

Municipal Budget Trade-Offs: Which services do local governments sacrifice under budget rules?

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Summary

1. We investigate the expenditure composition of 300 Flemish municipalities.
2. We observe that local governments tend to prioritize specific policy areas when they operate under fiscal constraints such as a balanced budget rule.
3. Our analysis reveals the considerable impact of the political and ideological position of local communities on budget priorities and internal trade-offs.
4. The budget composition patterns are also influenced by the age structure (inter-generational conflict) and ethnic diversity of local communities.
5. We suggest the introduction of new forms of democratic participation (e.g., participatory budgeting) for under-represented social groups at the local level, to align citizens' needs and municipalities' provision of local public goods.

1. Introduction

The fiscal behavior of local governments has gained significant attention from academia and policymakers driven by decentralization reforms transferring power from central to lower levels of government. As local governments assume more responsibilities for public goods and services, examining also their expenditure composition and internal trade-offs become more relevant.

While existing literature has examined the factors influencing the size of local government budgets, less attention has been given to the decision-making mechanisms and

trade-offs within budget allocations. Indeed, whereas a strand in the literature of public finance recognizes various socio-economic, demographic, and political features as relevant for explaining changes in the – overall or per capita – size of local government budgets, it is not always clear which exact expenditure components are sacrificed or manipulated (Adolph et al., 2020; Lipsmeyer et al., 2017). Moreover, although existing evidence indicates that certain budgetary components undergo modifications in response to socio-economic, demographic, and political fluctuations, further research is needed to comprehensively examine the nature of these reallocations (Hortas-Rico &

Rios, 2020; Martinez-Vazquez, Lago-Peñas, & Sacchi, 2017).

In this policy brief, we present the results of a DemoTrans study that investigates the expenditure composition of 300 Flemish municipalities, focusing on answering two central research questions. First, to what extent do municipalities demonstrate similar patterns in allocating their budgetary resources to specific policy areas? Second, which demographic, social, economic, urban, and political factors are able to explain the observed budgetary tradeoffs between policy areas?

2. Data & Methodology

The empirical analysis of our study leverages a unique dataset on the expenditure composition of local governments budgets at a very disaggregated level, with information about the allocation of fiscal resources for 149 expenditure categories (BBC, 2023). In that way, we are able to unveil the complexities of budgetary decision-making and highlight which expenditure categories are more likely to be sacrificed as the result of political manipulation of budgetary processes. This might reflect either ideological-political priorities and biases or structural socioeconomic characteristics. For the latter set of variables we relied on the Municipal City-Monitor database (ABB, 2022), the Belgian Statistical Office (StatBel, 2019) and the Comparative Manifestos Project (Lehmann et al., 2023).

Flanders allows for an excellent testing ground for exploring fiscal behavior of local governments, as it is characterized by a high degree of fiscal autonomy, with tax collection power over income and property. Since 2014 a new fiscal framework has become

operational, requiring all municipalities to effectively run a balanced budget. Thus, expenditure decision and tradeoffs between expenditure categories depend on political majorities at the level of local governments.

In our study we employ two research approaches. On the one hand, we apply an unsupervised clustering algorithm to the disaggregated expenditure composition of local budgets. In that way, we identify the municipalities that share similar patterns of budgetary expenditure compositions. On the other hand, we employ a binary logistic regression analysis that allows us to identify those socio-economic and demographic variables that explain the observed patterns of cluster memberships.

A common concern in the empirical literature of political economy is the issue of endogeneity and reverse causality between fiscal policy and political-ideological factors. For this reason we should interpret our empirical findings with caution and avoid any causal inference. However, we should underline that the presence of reverse causality is unlikely in the context of our empirical design, since the time it takes for the political decisions of local politicians to influence the ideological and political stance of their electorates is far longer than a single year, and usually transcends multiple elections to become effective. Nevertheless, for the estimation of our econometric model, we lagged the time-varying variables by one year in order to address potential issues of simultaneous endogeneity.

3. Results

Our results suggest that there is an important variation between municipalities regarding the political decisions of local governments to favor specific expenditure categories with

more budgetary resources, sacrificing in the meantime other policy priorities. We observe that there are three distinct clusters of municipalities with respect to the similarities in the expenditure composition of their budgets (see Figure 1).

In particular, the municipalities that belong to 'Cluster A: Elderly-Centric Care' tend to prioritize social care services for the elderly, sacrificing resources that could have been spent upon education, mobility, environment, and other policy areas. On the contrary, municipalities that belong to 'Cluster B: Balanced Education and Social Care' tradeoff between high budget shares for primary education, mobility, environment, social care services for families and significantly lower budget shares for social care services for the elderly. Finally, in 'Cluster C: Urban Development and Services-Oriented' municipalities sacrifice both policy areas of care services for elderly and primary education, in order to support administration services, mobility, safety, other social services (childcare), and urban planning.

Our econometric findings highlight specific elements of the socio-economic and political profile of local communities in predicting the budgetary policy priorities. In particular, poverty, measured by the number of declarations with tax income below a critical limit¹, increases the probability to observe budgets that prioritize education and social care services over caregiving services for the elderly by 36.4%. The size of population, average income, unemployment, and the size of the manufacturing sector, have either negligible or statistically insignificant effects on the likelihood to observe any of the three clusters. These findings suggest that Flemish

municipalities assume a limited role in macroeconomic stabilization and countercyclical policies, prioritizing social services and education provision.

