




## OECD Empfehlungen zum Finanzausgleich

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## Issues

- Aufgaben des Föderalismus (Anpassung an lokale Präferenzen, Nutzung lokaler Informationsasymmetrien:= Erbringung von gewünschten, qualitativ hochwertigen Dienstleistungen auf lokaler Ebene)
- Transparency
- Taxation autonomy
- Funding principles
- Redistribution
- Integration of externalities
- Incentives
- Efficiency of Service Provision
- Macroeconomic management and co-ordination  2 OCDE

## Transparenz

- Zeitgerechte Veröffentlichung von Haushaltsdaten
- Informations- und Erfahrungsaustausch
- Benchmarking
- Unabhängige Haushaltskontrolle

### **Develop information systems on sub-national government policies and performance (Spain 2005)**

- Promote the sharing of experience across sub-national governments.
- Develop benchmarking for services provided by sub-national governments and make the results public (for instance, waiting lists for hospital care) so as to enable local citizens to exert pressure on regional governments to improve the cost-effectiveness of their actions.
- Facilitate sub-national governments' access to tax data on a timely basis so as to enable them to introduce better informed tax policies.
- Improve the transparency of sub-national government budgets and audit them by an independent body to avoid the expansion of off-budget operations through public enterprises.



## Einnahmen

- Umverteilung
- Zuweisungen
- Ko-Finanzierung
- Zweckbindung
- Targeting
- Effizienz der Steuerbehörden und –einhebung
- Steuerautonomie
- Stabilität



## Revenue allocation

- ***Earmarking of revenues should be given up, and extra budgetary funds should be fully integrated into the budget of the respective government. Cofinancing should be strictly limited to cases where clear externalities are present and local provision is nonetheless preferable, and be based on output rather than input indicators. (Austria 2005)***
- Demand for local services relating to education, social facilities and health care varies by demographic group. ***Hence, the demographic composition of the population, such as the proportions of the elderly, young children and immigrants, should be used a priori as additional criteria in determining the sharing of tax revenue of sub national levels of government.***

## Equalisation schemes

- **Greater dynamism could be achieved with a less confiscatory equalisation system and a higher degree of tax autonomy and both of these should form part of any balanced tax and expenditure reform (Germany 1998)**
- ***The redistribution mechanism for municipalities should be simplified and the extent of redistribution reduced. One option would be to eliminate the wide range of vertical redistribution and achieve redistribution via horizontal transfers between municipalities for each state. (Austria 2005)***

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## **Transfer flows between government levels need to be targeted better and become more transparent (Austria 2005)**

- **The tax revenue redistribution mechanism among sub-national government levels should be simplified** and made more transparent, reducing compensation effects on own tax revenues below 100%.
- **Earmarked transfers to lower levels of government should be reduced.** Earmarked federal government funding for residential construction subsidies and infrastructure spending of the states should be phased out.
- The consultation mechanism should apply to legislation causing both positive and negative cost spillovers to other levels of government. **Compensating payments within the consultation mechanism should be made on an ex-ante basis**, rather than on the basis of *ex post* cost.
- **Co-financing should be strictly limited** to cases where clear externalities are present and local provision is nonetheless preferable, and should be based on output rather than input indicators.

## Contain the costs and adverse effects of the grant system (Japan 2005)

- **Reliance on earmarked grants should be reduced**, the objectives reviewed so as to avoid potential conflicts and old grant programmes reviewed in the light of new objectives and financial constraints.
- **End the reliance of equalisation grants (LAT) on volatile national revenues** for funding in order to reduce their asymmetrical behaviour over the business cycle.
- Reassess the coverage of local public services to be included in **equalisation schemes**. Adjust the grant formula so as to reflect **objective needs** (e.g. resulting from topographic or socioeconomic circumstances rather than from actual spending or infrastructure endowments).
- Remove the **incentives** embodied in the grant system that favour debt financing by ending the practice of including debt repayment costs in the calculation of grant entitlements for new bond issues.
- Limit discretionary elements (including the special LAT), which could create moral hazard problems, and improve the **transparency** of the adjustment factors accounted for in the LAT formula.

