Financial Relationships between Regional and Municipal Authorities: Insights from the Examination of Five OECD Countries[1]

by

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INTRODUCTION

The intergovernmental fiscal relations of local governments are diverse. They vary substantially across countries as do expenditure responsibilities and revenue generating powers. To the uninitiated, the picture can be quite confusing, especially if one is in search of best practices or exemplary cases. The situation is eased somewhat when one realizes that intergovernmental fiscal relations (notably transfers), expenditure responsibilities and revenue generating powers are, or at least should be, an integrated package but a package that can, indeed must, vary to suit different circumstances. Well designed packages can enable local governments to function effectively. Unsuitable arrangements will hamper performance.

This paper reviews the intergovernmental fiscal arrangements of local governments in five countries and provides a comparative assessment with the objective being to derive lessons to aid in the structuring of better fiscal arrangements between local and other governments. Although most local governments are municipal governments, there are often many other types of local governments that are also important but for which arrangements may differ. Hence, because the distinction is often important, the practice here is usually to refer to local governments or local authorities unless a specific type (e.g., municipalities) is under discussion. Federal countries get most of the attention here so relations between local and regional (provincial and state) governments are particularly important because they usually dominate, but those with the federal government are not neglected. Financial relations dominate the attention here but important intergovernmental fiscal relationships extend beyond those and so some attention is paid to other matters.

Four of the countries reviewed are classic federal states. There is Australia, which has a small local government sector; Canada and the United States, in which the local governments are of intermediate size, somewhat similar though by no means identical, and which have some unique features; and there is Germany in which local government is also of intermediate size but with rather different expenditure and revenue assignments. Denmark is also considered. Although not a federal state, it is an interesting example of a country having a large local government sector with somewhat unconventional responsibilities.

The paper begins with the country reviews. In the effort to establish some direction from those examples, the section following those reviews undertakes a comparative and more normative assessment of intergovernmental relations in the five countries. So as to understand better the patterns and trends observed, the structure of that analysis is based on the theory of fiscal federalism and the implications arising from the study of many countries. That theory and evidence provides a framework for looking (in particular) at the assignment of responsibilities, the revenue sources, the possible need for and place of transfers of different kinds.

The short concluding section itemizes the main lessons to emerge from the paper and the scope for relations between local and regional authorities.

COUNTRY REVIEWS

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Australia[1]

1. *Local Governments and Their Relationships with Other Governments*

By international standards for developed countries, Australian local government is small. Expenditures of Australian local governments amount to about 2.5 percent of GDP and their tax revenues amount to about 3.1 percent of the tax revenues of all governments. Still, local government there plays a significant role although it is primarily limited, as some characterize it, to "roads, rates and rubbish."

Currently, there are 727 local governments in Australia. Most of them are rural councils (usually referred to as shires) and 20 percent are urban (cities, towns, etc.). Certain regional bodies and the Australian Capital Territory are excluded. There is a tremendous diversity among Australian local governments. In particular, populations and population densities vary greatly with the vast majority of the population concentrated in urban areas but with many still living in rural and sometimes very remote and sparse areas. Many local authorities have only a few hundred residents and numerous rural shires have only a few thousand. Despite the larger urban agglomerations of Melbourne and Sydney, Brisbane, with a population of about 865,000, is the most populous municipality and no other exceeds more that half that size.

Local governments derive their authority from the state governments. There is no recognition of local governments in the nation's constitution and an effort to incorporate local government into the constitution in 1988 failed in a referendum with only one-third favouring the proposal. However, since the late 1970s, several state governments have modified their state constitutions to protect their local authorities from arbitrary dismissal.

Local governments' responsibilities and revenue generating powers are determined by the state governments. The role of local government is relatively small because Australian local government is not responsible for schooling or policing (even fire protection in some cases) which are state functions and they have very limited responsibilities for health or social welfare. Local responsibilities are dominated by roads, drainage, waste management, recreation and cultural activities, housing, care of the elderly, and local regulation of business and development. In most states, local government does not have responsibility for water and sewerage. In fact, the authority to engage in profit making functions (electricity) was removed from the Brisbane City council. Such local services are commonly provided through special purpose state authorities.

Given the state authority over local government, there are differences among the states in local government's role. This is illustrated, in part, by the variation in the per capita expenditures of local governments across states. For example, that in Queensland is almost twice that in Victoria; $1216 vs $650, with a large amount of that difference resulting from a large difference in the sales of goods and services. Overall, the average per capita expenditure is $837. Despite the clear emphasis on "property services" across Australian local governments, a review by the Commonwealth Grants Commission found a marked increase in the local provision of human services during the past 35 years.

Property taxes, user fees and revenues from sales of good and services are the revenue sources available to local councils to exercise. Property taxes (rates) represent over 99 percent of tax revenues. Revenues from these three sources continue to represent a relatively constant portion (about 75 percent) of local government own revenue but the share from rates has fallen since 1975 from 55 percent to about 45 percent while that from sales and fees has increased.

