

SHRINKING GOVERNANCE – ECONOMICAL ASPECTS IN LATVIA CASE

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ABSTRACT

Shrinking is a series of causes that have different effects on the rural areas. These effects are often direct and indirect, immediate or may express in a long-term dimension. The causes of shrinking are diverse: e.g. economic recession, increasing urbanization, changes in environmental conditions, etc. The most commonly shrinkage characteristic is a permanent decline in population. Latvia like several other European countries is losing population. As a monocentric country Latvia has some additional challenge - depopulation in the rural areas. The policy response to population decline is reflected to local governance and municipal services, where administrative territorial reform and the amalgamation of municipalities are one of the key.

The aim of the study is to analyze the effects of shrinkage management in Latvia on the basis of existing administrative structure. The focus of the research chosen by the authors best describes the policy response to this complex problem. The article is based on the analysis of state policy, local government documents, socio-economic indicators, population projection for 2030, analysis of local government budget expenditure, analysis of spatial data at the level of administrative territories.

We conclude that the response of government to development trends is not always adequate to deal with the effects of shrinking. The change of existing approach of the local municipality equalization fund, the budgeting principles of local governments is needed, due to lack of it sustainability. New management governance that takes into account shrinking causes and processes, is needed, based on more complex view on financial, structural and spatial contexts.

Keywords: shrinkage, rural development, administrative reform.

INTRODUCTION

Shrinking territories is a set of processes caused by multiple factors – macroprocesses of the economy, social and political system as well as natural disasters including climate change. It is believed that the main reason for shrinkage is the population decrease, which consequently causes demographic aging, “brain drain”, empty homes, underutilization of infrastructure [1], social consequences that influence the life quality and social potential of the area [2] – skills and competences of the people that have stayed and even their attitude towards the existing surroundings [3]. This gives a challenge in administering of the territories – what should it be like under circumstances of shrinkage.

Good practice, as described in the literature, suggests that governance issues as a whole are based on a flexible response, contrary to a pre-defined strategy [3], action at different levels of governance is essential [4], [5].

Socio-economic territory shrinkage is ongoing in several Eastern European countries. Being the key indicator, population dynamics shows that the shrinkage on national level is the most rapid in Latvia, Lithuania, as well as in Romania and Bulgaria, with internal territory shrinkage being characteristic to other countries. Shrinkage can be a determinant for developing governance solutions effecting the national administrative division. Reforms are being linked to economic and social consequences of shrinkage, need for a more rational use of the public funds.

Administrative re-arrangements in Latvia are long-drawn, as a result of which 119 local municipalities were created in 2009. Multiple government reports have indicated that the previous territorial reform is deficient and incomplete since it only partially complies with the criteria for local municipality creation [6], [7]. Local municipalities that have been created are heterogeneous, they do not comply with the criteria defined, also the impact of the regional government structure creation on the differences in territory administration function implementation has not been agreed on. The second phase of the administrative and territorial reform (ATR) in Latvia has been started in 2019. Arguments circulating in public are linking the reform to the process of demographic shrinking, possible savings of the local municipality public funds, equal development opportunities for territories, however justification of these arguments raises questions.

It is common to emphasize that scale economy justifies the concentration policy, envisioning that larger structures and their concentration brings greater effectiveness. It is also being argued that it improves the quality of the services provided to the inhabitants [8], [9]. However, research done in multiple countries contradicts the statement. Political governance of the territories is often seen as and narrowed down to reducing of the number of the municipalities and enlarging the size of the territories, forgetting that the territory governance includes provision of demographic representation, area identity and access to the services as well. Thus, when concentrated, the services distance and become more expensive to the inhabitants [10], [11]. Also, there is no unambiguous opinion about the impact and effectiveness of the reforms. Some studies have proven that there is no direct correlation between the size of the municipality and their effectiveness, tax income or municipality cost decrease [12].

Shrinking governance or governance for shrinking is a notion accepted by the authors to denote to government's response to shrinkage processes. (Fig.1). The causes and manifestations of shrinkage provide a context for governance in the form of political agenda and implementation.

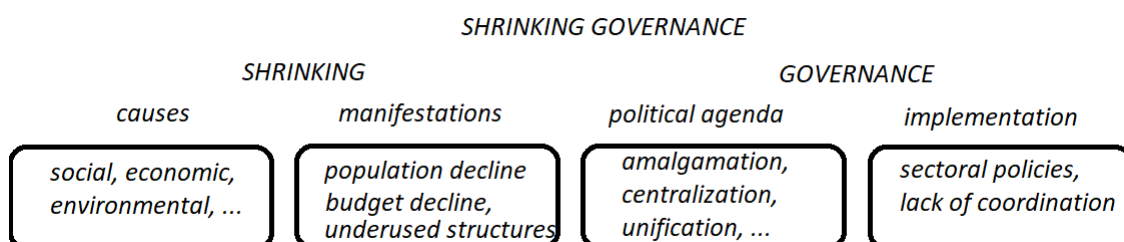


Figure 1. Logic of shrinking governance

Source: authors produced

The study examines the impact of shrinkage on various socio-economic and governance indicators as well as on administrative structure.