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## Integrate externalities

- Some regional centres servicing bordering municipalities are being funded less well than other similarly sized municipalities. *The provision of such services should be taken into account in the distribution of tax revenues of local governments.* (Austria 2005)
- *The legal environment for large infrastructure projects should be reformed in a way which takes account of all interests involved while allocating the final responsibility to the higher government level.* (Austria 2005)

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## Fragmentation in decision-making should be overcome (Austria 2005)

- Financing and spending responsibilities for hospitals and practicing physicians should be assigned to one government level.
- Sub-national levels of government should not be able to block hospital supply planning decisions unless they are fully in charge of paying for hospital-provided health care services.
- The annual sustainable development implementation reports should contain an explicit statement about the main indicator changes to be achieved by individual programmes. The terms of reference for the evaluation of the overall strategy should include an explicit request to assess the cost effectiveness of individual programmes. Future prioritisation of programmes should take cost effectiveness explicitly into account.
- The government should therefore make sure that the measures outlined in a big interdisciplinary flood study are also implemented by the responsible lower levels of government. Conditioning part of federally provided transfers on compliance with appropriate flood risk prevention measures could enhance efforts in the right direction.
- A mechanism should be put in place within the National Strategy for Sustainable Development which would allow the reconciliation of the different dimensions of sustainable development before the start of supra-regional projects. Indicator reports should include benchmarking information, which would allow a comparison of how Austria fares with respect to programme efforts and international best practice performance.

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## Own tax revenues

- Sub national governments should rely more on tax revenues under their own control with real estate taxation a likely candidate for this purpose. *To this end, valuation of real estate for tax purposes at the level of municipalities should be updated more frequently and unified across sectors in line with market valuations. At the level of the states, consideration should be given to introducing genuine taxing powers that replace the states' levy on the municipalities. Allowing the states to incorporate a limited flat income tax component into the income tax schedule would be an option. (Austria 2005)*

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## Tax sharing arrangements should be improved (Austria 2005)

- Distribution of tax revenue shares across sub-national governments should be more closely linked to indicators for demand of local services, taking into account the demographic composition of the population, as well as the provision of services by centres of agglomeration which are demanded by residents of neighbouring municipalities.
- Revenue allocations to the different levels of government should be fixed for a longer period than four years.
- Earmarking of specific tax revenues should be given up.

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## Utilise economies of scale in service provision

- Many municipalities in Austria are very small, incurring on average much higher administrative costs per capita than larger municipalities. Hence, there is a need to exploit returns to scale of community size in the provision of government services so as to control costs and debt accumulation. From an economic perspective, voluntary mergers of municipalities would be a preferable option as mergers allow the benefits of increasing returns to scale to be reaped while preserving accountability to local voters. Widening cooperation between municipalities through the joint provision of services is a second option. At present, legal hurdles prevent the establishment of associations of municipalities across different states. *These barriers should be abolished.*

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## Returns to scale in services provided by municipalities need to be better exploited (Austria 2005)

- Consideration should be given to promote merging small municipalities where this can reduce administrative costs.
- Regulation on the creation of municipal associations, notably across borders of states, should be eased.
- Local authorities should be able to purchase services from each other.

## Improve local governments' ability and incentives to manage local public services efficiently (Japan 2005)

- Pursue and diversify measures to enable local governments to **exploit scale economies**. Co-operative arrangements across local governments should be encouraged. This would require reforming further the grant (LAT) system and possibly providing legal and accounting assistance to local governments.
- Reassess the need for strict standards and regulations imposed on the delivery of local public services. For those sectors where national objectives are of concern, rely on norms defined in terms of outcomes/outputs rather than on regulations on inputs and operational management. **Standards on local government employee salaries should also be reviewed, allowing regional variations in wage levels.**
- Clarify the actual norms imposed by the central government and the responsibilities of both prefectures and municipalities so as to allow local governments to exercise their autonomy and become more accountable towards local citizens.
- Improve transparency in local public procurement contracts, with clear dispute and settlement facilities.



## Reduce dispersion of decision making

- *Financing and spending responsibilities for both the hospitals and practicing physicians should be assigned to one government institution, giving it the role of an active purchaser of health services. To this end the health care agencies could be developed further and given effective decision-making powers to terminate contracts with health care providers. An alternative option for reform would be to assign financing and spending responsibilities for both health care sectors fully to social insurance. In both cases health agencies could play an important role in capacity planning and co-ordination and quality control. (Austria 2005)*

## **Tax-setting powers of sub national governments should be strengthened. (Austria 2005)**

- Valuation of real estate for tax purposes should be updated more frequently and unified across sectors in line with market valuations.
- The states should be allowed to set a flat-rate surcharge on the personal income tax schedule subject to a corridor whose width is to be determined by the federal legislator.
- The states' levy on the municipalities should be abolished.

## **Reform local government taxes and be prudent in transferring new spending responsibilities (Spain 2005)**

- Consider carefully the potential risks (losses of the benefit of scale economies and adverse spillover effects) which would result from the transfer of new responsibilities to the local sector before taking a decision.
- Increase local governments' reliance on the real estate tax. To this end, the land register should be upgraded so as to provide more homogeneous and up-to-date property tax values.
- Abolish the local business tax.