Since 1974-75, the Commonwealth (federal) government has provided general purpose grants (through the state governments) to Australian local governments. Since then, while local own-revenue shares appear to have been maintained, the contribution from state grants has declined.

State governments occasionally intervene quite extensively in local affairs. In the mid 1990s, Victoria mandated a reduction in local rates. Also, state governments have periodically imposed or seriously considered (often large scale) amalgamations of their local governments; e.g., New South Wales and, more recently, Tasmania and Victoria.

Efforts over the past two decades to enhance the efficiency and effectiveness of Australian government at all levels have impacted particularly upon local government. Combined federal, state and co-operative initiatives have instituted various programs to increase accountability and efficacy. For example, a minimum share of local budgets muct be exposed to competitive bidding (market testing), management reviews are undertaken by the states, there is a national bench marking program to identify best practices and relative performance, and comparative reporting is being practiced. Efforts to identify performance measures are widespread and there are various efforts being made to improve service quality.

2. Local Governments' Expenditures and Revenues

The IMF data for Australia in Table 1 (all tables are at the end of the document) demonstrates the magnitude and pattern of local government expenditures in 1998. Total expenditures were $12,846 million (Australian) which constituted 6.1 percent of consolidated government expenditures and 2.2 percent of GDP that year. That modest amount of expenditure is concentrated in transportation (27.5 percent), housing and community amenities (18.7 percent) and recreation and culture (17.7 percent) which, along with general services (13.7 percent) represent more than three-quarters of total outlays. Note that education, health and social security and welfare together amount to less than nine percent of the total with most of that (6.3 percent) for social security and welfare. Public order and safety comprises only 2.4 percent of expenditures.

The revenue picture is shown in Table 2. Own revenues from taxes and nontax own-revenue sources account for just over three-quarters of total revenue. Taxes, effectively entirely property taxes (rates) are 44.8 percent of the total while 24.3 of the 32.6 percent coming from nontax sources is from fees, sales and fines. Intergovernmental grants contribute 16.4 percent. The 6.2 percent which is capital revenue, and which is not clearly specified, confuses the picture somewhat. In Australia (2001), capital revenue is said possibly to include some capital grants although, as noted later, it is suspected that such is not the case here.

The Australian Government's own numbers for 1999-2000 (see Table 3) present a slightly different picture. Revenues from taxation, sales, and grants are each somewhat smaller than reported in Tables 2 while other revenues, at 15.7 percent, are larger. Expenditures for that year also show some variation from that in Table 1. In Table 3, transportation, housing and community amenities and general public spending are relatively more important and recreation somewhat less.[2]

Interesting is the contribution of grants to specific local expenditure areas. Table 3 reports combined Commonwealth and state government grants which in 1999-2000 amounted to $2460 million. That grant funding is shared approximately 50:50 by the two senior levels or government although the Commonwealth's share is allocated through the states. In addition to those funds, the Commonwealth provides small amounts of separate specific purpose grants (largely for support of services for children, the aged, and the disabled). For 2000-01 those specific purpose grants amounted to $111.4 million and this amount is taken to be representative of that spending. Under this assumption, total grants amounted to 17.3 percent of expenditures. The largest proportions of expenditures by category that are funded by grants are, at about one-quarter, for housing and community amenities and for public order and safety. Transportation is next, at 13.4 percent (somewhat smaller than the 16.4 percent reported in the appended table, Table 7, for 1993).[3] Other transfers most likely consist of unconditional grants.

Of the $2,460 million in grants provided to local governments through the states in 1999-2000, $1,244 million came from the Commonwealth government and $1,216 from state funds. The Commonwealth (financial assistance) funds are distinguished as those for general purposes, $866 million, and those to support the provision of roads, $378 million.

Despite the designation of the latter, the total amount is effectively untied funding because local governments are not required to use the Commonwealth road grant funds for roads.

The total amount of the Commonwealth financial assistance grants is currently escalated each year for population growth and inflation. In the early years after the Commonwealth first began making general purpose equalization transfers to the local governments (1974-75), the amount of the funding was based on revenue sharing (a share of federal personal income taxes) but, by the mid 1980s, tax sharing was replaced by financial assistance grants (in part to provide more stability and predictability to the revenues).

The distribution of the Commonwealth local financial assistance grant among the states differs by component. The general purpose component is allocated on a per capita basis (about $45 per person in 1999-2000) but the road component for that year was based on the relative magnitudes of Commonwealth grants to the states for state (not local) assistance. The road grant averages about $20 per capita but the per capita amounts ranges across the states from 83 to 230 percent of that. The road relativities are now fixed as a result of the new Goods and Services Tax (a value added tax introduced in 2000) that is distributed among the states with somewhat different state relativities replacing the previous state financial assistance program. Currently, and likely temporarily, the local road grant annual component is simply an escalation of the previous year's amount.

