts on operating expenditures
 - Cutting back investments (both replacement and new)
 - declining local infrastructure → declining living standards → further population decline



Potential impacts on multilevel governance

- Pressure to reorganize services
 - Closures of facilities
 - Focusing on statutory services
 - Outsourcing service production
- Pressure to find alternative ways for service delivery
 - Intermunicipal cooperation
 - Cooperation with private sector and third sector
 - Municipal mergers (voluntary and compulsory)



Central governments as enablers of smooth adjustment to shrinkage

- **Planning** for the smaller population
 - Administrative reforms
 - Land use and spatial planning
- Helping **build capacity** at the local level
 - Up to date information base
 - Sharing best practices on strategies to tackle shrinkage
- Ensuring the **legal base** allows and encourages intermunicipal cooperation
- Rethinking **spending assignments** between levels of government
 - Regionalisation or centralisation
 - Privatisation
- Reforming subnational government **financing** to enable allocative efficiency
 - Transfer system, subnational government own revenues

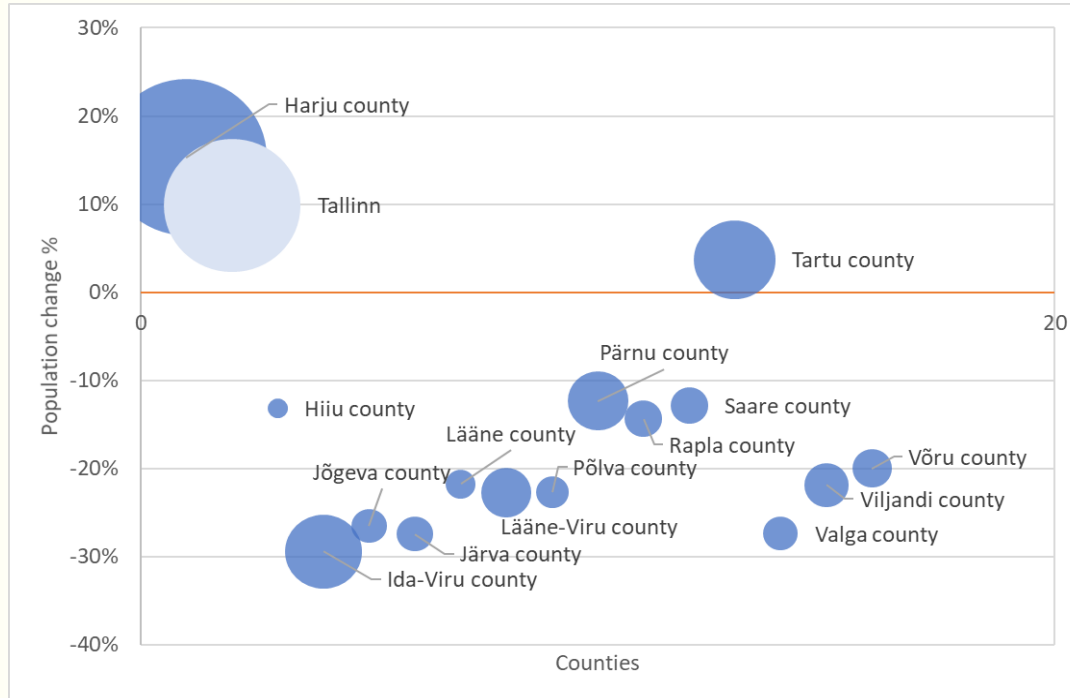


Shrinking population and Estonian municipalities



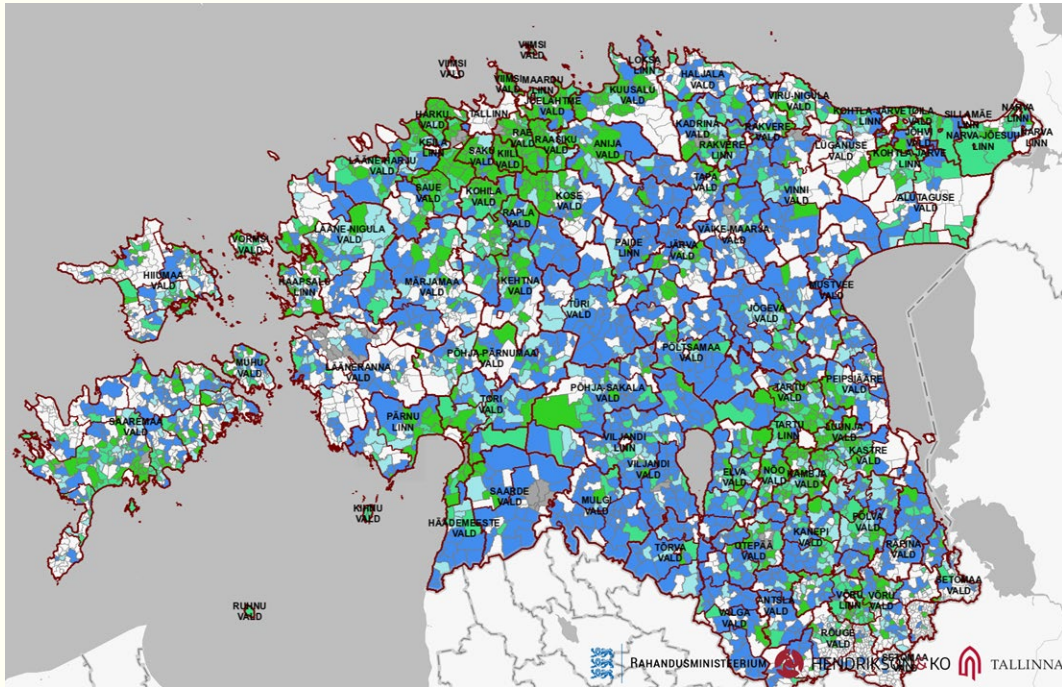


Estonian population is projected to decline by 2040 in all but two counties



Source: Statistics Estonia (2021) [Statistical database]

Shrinkage will affect the majority of municipalities



Generalized type by population

Growing up and with children



Growing up with few children



Stable/low-shrinking, with children and few children



Shrinking, with children and few children



No data available



Source: <https://www.hendrikson.ee/maps/V%3c3%a4ikeasulad/>



Shrinking population continues to be a problem at the municipal level

	Year			
	2000	2010	2017	2021
Number of municipalities	227	226	213	79
Average population size	6 173	5 900	6 171	16 559
Median population size	1 910	1 755	1 823	7 372
Average area, km ²	192.1	193.0	202.7	562.7
Average density, inhabitants per sq. kilometre	171.2	157.4	143.8	163.9
Share of municipalities with negative one year population change	59.5%	68.5%	67.3%	59.5%