Furthermore, our analysis reveals the considerable impact of the political and ideological position of local communities on budget priorities and internal trade-offs, in line with the theory of partisan politics (Baraldi, 2008; Bremer et al., 2022). The theory of partisan politics suggests that political parties compete for votes promising measures and reforms that best serve the interests of the social groups they represent. A shift towards the right in the politico-ideological position of local electorates increases by 64% the likelihood of municipalities prioritizing caregiving services for the elderly while decreases by 49% the probability of prioritizing education, mobility, and the environment.

Moreover, we find support for the so-called intergenerational competition hypothesis, which assumes significant distributional conflicts between elderly and younger cohorts. For instance, a 1% rise in the share of older population (80+) reduces the likelihood of prioritizing municipal expenses on education by 25.9%. Likewise, the likelihood of observing budgets that sacrifice caregiving services for elderly rises by 8.2% with respect to the student population. Furthermore, as the percentage of foreign residents increases, the likelihood of finding allocations favoring greater spending on caregiving services increases by 5.1%, an observation that aligns with existing research showing that foreigners often help address caregiving workforce shortages.

¹ Tax income below a critical limit is defined as the share of individual tax returns (without zero returns)

with net taxable income less than €10,000 and of joint declarations with less than €20,000.

All in all, local government budgets that prioritize caregiving social services for the elderly are more likely to be found in communities with more conservative electoral bases and a larger ethnic diversity. Policymakers tend to favor expenditures on education, when the politico-ideological position of local communities is less conservative, the age structure is tilted towards younger generations and there are higher shares of poverty. Finally, expenditures that support general administration services and urban planning are prioritized by municipalities with higher fiscal self-reliance (fiscal effort) and more equal communities in terms of poverty rates.

4. Policy Recommendations

Overall, our results reveal how local governments tend to prioritize specific policy areas in the design of their budgets, when they operate under strict institutional and fiscal constraints such as a balanced budget rule. Although our findings are linked to Flanders, our analysis offers valuable insights to policymakers for reformulating fiscal policies and implementing institutional reforms that mitigate the scale and scope of inter-generational and politico-ideological gaps in public goods and services provision by local governments.

First, the distribution of responsibilities for critical public goods, like education and social care, can be re-assessed among local, regional, and central governments. This approach can address fiscal pressures and ideological biases at the local level. Second, introducing new forms of democratic participation (e.g., participatory budgeting) for under-represented social groups reduces the gap between citizens' needs and municipalities' provision of goods and services. Local government expenditure decisions after all

reflect policy priorities which in turn result from the complex interaction of factors (e.g., socio-demographic, economic, institutional, politico-ideological). As the results of our study indicate, shifting budget resources involves a political trade-off. Consequently, developing adequate forms of civic representation empowers marginalized groups to contribute to their social and political advancement.

What is DemoTrans ?

DemoTrans is an impact-driven research project that will provide theoretically and empirically robust recommendations on how to reinvigorate democratic governance by improving the accountability, transparency, effectiveness and trustworthiness of rule-of-law based institutions and policies.

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Figures

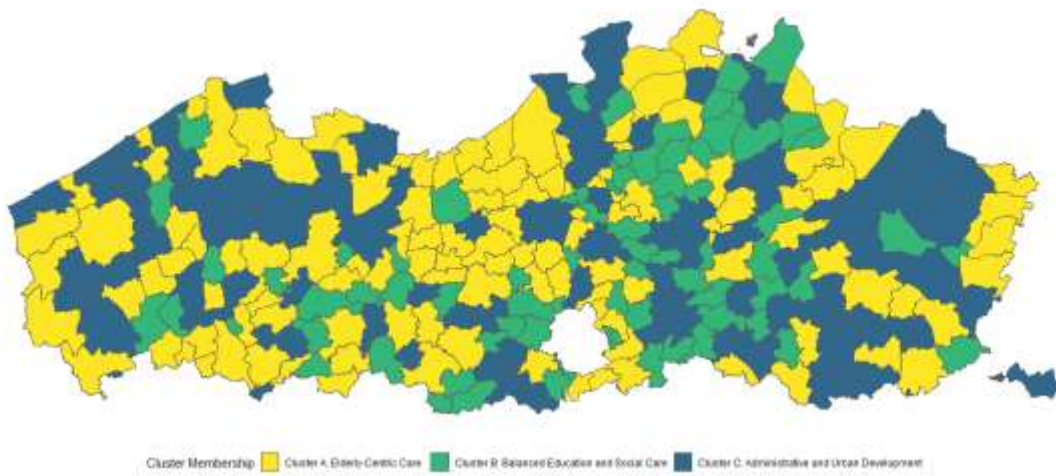


Figure 1 - Cluster Memberships of the Flemish Municipalities

Source: Own Illustration. Data: BBC, 2023

Further Information:

Iliopoulos, P., & De Witte, K. (2023). [The Expenditure Composition and Trade-offs in Local Government Budgets](#) (Discussion Paper DPS 23.17; Discussion Paper Series, p. 53). KU Leuven, Department of Economics.



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