The Commonwealth local financial assistance grants are allocated by the states, through state local grants commissions, following basic federal principles and subject to federal government approval. For the general purpose component, there are four principles to be followed. First, the funds are to be distributed to enhance horizontal equity among local governments. Second, assessments for the grant is to ignore local tax effort and expenditure levels (i.e., be effort neutral) to permit local authorities to pursue their own fiscal policy and not be penalized or rewarded by this grant for their choice. Third, other grants are to be counted in determining local financial capacity. Fourth, each council is to receive a minimum general purpose grant which on a per capita basis is not less than 30 percent of the per capita general purpose grant to the state. The principle governing the road component is that it be distributed according to road expenditure needs including considerations of length, type and use. The road component, however, need not be used for road expenditures.

The state local government grant commissions allocate the Commonwealth financial assistance grants subject to the principles outlined. With each state using its own methods, these commissions estimate the expenditure required of individual local governments to provide a standard range and quality of local services. They also estimate the revenue potential assuming standard tax rates and other revenues. The difference is the assessed general purpose grant need. These values plus the minimum grant requirement are the basis for the distribution of the general purpose grant. The road component is distributed on the basis of estimated road expenditure need. Determining these estimates is a complicated process as reference to the methodologies described in Australia (2001) readily illustrates.

At about 70 councils, or just under 10 percent of local governments, few councils are subject to the minimum grant. Those which are tend to be in the metropolitan areas and often are capital cities. Year to year variations in local circumstances (data) or methods can result in significant changes in the amount of grants which a local authority might receive. Therefore, the local grant commissions commonly "cap" the year to year changes that are permitted; e.g., minus five percent to plus 10 percent.

As noted, the Commonwealth also provides some specific purpose funding to local governments. At about nine percent of the total Commonwealth funding to local governments, its specific purpose funding is relatively minor. The states' funding to local governments appears to be essentially entirely of the specific purpose type.

Especially since 1974, the Commonwealth government has come to play a more significant role in local government affairs despite local government being under the constitutional jurisdiction of the states. This shifting contribution may reflect a less clear distinction of the roles and responsibilities for the various levels of government on the expenditure side than the distinction on the tax powers side or it may reflect a greater willingness to accommodate Commonwealth assistance in aid of local (and indirectly to the state level of) government. Regardless, the federal government's contribution is important and its criteria provides valuable guidance for grant allocations.

Canada[4]

1. *Local Governments and Their Relationships with Other Governments*

There are approximately 4000 municipal governments in Canada. The most typical forms are cities, towns and villages and, in the rural areas, counties and rural municipalities. In addition to these general purpose municipalities, there are a large number of special purpose local authorities, boards and commissions that have responsibility for schools, police services, public utilities, conservation areas, local health services, etc. Among these specific purpose bodies, school boards dominate in that they are ubiquitous and their expenditures often almost match those of the municipalities and their members are directly elected. The role and even presence of other special purpose bodies varies substantially among the provinces and the degree of their independence from (or integration with) general purpose local governments varies but they are usually minor authorities. Thus, municipalities and school boards are typically regarded as the major forms of Canadian local government.

Local school boards are responsible for schooling (i.e., elementary and secondary education) and municipalities are responsible for a broad (but conventional) range of local services. Municipal services focus on transportation (roadway and public), protection (police, fire and emergency services), environmental services (water, sewerage, garbage collection and disposal), recreation and culture, land use planning and business regulation, local health and social services. Beyond schooling, local (i.e., municipal) government typically plays a very small role in social services such as health or social assistance where the provinces effectively are the suppliers.[5] As a share of GDP, local government own revenue (usually 4 to 5%) and expenditure (typically 7 to 8%) have remained relatively constant since 1970. During that time, however, its share of total government spending has declined from one-quarter to about one-sixth largely due to the growth of provincial expenditures primarily in the areas of social expenditures, notably health.

The authority of local government in Canada is derived entirely from the provinces. The Constitution only mentions municipalities to declare that they are the exclusive jurisdiction of the provinces. As "creatures of the provinces," their responsibilities and powers are only those delegated to them by the incorporating province and to which their actions must conform. The provinces have the power to modify those responsibilities and powers and, indeed, to create, change and abolish municipalities at the province's will. The provinces have not been reluctant to "reform" local government by changing boundaries, responsibilities, powers and funding. Besides, the provinces control their municipalities closely with a host of laws and regulations.

The provincialization of schooling, which has crept across the provinces especially during the 1990s, illustrates the authority and intervention of the provinces in local affairs. As recently as 15 years ago, the conventional arrangement for schooling could be described as shared local and provincial responsibility in that the province provided (usually) most of the funding (on an equalizing basis) with the local school board generating additional funds as required from a local property tax levy. This shared funding arrangement now only characterizes two provinces. Elsewhere, the provinces have assumed full funding responsibility for schooling but, in doing so, have usually taken over the local school property taxes in the form of a provincial property tax. Local school boards have been stripped of their taxing powers and local voters and taxpayers of any discretion in school finance. Now, only the provincial government decides on the level of school expenditures. Within the bounds of the provincially provided funding, school boards have discretion in spending to deliver schooling subject to substantial oversight by the provincial ministries of education. Provincial oversight includes, for example, defining curriculum, requirments for common exams, teacher qualifications, requirements for the schooling of challenged students, etc.