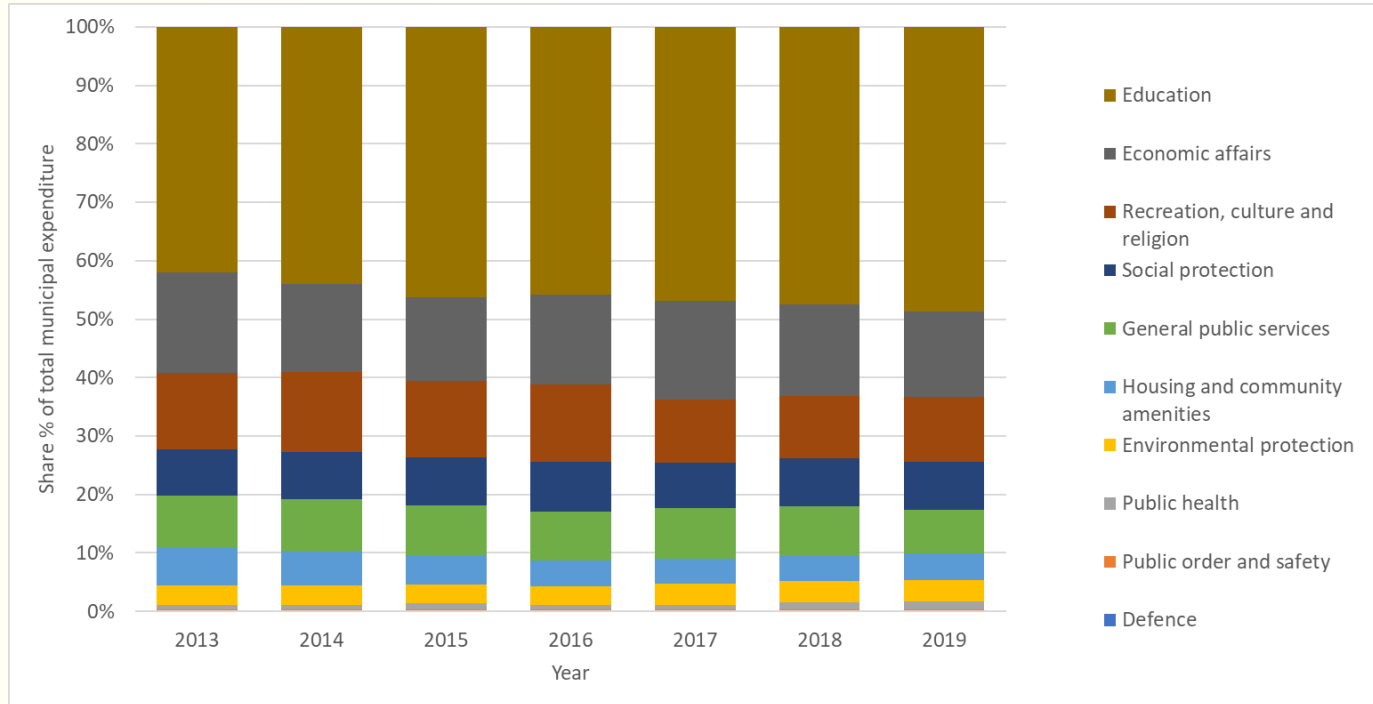
Source: Statistics Estonia, <https://andmed.stat.ee/en/> (visited May 25th 2021).



Decentralisation and municipal financing in Estonia



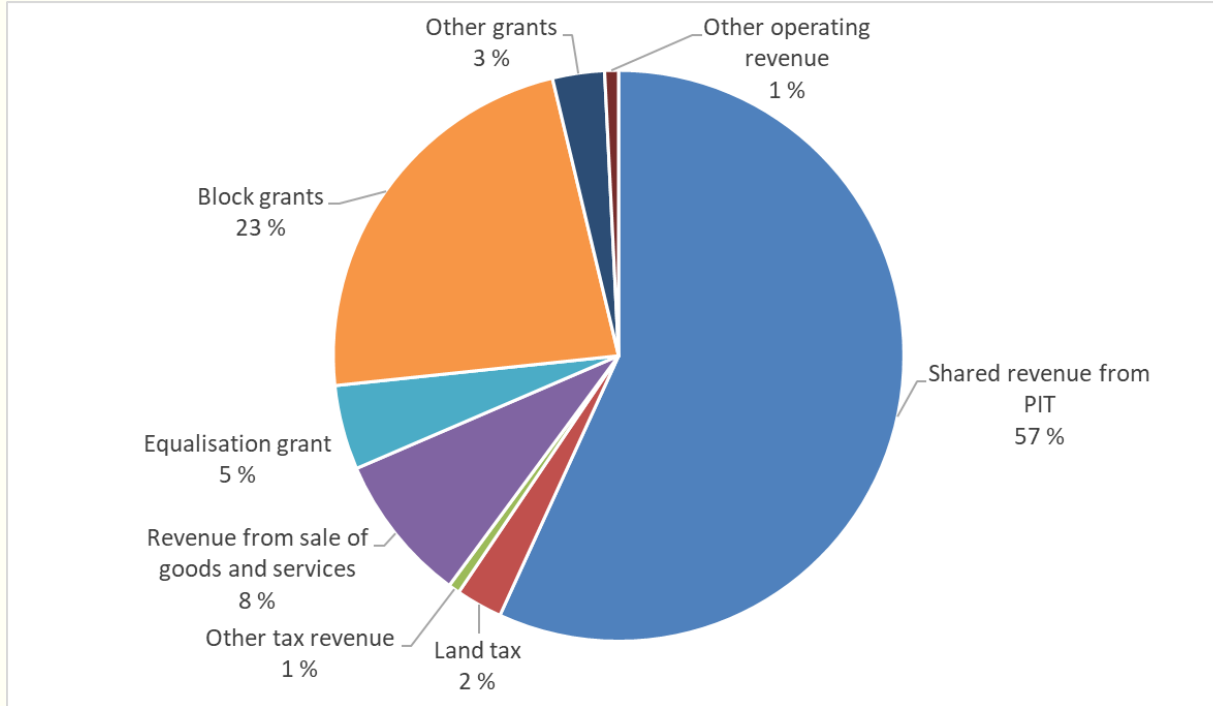
Education is the main task of Estonian municipalities