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## **Increase local government tax autonomy while keeping the tax system as simple and neutral as possible (Japan 2005)**

- Barriers to the effective use of existing powers to set local tax rates should be removed. In particular, central government permission for local bond issuance should no longer be made conditional on local governments' setting local tax rates at, or above, the standard levels defined by the central government. Local business and property taxes should no longer be deductible from central government tax bases.
- In raising local government tax revenues, priority should be given to base-broadening measures for existing taxes (in particular the personal income tax) as opposed to the introduction of new taxes. Local governments' right to introduce specific tax rebates to attract companies should be limited since it does not promote healthy tax competition. Raising property values for tax purpose closer to the market value would also be desirable. If new tax resources are to be transferred to local governments, give priority to taxes which are less volatile, have no significant adverse effects on the potential growth rate and cannot be easily exported.

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### Reform the financing principles of sub-national governments I (Mexico 2005)

- Improve the incentives and framework conditions for the effective use of existing taxing powers of sub-national governments before transferring new ones. In particular, *ad hoc* increase in federal transfers should be avoided.
- Give more taxing powers to sub-national governments to promote their accountability, while taking into consideration existing disparities in revenue-raising capacity and technical resources across jurisdictions. At the municipal level, upgrading the land register is a necessary condition to raise more tax revenues in a fair way and this may require technical assistance from higher government levels. States should be attributed at least one main tax, possibly substituting for the existing payroll tax. There are two main options: allowing for a further reliance on a surcharge on the federal personal income tax or implementing a dual VAT system. If states' payroll taxes are maintained, they should no longer be deductible from the federal corporate income tax base.

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### Reform the financing principles of sub-national governments II (Mexico 2005)

- Adjust the formulae for allocating earmarked grants across sub-national governments (in particular for basic education), taking better into account objective criteria instead of historical costs (e.g. number of teachers and schools) in distributing money across states. Redress the existing perverse incentives in the use of some earmarked grants (FAIS for social infrastructure, FAEB for education) by improving transparency on the use and outcomes of these grants, and by introducing more flexibility in the timing of the use of investment grants.
- Allocation criteria for the earmarked grant for the strengthening of states' financial position (PAFEF) should be clarified and money used strictly to foster the reform of state employees pension schemes.
- Consider transforming some earmarked grants into a new system of grants which would be general-purpose and equalising grants when spillover effects of public spending programmes cannot be clearly identified or sub-national government use of the grant cannot be monitored.

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## Income replacement schemes run by sub-national governments need to be reformed (Austria 2005)

- Social assistance and unemployment assistance for recipients who are able to work should be combined into one means-tested income replacement scheme. Responsibility for the financing of social assistance payments should be moved to the federal government, with the Public Employment Service (*Arbeitsmarktservice*) in charge of disbursing the benefits. Recipients should cease to be obliged to repay social assistance benefits, while ensuring that needs testing and work availability testing are strict.
- The responsibility for the financing of combined means-tested income replacement benefits for individuals who are not disabled or unable to take up a job for other reasons should be assigned to one level of government, and care needs to be taken that the segregation of responsibilities for paying unemployment-related benefits and job placement is overcome.

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## The budgeting framework at all levels of government should be revised (Austria 2005)

- • Extra-budgetary funds should be fully integrated into the budgets of the respective governments.
- • The accounting framework should be fully harmonised across government levels.
- • A medium-term budgeting framework as well as long-term sustainability analyses should be introduced at all levels of government.
- • Output-oriented budgeting should be introduced, with ministries held responsible for programme management, on the basis of an improved information base for cost and benefit analysis of spending and revenue programmes.

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## Reform the rules governing public employment (Spain 2005)


- Increase the flexibility of permanent job contracts in the public sector and of wage setting to better reflect local circumstances.

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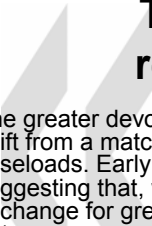
## Upgrade the financing framework for the regions (Spain 2005)

- Take demographic developments better into account by softening the conditions for implementing the *asignaciones de nivelación* when regions have experienced changes in total population since 1999. Population changes should be taken into account in a symmetric way. Announce well in advance how financing arrangements for the regions will respond to the likely increase in regional government spending stemming from population ageing.
- Gradually correct existing deviations from the objective needs criteria when adjusting the regions' financial resources for developments not fully accounted for in the framework (in particular demographic developments and the fiscal consequences of ageing).
- Relax the obligation for regional governments to spend a minimum amount on health care. Make the health cohesion fund more supportive of regional co-operative arrangements: the financial compensation received by providing regions should cover the full costs and be paid by the region of origin.
- Avoid using earmarked grants or at a minimum increase transparency on the overall amount and criteria used to allocate them across regions. Reconsider undue regulations imposed on regional governments using earmarked grants, in particular for ALMPs.
- Reduce the bias in favour of less developed regions in allotting central government investment. Consider using more effective instruments in supporting poor regions' growth potential (such as education policies) and/or in redistributing income.