The loss of local governments' access to sales and income taxes further illustrates the provincial control. During the World War II, the federal and provincial governments came to an agreement giving the federal government full control over (primarily) the personal and corporate income taxes. The provinces were compensated. However, the local governments, some of which employed income taxes and sales taxes, were excluded from those fields thereafter. Since then, the property tax is essentially the only source of taxation available to Canadian local governments.

A consequence of provincial authority over local government is the considerable interprovincial variation in local government. While the major features are (typically) quite parallel, there are a host of minor (and some not so minor) variations which often make generalizations tenuous. Another consequence is that direct relations between the local and the federal government are minimal, in part because the provincial governments carefully guard their authority. Regardless, the municipalities lobby the federal government (e.g., the Federation of Canadian Municipalities) and some, typically relatively modest and sporadic, federal funding is directed to municipalities. Typical of this is the federal government's infrastructure program of the late 1990s (and soon to be renewed).

2. Local Governments' Expenditures and Revenues

The pattern of local government expenditures in Canada can be seen from Table 1. Education expenditures, essentially entirely by school boards, represented 42 percent in 1998. Municipal government is essentially responsible for all the rest. Transportation and communication, which for Canadian municipalities is only transportation, is the largest expenditure area (at 11.3 percent of local government expenditure). Protective services is the second largest expenditure area. Other areas (with the exception of health and of agriculture, forestry and fishing which are quite small) are more modest and relatively uniform. Note, the importance of social services spending is due primarily to the importance of social services spending by Ontario municipalities (25 percent of their municipal expenditures). In contrast, social security and welfare represents less than one percent of municipal expenditures in most provinces. Although it is not reported separately in Table 1, note that debt servicing constituted 6.8 percent of municipal expenditures. In all provinces, municipal governments are permitted to borrow for capital expenditure purposes only.

In total, local government expenditures were 8.1 percent of GDP in 1998 and 18.1 percent of total consolidated government expenditure in Canada. Municipal government outlay was 4.7 percent of GDP while school board spending was 3.4 percent.

Looking simply at local government masks the considerable differences between municipal and school authorities. These differences are more apparent from the data in Table 4 which reports the revenue sources for the two form of local government. School boards receive about 75 percent of their funding as grants. These grants come almost entirely from the provincial government. The other 25 percent is from their own revenues. One must be careful in the interpretation of this number because, with the provincialization of school finances, most of that money is really from provincial school property taxes attributed to school boards and are not property taxes levied by the boards under their own authority or over which they have any discretion. In contrast, municipal governments raised 56.7 percent of their revenue in 1998 from locally determined property (and property related) taxes. User fees, again decided by the municipal government, generate over 20 percent. Property taxes, user fees and various other sources of income constitute the own revenue of municipal governments which represents almost 85 percent of total municipal revenue. The remaining 15 percent comes from grants. In a decade, as a result of the austerity programs of senior governments, the contribution of grants has dropped from 23 percent to 15 percent. Again, the transfers are almost entirely from the provincial governments. Also, most of the transfers are conditional with less than 20 percent of grants being unconditional (down from 25 percent in 1988).

Provincial conditional grants have typically provided a large and confusing array of incentives to municipal governments. The number or variety, if not the complexity, of these transfers has diminished over the years, in part with the levels of funding. Usually, grants are available to support aspects of the full range of services. Transportation is traditionally an area relatively well supported by transfers. Turning to the somewhat dated but internationally comparable data in the appended table (Table 7), the final column reveals that 25 percent of Canadian local government spending on transportation (and communications) in 1991 was provided by grants. Even of the small amount of spending by local government on health care (1.4 percent), 46 percent came from transfers. The education spending by school boards, of course, is heavily funded by grants and that share has increased; from 67 percent in 1991 to 75 percent in 1998.

Unconditional funding is normally only a fraction of conditional grants. In only three provinces does unconditional funding dominate conditional. Even if the amounts are small, unconditional funding is usually allocated in an equalizing fashion designed to assist (or assist more) the fiscally disadvantaged localities. Equalization played a particularly important role in the assistance to school boards when the boards had access to and utilized extensively local tax sources. With the provincialization of school finances, uniform provincial financing has recently taken over most of that role. Equalization plays a role in the allocation of unconditional funding among municipal governments in most provinces. Auld and Eden (1987) provide an overview of equalization across the provinces. They identify three types of programs being used -- relative fiscal disparity equalizing, fiscal gap equalizing and fiscal need equalizing. The relative fiscal disparity approach allocates the available grant funds inversely to the relative fiscal capacities of the municipalities; e.g., inversely to the ratio of the per capita tax base of a municipality to the average. All municipalities receive some funds. The fiscal gap equalizing method looks at the difference between each municipality's own and a standard per capita tax base and allocates funds to those municipalities having a deficiency in proportion to the deficiency. The fiscal need approach determines standardized expenditures and standardized revenues for municipalities and provides grants to those with a deficiency between the two. Largely because of inadequate funding, most of the programs were found not to generate substantial equalization. One of the main difficulties with equalization is determining an equitable distribution between rural and urban municipalities and between small and large urban centres.