Source: Statistics Estonia.



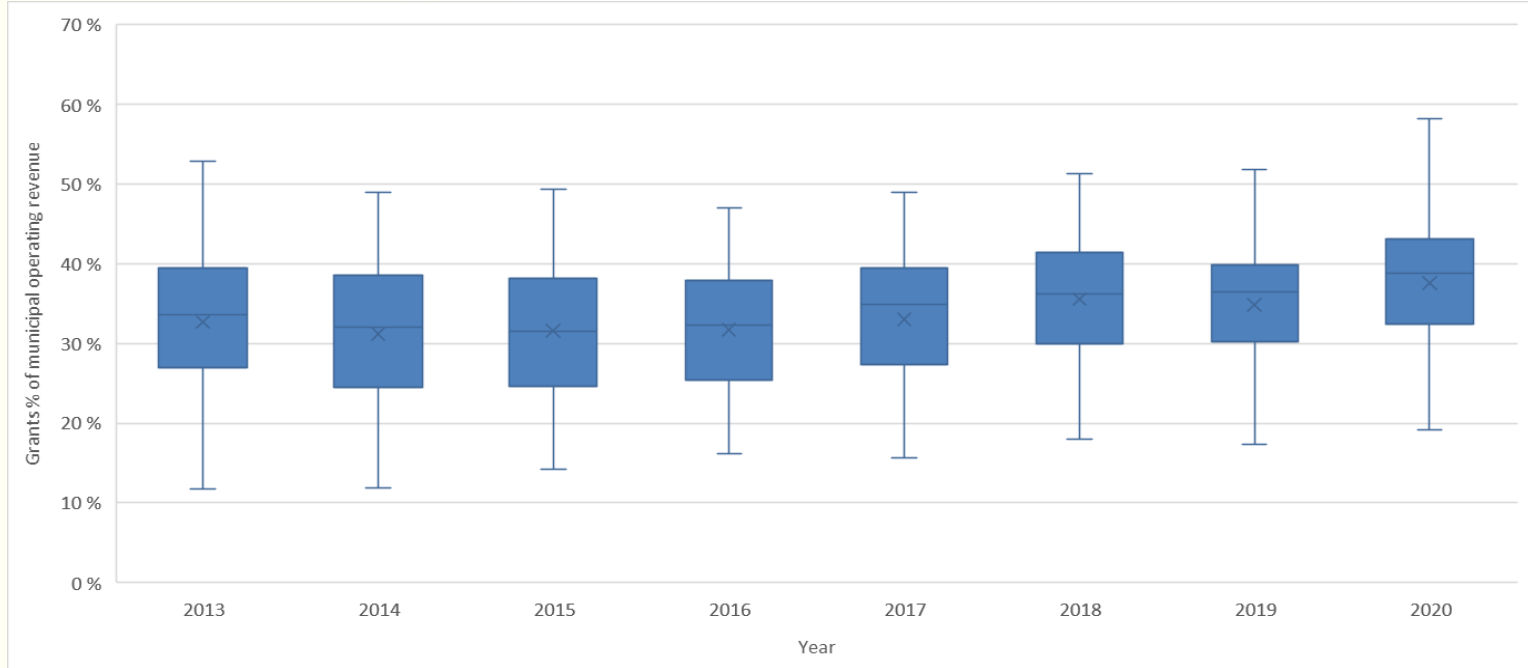
Central government plays a key role in municipal financing