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- **Accompany enhanced autonomy by more accountability (Mexico 2005)**
  - • Clarify the assignment of spending responsibilities across levels of governments and reduce overlaps.
  - • Improve information on how sub-national governments spend their resources and on the outcomes of their policies. Further develop exchange of experience carried out at a sub-national government level.
  - • Reconsider the no re-election rule or, at a minimum, lengthen the duration of the municipal mandate.

## The allocation of spending responsibilities (USA 2005)


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- The greater devolution of welfare programme design to the states together with the shift from a matching to a block grant has proven remarkably successful in reducing caseloads. Early fears about a race to the bottom appear to have been unfounded, suggesting that, where states have the fiscal capacity, programme devolution in exchange for greater sharing of financial risk by the states can lead to superior outcomes.
  - □ Tendencies to restrict states' ability to tailor programmes to their local needs by tightening work requirements in ways that prove impractical for states to implement should be resisted or reversed.
  - □ Given that a nation-wide highway network has been established, responsibility for highway funding should be turned over to the states, together with the right to charge tolls, and the federal highway trust fund should be dissolved.
  - □ The costs imposed on the states by the No Child Left Behind Act need to be more precisely quantified, and adequate federal funding of those costs ensured.
  - □ However, in some areas, notably Medicaid, the rate of expenditure growth may be such that states would not be able to assume greater responsibility for financing than they already have in view of their limited ability to raise revenues. A shift of all expenditures for the elderly and disabled beneficiaries from Medicaid to Medicare should be considered, as it would concentrate responses to the nation-wide challenge of ageing at the federal level, while Medicaid would be largely re-focussed on the working poor.

## Enhance the flexibility of the fiscal rules (Spain 2005)

- Amend the Budget Stability Law so as to account for the impact of cyclical developments on the central government and aggregate regional budgets.
- Rely on the Council for Fiscal and Financial Policies to set fiscal targets for individual regions on the basis of individual medium-term scenarios. Regions overshooting their targets because of a significant structural deficit should still be required to present a medium-term adjustment plan.

## Harden fiscal rules and strengthen the role of financial markets (Japan 2005)

- The “net revenue” rule should be transformed into a balanced operating budget rule while the coverage of the rule on debt servicing costs should be broadened to include all bonds and interest payments.
- To enhance local government incentives to comply with the rules, sanction mechanisms may be needed. At a minimum, the existing financial support for local governments facing financial difficulties (e.g. subsidies for bond issues, access to preferential borrowing conditions) should be eliminated so as to avoid moral hazard problems.
- Fiscal rules should be re-designed so as to prevent new debt from raising grant entitlements and thus enabling local governments to accumulate more debt.
- Financial markets should be given a role in disciplining local government fiscal behaviour. This will require reducing further the share of local bond issues underwritten by public bodies, by removing central government *de facto* guarantees (grant entitlements being adjusted to cover bond repayment costs) and by stating consistently that the central government will not act as a lender of last resort.
- Improve transparency of local government contingent liabilities (including the unfunded liabilities stemming from retirement allowances and pension commitments for local public employees, deficits and liabilities of local public enterprises and public-private partnerships).
- Clarify risk-sharing arrangements when local public enterprises or third-sector enterprises are providing public services on the behalf of one or several local governments.



- **Promote fiscal stability and sustainability (Mexico 2005)**

- ● Reduce the volatility of federal government transfers by smoothing the impact of cyclical developments and/or oil prices.
- ● Limit the use of federal government transfer as a guarantee for sub-national government borrowing and promote the implementation of prudent fiscal rules at the sub-national level.
- ● Promote the publication of harmonised information on sub-national government financial positions, including implicit and contingent liabilities.



## **Fiscal rules and macroeconomic stabilisation (USA 2005)**

- States' balanced budget requirements appear to have been effective in avoiding defaults and bailouts of sub-national governments; so has financial market discipline. However, the experience during the most recent budget crisis has shown that rainy-day funds were insufficient to avoid welfare-reducing cuts in core expenditures. This issue is gaining in importance as state spending shifts further towards health and education. The strictest forms of state and local tax and expenditure limitations lead to unintended distortions in expenditure shares and are in need of fundamental reform.
- In light of recent experience, states should quantify, and accumulate, rainy-day funds of sufficient size to avoid welfare-reducing cuts in core expenditures except under exceptional circumstances. Those states that have statutory caps on rainy-day funds should adjust them if necessary.
- Tax and expenditure limitations should be formulated with reference to desired spending levels, not to growth rates of revenues or expenditures, so as to account for changes in demand for public services due to demographic developments and to avoid ratchet effects in the aftermath of recessions.