Revenue sharing is the basis of unconditional, largely equalizing, transfers in three provinces. Normally the shared revenue is defined as a small share of specific provincial taxes (particularly the personal and corporate income taxes as well as other revenues) and the funds are distributed among all municipalities in an equalizing fashion. In three provinces, selected vehicle revenues (e.g., gasoline taxes) are shared with their major cities (Calgary, Edmonton, Montreal and Vancouver).

The United States[6]

1. *Local Governments and Their Relationships with Other Governments*

As of 1997, there were 87,453 local governments in the United States. Of those, 39,044 (44.6 percent) were general purpose authorities, 13,726 (15.7 percent) were school districts and 34,683 (39.7 percent) were other forms of special districts. General purpose authorities are classified as counties (3,043), municipalities (19,372) and townships (16,629). Although some other types exist, municipalities are usually cities, towns and villages. Counties, which exist in all but three states, originated as administrative units of the states but became general public service providers outside municipalities. In large urban/metropolitan areas, county and city governments have often merged in various forms. Townships occur in 20 states, largely in the northeast and the midwest. They originated largely to provide roads but their responsibilities expanded with population and needs. Single purpose school districts exist in all but four states and are a major form of local government. Other special districts are numerous, typically designed to provide one or two services (e.g., conservation, fire protection, water and sewerage), growing in number (17 percent more than a decade earlier), and may be hived off general purpose governments as a way of dealing with cross-boundary issues, achieve scale economies, and separate often largely self-financing functions. Their visibility is relatively low as the members of these bodies are not often directly elected unlike those for general purpose local governments and school districts.

School districts are responsible for elementary and secondary education. The school districts operate under the authority and supervision of state departments of education but as separate local governments with locally elected boards. Local authorities may administer community and vocational colleges. The general purpose local governments are responsible for a broad range of services including transportation (roads and public), public health services (often, especially counties, including hospitals), social welfare (often administration and sometimes significant financing), police and fire protection, recreation and culture, and land use planning and local business regulation. Local governments may also operate public utilities through their departments but often through special districts and special authorities or as public enterprises.

Local governments get their authority from their state governments. There is no recognition of local governments in the constitution of the United States. The state governments assign their responsibilities and powers; that is, local governments are the legal creatures of the states. Unless provision is made otherwise, local powers are narrowly interpreted -- following the Dillon Rule (the guidance of John Dillon, a 19th-century jurist and authority on municipal law) -- to be only those which the state has explicitly granted. To avoid the restrictions of the Dillon Rule, states have adopted some form of home-rule provisions. The strongest form is incorporation of home-rule authority into the state constitution. Home rule allows local government discretion in local affairs and limits state intervention in local matters and may even allow local action in any area not excluded by state law. Only a few states have adopted the strongest version of home rule but most have adopted provisions that relax the impact of the Dillon Rule. Some degree of home rule exists for municipalities in 48 states for municipalities and in 37 for counties. The legal interpretation of such provisions have not always been uniform so the practice and what may have been the original legislative intent may vary and seemingly similar provisions can be interpreted differently across states.

Towards meeting their responsibilities, total local government expenditures were 8.8 percent of GDP in 1998 with about 44 percent of that accounted for by school districts. In contrast, state government expenditures (net of intergovernmental transfers to local government) were 4.3 percent and federal expenditures (net of transfers) were 17.9 percent. While local governments exceed the states in final spending, state governments are larger on the revenue side accounting for 26 percent of total (consolidated) government own revenues versus 16 percent for local governments (and with 58 percent of the total raised by the federal government). Local governments, especially school districts, rely heavily upon state government particularly for grants to fund their expenditures.

The role of intergovernmental grants has changed substantially for local governments and in the U.S. federalism generally over the past half century. Federal assistance to state and local governments rose from 11 percent of state and local expenditures in 1958 to 18 percent in 1968, to 25 percent in 1978 but dropped to 17 percent by 1988 only to rise again reaching 22 percent by 1998. For a short period, a “revenue sharing” program was the basis for distributing federal funds to state and local general purpose governments (i.e., school districts were not included). No specific revenues were shared but rather designated amounts of monies were allocated. The program operated from 1972 to 1986 but, from 1980 on, it distributed funds to local governments only. The revenue sharing funds amounted to less than three percent of local expenditures. The decline in federal support for the subnational governments is associated with the President Reagan's "new federalism" which was aimed at reducing the federal governments role and its influence over state and local governments. During the Reagan administration, federal transfers were simplified (as well as reduced) by consolidating many categorical grants into a small number of block grants. In 1998, federal direct assistance to local governments amounted to about 10 percent of total assistance and 4 percent of revenues (less than half the contributions in 1978).