Source: Statistics Estonia.



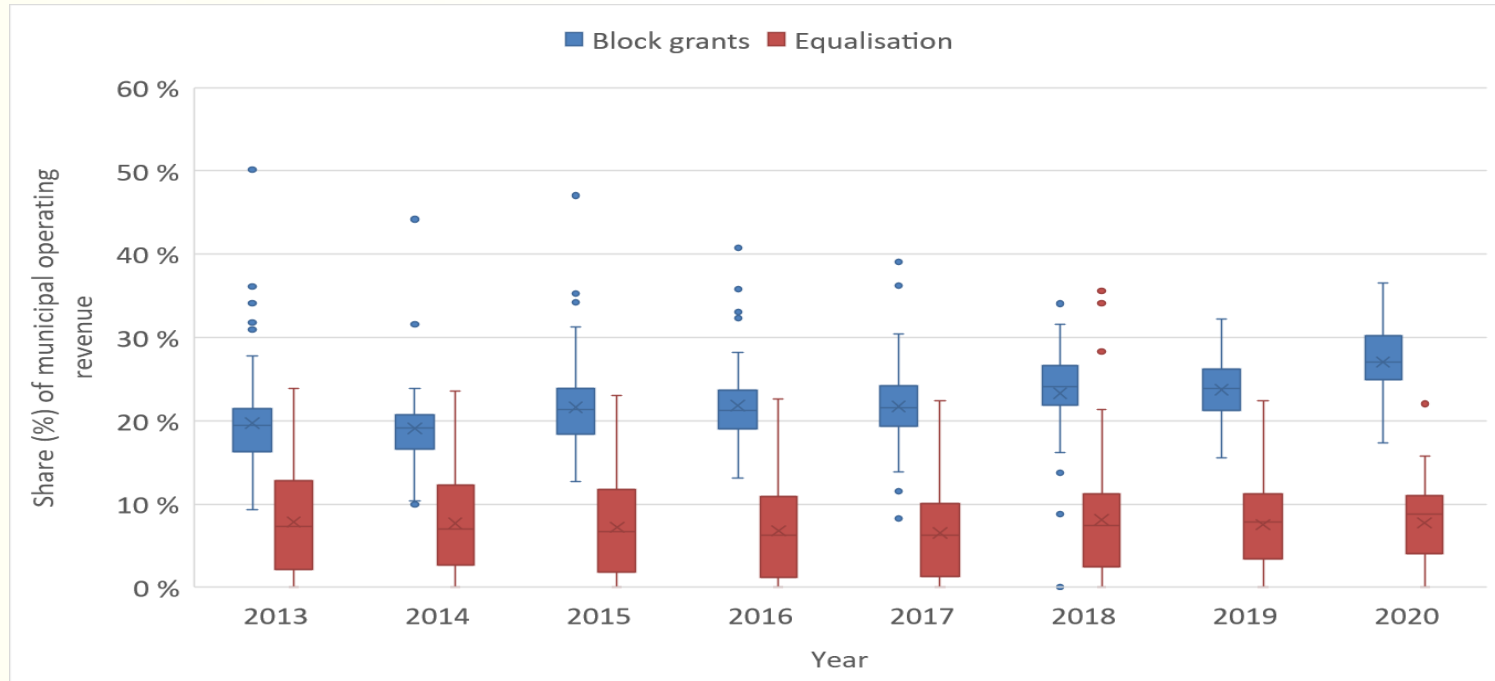
Municipal finances are becoming increasingly dependent on grants



Source: Statistics Estonia.