MATERIALS AND METHODS

Our study is done for all territory of Latvia, based on municipal level - 119 municipalities. The database with different socio-economic indicators from Central Statistical Bureau of Latvia (CSB), Treasury Republic of Latvia and Regional development indicator module (RAIM) with individual local budgets data was created to carry out a study. Analysis of the study is based on the population forecast until the year 2030. It is based on extrapolation of the population dynamics tendencies of 2010-2018. For income and governance cost prognosis and evaluation of the perspective changes to the infrastructure load, population projection on year 2030 has been used for data analysis. Population in Latvia has decreased from 2,6 million in 1991 to 1,9 million in 2018 [13]. There is territorial nature to the population changes – it is decreasing the most in the periphery, and an increase is planned in the central area and in the districts boarding with Riga, the so called Pierīga (see Fig. 1).

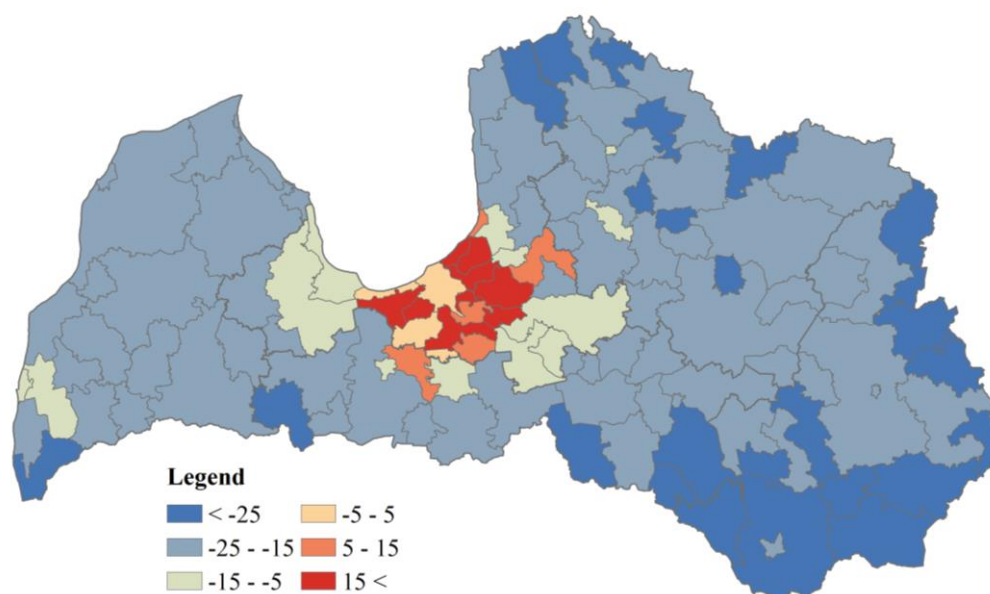


Figure 1. Population change forecast for 2017-2030

Source: authors' calculations by RAIM and CSB data

To evaluate the relative economic development of the territories, the Municipal territory economic dependency index (EDI) that characterizes territorial differences in generation of the added value, has been developed. The following data is being used for calculating the EDI: application of the personal income tax depending on one of the two perspectives – based on the employer's location (legal address) and declared home address of the employee. The formula for calculating is $EDI_i = (IINDD_i / IINDN_i) - 1$, where IINDD – deducted personal income tax total in the territory i, and IINDN –

deducted personal income tax total applicable to the territory i based on the declared home address of the employee.

The following methods were used in the research: quantitative data analysis and interpretation, analysis of the national and local municipality planning documents, GIS methods for spatial analysis and displaying of the results.

RESULTS AND DISCUSSION

Future decrease of the population will directly affect the local municipality income as well as payments from the local municipality equalization fund. Having been created as a temporary mechanism for financing of the administrative units, the latter has become an essential part of the local municipality income. There are only few municipalities contributing to the local municipality equalization fund, mainly the ones belonging to Riga agglomeration, but there are 100 municipalities out of 119 receiving the payments (see Fig. 2.). The volume being redistributed through this mechanism has grown significantly in the past five years – by 40 %, which indicates increasing territorial differences in the inhabitant economic productivity and location of the economic activity territories.