State government grants to local authorities have been larger and more stable at about one-third of revenues for many years. The increase in the transfers to school districts prior to the 1980s came from the state governments but that contribution has been stable at about half of school revenues for the past 20 years. Special districts are the only category of local government for which federal grants exceed state grants.

The bulk of intergovernmental assistance to local governments, about 60 percent of the total, goes to schooling. Ninety percent of that comes from the state governments. The role of the states in school finance was growing but received a boost with a wave of court decisions beginning in the early 1970s which declared that local school financing should not depend unduly upon the local property tax base. Thereafter, state aid for schooling rose from 37 percent in 1962 to 50 percent in 1982 and remained at 50 percent in 1998.

Unfunded mandates have become a serious concern of local governments.[7] The problem might be traced back to a decline in federal transfers to the subnational governments and, as some see it, a switch to the federal use of unfunded mandates to exert its influence over the state and local governments. Especially with financial pressures on the states, unfunded mandates quickly emerged as a tool of the state governments to exercise on local governments. Mandates emerged as a problem throughout the U.S. federal system.

Being at the end of the line, unfunded mandates are a particular problem for local governments. Mandates are seen as distorting priorities, restricting flexibility and imposing costs. Estimates exist that between 20 and 90 percent of local expenditures are to satisfy federal and state mandates and that a high proportion of state laws impact financially upon local governments. A difficult problem in deriving such estimates is making a distinction between the legitimate assignment of responsibilities and illegitimate mandates. Clearly, some of the mandates are designed to realize political gains for state legislators at local governments' expense. Cases where generous exemptions from the property tax base are granted or the level or growth of property taxes are constrained with no compensation offer examples.

Local governments have been active politically and legally in resisting the abuse of mandates. Both the federal and many state governments have taken some steps to reduce the adverse impacts. The federal government passed the Unfunded Mandate Reform Act in 1995. Over 40 states require fiscal notes be attached to proposed legislation showing the estimated cost to local authorities. Some states call for reimbursement or, at least, allow local tax increases to cover all or part of the added costs. Reimbursement requirements are sometimes simply ignored. Requiring a two-thirds majority to pass an unfunded mandate may be a more effective deterrent. The effectiveness of these options is being questioned. Presently, surveys of local officials reveal that large numbers see the mandate problem as not improving if not getting worse.

Some limitations on local governments come not from the state governments but from citizens through voter initiatives and referendums. A majority of states have the option of issues being proposed by citizens and, if they gather sufficient support via petitions, being decided by statewide referendums. Many fiscal issues impacting state and local governments go to referendum ballots. One of the best known cases is Proposition 13 in California (1978) which severely restricted property taxation and property tax growth and which, as a result, considerably changed local and state finance there. Evidence suggests that in states where there is a greater potential for using voter initiatives, the levels and composition of taxes and spending is different (Matsusaka, 1995).

2. Local Governments' Expenditures and Revenues

The pattern of local government spending is reported in Table 1. Schooling is the single largest item at 43.3 percent of the total for 1998. This leaves about 56 percent accounted for by general local government. Protection and safety (i.e., fire and police protection) is almost 11 percent of the total. The other large identified categories are health (8.9 percent), social services and welfare (7.8 percent), transportation (6.0 percent) and general public services (5.7 percent). Relatively less important are recreation and culture (3.4 percent) and housing at (2.0 percent). In total, local expenditures are about one-quarter of consolidated government expenditures.

As in the Canadian case, local school authorities are typically distinct from local general government and the two are funded quite differently. Hence, it is useful to distinguish between the two especially on the revenue side. School district and general purpose local government revenues are separated in Table 5. More than half of school district finances come from intergovernmental transfers with essentially half (49 percent of school expenditures) from state grants. Charges and miscellaneous revenues provide six percent. Taxes, almost all property taxes imposed by the individual school districts, provide 30 percent of school revenues. This percentage likely understates the importance of taxes to school finances because the contributions of supporting local governments (8.4 percent of school expenditures) must be financed and that contribution comes from other governments (hence the subtraction of a corresponding portion from general purpose revenues which fund the contribution).

In contrast to the school boards, general purpose local governments rely heavily on their own sources of funds. Only about one-quarter of local government revenues come from transfers with the state providing over 90 percent of the grants. Charges provide another quarter of the revenues and miscellaneous sources 10.8 percent. Contributions from user charges have grown relatively over the past 30 years. Locally imposed taxes provide the remainder. Property taxes provide over 60 percent of the tax revenue for the general purpose governments. Local sales taxes account for about 25 percent. Local (personal) income taxes raise almost 10 percent.