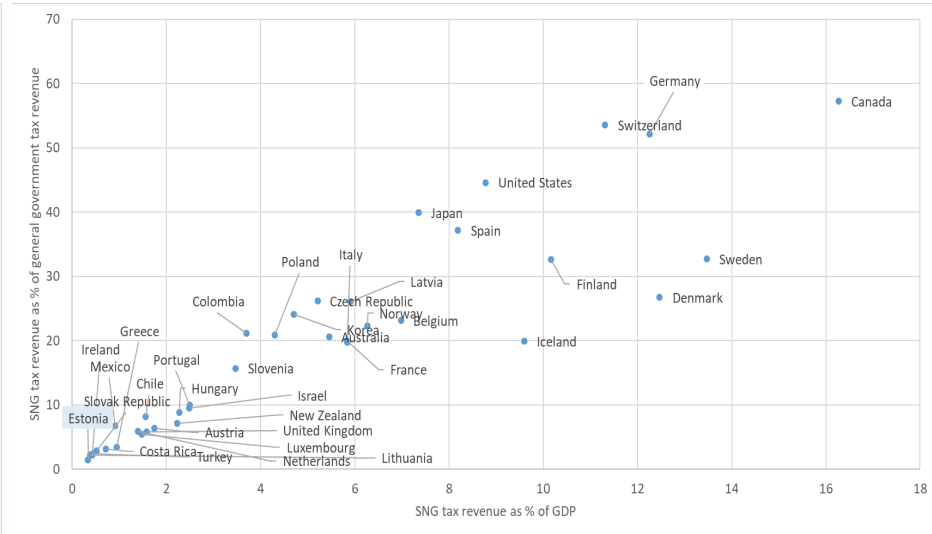
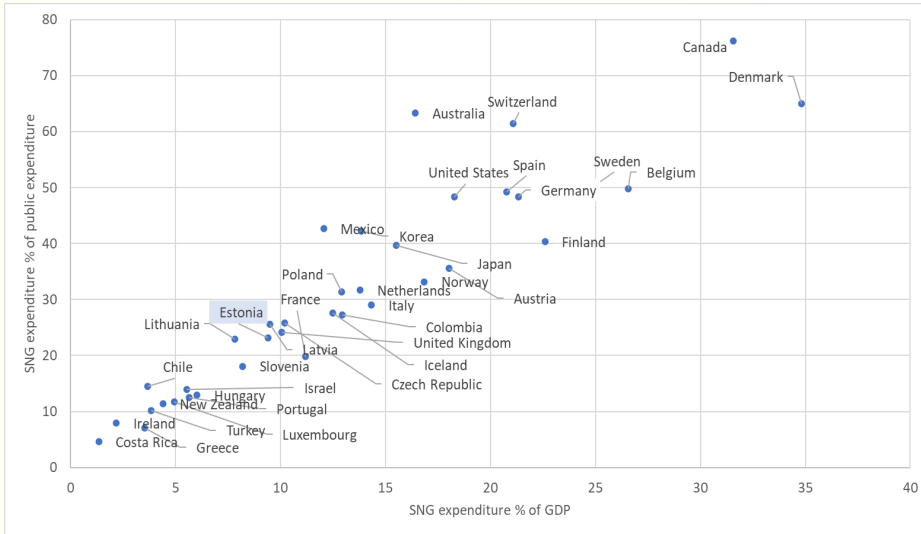
The importance of earmarked grants is growing



Source: Statistics Estonia.