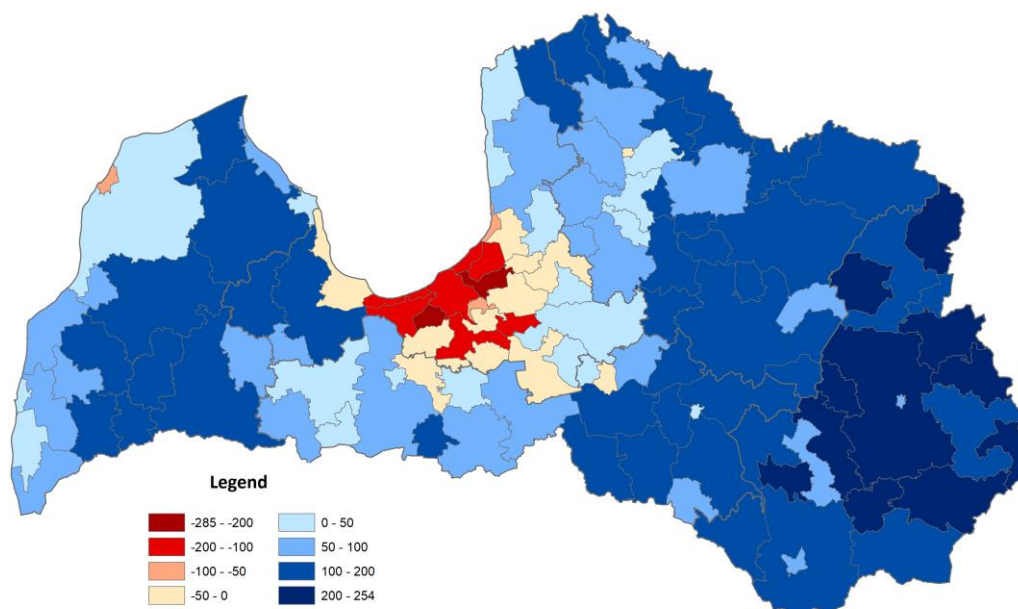


Figure 2. Municipal dependence from payments in Local Government Equalization Fund

Source: authors' calculations by RAIM data

The existing local municipality equalization fund approach can be argued about and indicates shortcomings in the regional policy being implemented before. It affects the payers as well as the receivers of the funding. Contributing municipalities need the resources for themselves to finance their growing development demands. In addition, the criteria for receiving of the equalization fund aid does not stimulate receiving municipalities to develop economic activities in their territories and provides a secure income for financing their growing needs.

Municipal territory economic dependency index (EDI), created by the authors, supports the fact that there is a dramatic dependency on economic activity in the few

municipalities of the country. It assumes that, being part of the added value, the deducted personal income tax of the employees can be closely linked to the economic activity and its productivity. Evaluation of the EDI states that only five out of 119 local municipality territories have a positive index, with four of them belonging to Riga metropolis (see Fig. 3).

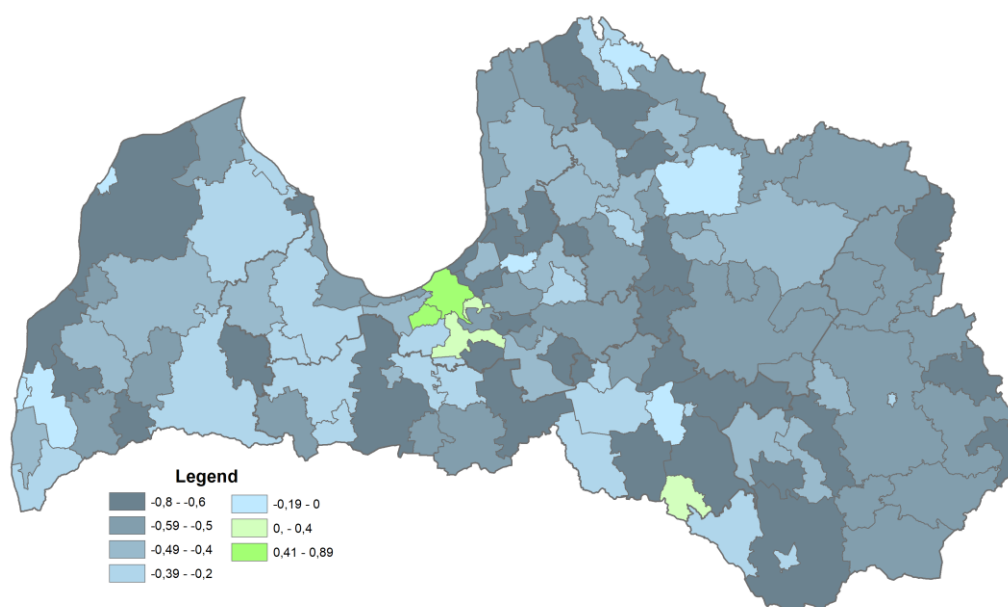


Figure 3. State of municipal territories' economic dependency, based on EDI, 2013-2017 average.