Separating school and general purpose authorities as in Table 5 demonstrates the quite different circumstances of the two types of local government. Those differences tend to be obscured when the data are combined as in Table 2. Table 2, however, does indicate the revenue picture for local government overall.

Local tax structures vary considerably across states. Property taxes dominate. Taxes on real property (land and improvements) based on market value are the conventional form but personal property taxes (i.e., on furniture, vehicles, inventories, financial assets) still persist in some places and generate small sums. General sales taxes are widely used but almost entirely by general purpose local governments. Somewhat dated literature refers to 6500 local jurisdictions in 31 states using sales taxes but the "Local Government Revenue by State" table from the U.S. Census shows local governments in almost all states realizing some sales tax revenue.[8] In many cases, however, the contribution to local taxes are small but in three states local sales tax revenues amount to close to half of local tax revenue. Tax bases (usually the state sales tax base) are state determined and rates are often restricted to a specific range. Four states require local sales taxes. Local income taxes are less common but still important. They are extensively used by local authorities in three states (Maryland, Ohio and Pennsylvania) where they account for between 20 and 30 percent of local tax revenue. They are also particularly important revenue sources in Kentucky and New York (about 30 percent of tax revenues) and in Washington D.C. (37 percent). In many states, local income taxes are used by cities for which they are a significant revenue source often amounting to one-third or more of own revenue. School districts in three states have access to local income taxes. Income tax rates are normally low; e.g., 1.0 to 2.5 percent. While local income taxes are occasionally piggybacked on state income taxes, the payroll form with filing by the self-employed is more common.

The federal government allows local property and income taxes to be deducted (if personal expenses are itemized) in the calculation of federal personal income taxes. This provision provides a federal subsidy to local governments by reducing the cost of local taxes to the federal income taxpayer and shifting a portion of that cost to the federal government and federal taxpayers generally. Since 1986, local (and state) sales taxes have not been deductible. The federal government also subsidizes local debt in that the interest paid on local government bonds is not subject to federal income tax thus allowing local debt to be issued at lower than market interest rates. Both these deductibility provisions have been criticized on efficiency and sometimes on equity grounds.

Direct aid to local governments comes from both the federal and the state governments. The federal transfers are relatively small, about 3.8 percent of total local revenues, and about 70 percent of that is directed to schools. Almost 90 percent of the grants to schools come from the states. Of the $160.2 billion in state aid to schools in 1997-98, $112.2 billion was formula assistance (while the remainder is directed to specific programs such as the handicapped, vocational education and transportation). Formula assistance is typically based on need and fiscal capacity and is distributed in an equalizing fashion. Especially since the 1970s, considerable attention has been paid to these distribution formulas and their ability to reduce local school funding from the local property tax base.[9]

Federal aid to local general purpose governments amounts to only 1.9 percent of revenues while state grants account for 24.4 percent in 1998. Federal grants are specific purpose (categorical) and often aimed at such objectives as urban redevelopment, roadways and public transit. Federal grants are directed primarily to state governments and those funds may percolate down to local governments through state programs and funding. In the late 1990s, over 60 percent of federal grants to state and local governments went to funding federal programs making payments to individuals (notably Medicaid and income security) and less than 40 percent went towards assistance specifically for state and local governments. For example, in 1996, the federal government devolved responsibility for aid to families with dependent children (AFDC) to the states, many of which passed part of that responsibility on to their counties. Local governments particularly are concerned that the increasing demand upon them to provide social assistance will become an onerous burden especially if economic conditions deteriorate.

State transfers provide over 90 percent of the intergovernmental aid to local governments. About 75 percent of that aid is categorical. Social welfare accounts for about one-third of total state grants, aid for roadworks about 12 percent, other specific purposes 30 percent and general support about 22 percent. The nature of the programs vary considerably across the states but matching funding requirements are typical of specific purpose grants. A few states have revenue sharing arrangements with their local governments (e.g., Arizona, Alabama). Arizona's municipalities receive 15.4 percent of the state's income tax revenues but have had to politic vigorously to prevent that share from being reduced (further as it was recently reduced from 15.8 percent).

Germany[10]

1. Local Governments and Their Relationships with Other Governments

Germany has a federal system of government with federal, state (Land, 16 with three city-states) and local levels of government. The local level consists primarily of two tiers; the counties (Kreise) and the municipalities (Gemeinden). Municipalities can be of two types -- unitary or an association of municipalities (a local mini-federation). As a result, fewer than half of the 8500 Gemeinden in old/west Germany have their own administrations. In addition to the 329 Kreise and the 14,915 Gemeinden, there are 115 county-free towns/cities (Kreisfreie Stadte or Stadtkreise) which have the combined powers of municipalities and counties.