Estonia is among the least decentralised OECD countries from revenue perspective (right panel)



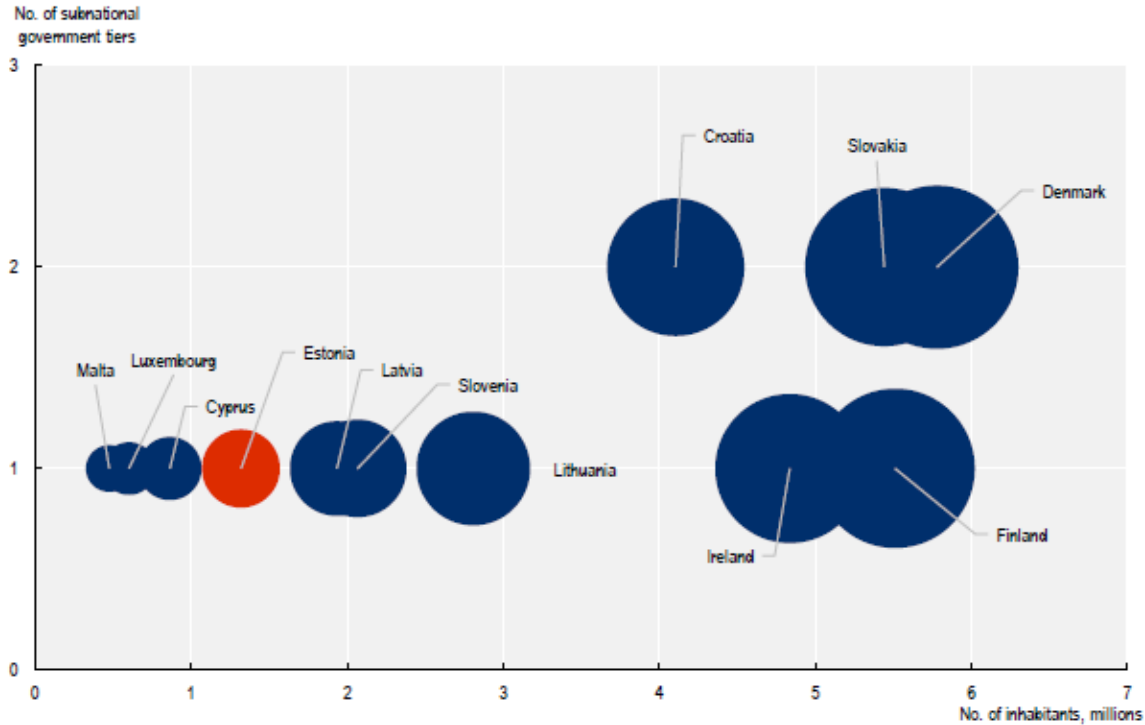
Source: World Observatory on Subnational Government Finance and Investment, <http://www.oecd.org/regional/observatory-on-subnational-government-finance-and-investment.htm>.



Recommendations



Applying single-tier subnational government system



Source: Author's elaboration of Eurostat Data, <https://ec.europa.eu/eurostat/web/population-demography/demography-population-stock-balance/database>



Preparing for future reforms

- Reaping the full benefits from 2017 administrative reform
 - Reorganising municipal service structure and administration
 - Building municipal capacity to meet the future challenges
- Raising the awareness of effects of shrinking population
 - Central government could establish an advisory service for municipalities to prepare for shrinking population.
 - Creating a database on local costs to enable benchmarking between municipalities.



Utilising intermunicipal cooperation

- Creating the right conditions for intermunicipal cooperation (IMC)
 - Clarifying the legal base for IMC.
 - Creating financial incentives for voluntary IMC.
 - Utilising piloting and experiments on voluntary IMC.
 - Assisting municipalities to build administrative capacity to organise IMC.
- Rethinking municipal tasks
 - Carrying out a nationwide review of municipal service responsibilities.



Reforming the municipal financing model

- Strengthening the municipal own revenue base :
 - Finalizing land tax base revaluation (already underway).
 - Easing the land tax rate regulation.
 - Considering a local income tax in some form.
- Reforming the transfer system
 - Reducing/abandoning the earmarked grants system.
 - Strengthening the equalization.
 - Increasing the transparency and rethinking the indicators.
 - Taking the population change aspect into account in the grant system.

Thank you!

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