Source: authors' calculations by RAIM data

The analysis of indicators also shows that under circumstances of shrinkage administrative units will be facing great challenges in infrastructure maintenance. For example, over the next ten years road infrastructure load per capita in many territories can increase by as much as 20-30 %. It is particularly characteristic to the peripheral areas, regardless of the size of the municipality (see Fig 5.).

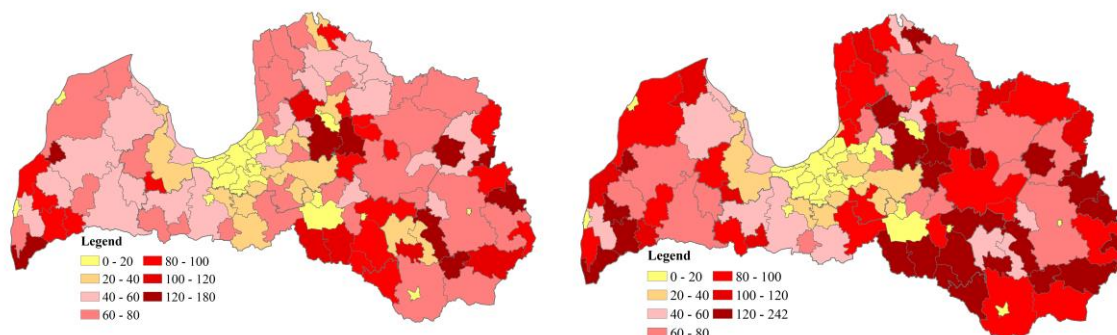


Figure 5. Length of the roads (m/inhabitants) in 2017 and 2030, main roads excluded

Source: authors' calculations by RAIM data

In circumstances of shrinkage effective use of the public funds becomes crucial. Therefore, we assessed the benefits gained from enlarging of the local municipalities. In our assessment, we assumed that a part of the local municipality functions performed depend on the service volume and have been optimized already, for example, building authorities, utilities and other services linked to territory maintenance, education services that are linked to the number of children and their location in the territory. We also assumed that the reform does not mean centralization of population placement. Consequently, merge municipalities can only have a direct impact on general government costs. If we assume that merging of the structures could bring a relative reduction of such costs by 30 %, then we are able to model the possible cost savings depending on the scale of the merger. If the criteria for merging of the municipalities is target population of 5000, it would affect 40 municipalities and could bring administrative cost savings of 4,6 MEUR (Table 1). When increasing the target to 25000, maximum annual savings could bring 29 MEUR at 2017 prices, which is only 1,3 % from the total municipality budget. This does not differ significantly from the conclusions of the study of the Bank of Latvia [14], where methodology differs by assessing costs of education and social security in addition to assessment of administrative costs, assuming per se that reforming of the municipality borders would lead to local policy reforms in education and social security.

Table 1. **Economic effect of the merger – general government cost reduction by 30 %**

Municipal merger criterion - population	5000	15000	20000	25000
Number of municipalities affected	40	89	95	106
Budget savings in MEUR, 2017 costs	4,6	18,2	21,2	29,0
Share of Local Government Budget	0,20%	0,80%	0,90%	1,30%

Source: calculations by the authors

Reaction to shrinkage problems in our view is complex, with ATR comprising only a part of the municipality activities. It is more important to ensure growth opportunities for territories by basing them on incorporating economic growth factors into funding of the municipality development, for example, by adding to the municipality funding a proportion of the corporate income tax and private income tax depending on their economic activity rating. The state should foster creation of the jobs, particularly in periphery.

Demographic shrinkage considered in particular, national policy should be proactive. Analysis of the national and local municipality documents shows that assessment of shrinkage processes is missing in the development documents, often focus for future is the population size staying unchanged or increasing, while statistical data is showing an opposite trend. Local municipalities are not planning for relevant actions to manage the shrinkage process and to administer under circumstances of the shrinkage. There is no common experience to transfer for creation of the municipality territorial network, since effective solutions are founded on the cultural, historical, social and economic environment.

CONCLUSION

1. The existing approach of the local municipality equalization fund is not sustainable, it does not contribute to the economic growth of municipalities, and therefore transformation is needed.
2. Negative score of the Municipal territory economic dependency index for most of the municipalities shows the need for transformation of the budgeting principles and it is important to raise more revenue from entrepreneurial/economic activity in the territory of the administrative units.
3. The development of municipalities are planned and managed without regard to the apparent shrinkage. With the municipality budget income being strongly linked to the size of the population, it will be an increasing challenge to maintain existing infrastructure in circumstances of the shrinkage.
4. Mergers of administrative units, which result in changing the administrative borders, do not contribute significantly to the reduction of administrative costs.
5. There is a need to change the thinking paradigm, from often delayed response to proactive action, particularly to improve the economic situation of municipalities.

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