Local government in Germany underwent a period of consolidation and amalgamation between 1968 and 1987 (though concentrated in the initial decade). By 1987, for example, the number of municipalities had been reduced to almost one-third of that in 1968 and the number of counties from 425 to 237. Still, in 1987, over 85 percent of municipalities had populations less that 10,000 persons. The objectives of the consolidations were to create local governments of a more efficient size for the provision of local services while maintaining an adequate sense of representation and to establish local governments capable of handling functions to be decentralized. To a considerable extent, the consolidation of local government was renewed following the reunion with the east German states. As in many aspects of German politics and government, there was considerable regional variation in the approaches and outcomes of the consolidation initiative; for example, the amalgamations yielding unified versus associations of municipalities. Also, partly in response to local government consolidations, in the larger urban jurisdictions, it is common to have (sub-) districts many of which have directly elected representatives and certain decision-making powers within the local government; that is, a form of internal decentralization.

The responsibilities of German local governments largely fall into three categories; delegated, obligatory or mandated, and voluntary. The delegated functions are those which are the responsibilities of the federal and/or state governments but which those governments have delegated to the local governments to provide, typically with considerable direction and often financial aid. Examples of delegated functions are registration of births, deaths, marriages, etc., vehicle and property registrations, passport administration, building inspection, social assistance and housing allowances (paid for federally), public transport, some roads and highways, and some police services. Services that local governments are required or obliged to provide include school facilities (lower levels primarily by the municipalities and senior levels more by the counties; teachers are provided by the state governments), vocational training (the counties), aspects of health care, food inspection, day care for children, local roads, fire protection, water, sewerage and waste disposal, and cemeteries. In addition, local governments may voluntarily undertake a wide range of (discretionary) services such as sports and recreational services, cultural facilities and programs, homes for the aged, youth programs, public housing, economic development, markets, further support for education, and various additional public utilities (e.g., electricity, gas, heating). Voluntary services can even extend to saving banks, post offices and health insurance. There is a considerable degree of both horizontal and vertical integration of services -- horizontal in the sense that both levels of local governments are engaged (typically cooperatively) in services to local residents and vertically in the sense that many services delivered by local authorities are services for which state or state and federal governments are involved. One consequence is that responsibilities for services become blurred.

Social services dominate local government spending. One-quarter of local outlays go to social security and welfare with somewhat smaller amounts (14.5 and 13.0 percent) going to health and education (Table 1). Those three areas represent fully half of expenditures. In addition, there is housing (and community amenities) which represents another 15.3 percent. In contrast, transportation amounts to 6.0 percent, recreation and culture 5.7 percent, and protection 3.4 percent. Total expenditures by local governments represents 18.0 percent of consolidated government expenditures and 9.2 of GDP. Interestingly, despite the intention of local government consolidation to prepare local governments for expanded responsibilities and reference to the expansion of the responsibilities delegated and mandated to local governments, the 9.2 percent of GDP figure is only slightly larger than the 8.5 plus percent values observed from 1965 to 1980 (and values below the 8.5 percent level have been observed during the 1990s). Any significant down loading of responsibilities is not immediately obvious in local government spending as a percentage of GDP. Social services have expanded as a share of local budgets since the 1960s while infrastructure investment has declined.

Excluding the small amount (4.2 percent) of capital revenue, the revenues of local governments are split almost evenly among taxes, nontax revenues and grants (Table 2). This pattern has been quite stable although the tax share may have diminished somewhat during the 1990s after reunification. The major locally determined tax is a tax on local businesses (a portion of which is shared with senior governments). Local governments also levy a property tax. In addition, local governments receive a share of the personal and corporate taxes and the VAT (among some other minor shared taxes). This shared tax revenue is considered in the data comprising Table 2 as local taxes although local influence on the taxes and their shares is minimal. The taxes and tax sharing arrangements have also been quite stable. Nontax income is relatively high and quite important in local budgets. Intergovernmental transfers come in a variety of forms. Local governments may borrow but debt is generally used carefully and tends to be subject to at least the informal scrutiny of state governments.

Local government is a constitutionally recognized level of government in the German federation. Directly elected representatives are to manage local affairs.[11] The responsibilities of the three levels of government are defined under the Basic Law. Local government, however, is the responsibility of the state governments (although both the federal and the state governments legislate in areas that impact upon local government; e.g., taxation, education). As a result of the state responsibility, there is considerable variation (often regional) among the specific provisions across the states. The federal and state governments can delegate their responsibilities and many are delegated to the local governments, often with a considerable degree of supervision making the local governments effectively agents of the senior government in those areas. In addition, the state governments frequently use local governments, the counties particularly, as a level within their own administration. Beyond delegated and mandated responsibilities, the local governments are guaranteed the right to manage their own affairs. That is, manage their own affairs within the limits of the law. This authority is interpreted as being able to act in those areas not explicitly assigned to or reserved for another level of government. Local government is also granted the right to self-administration within the law; that is, it has the right to address its problems in those ways that it sees fit. Sources for own revenue and the distribution of major shared taxes are set in the Constitution. While following subsidiarity has resulted in the devolution of responsibilities in the German federation, taxes tend to quite centralized -- a feature which may constrain local autonomy.

The state governments provide the main supervision of local governments. The state department responsible for local government is the main general supervisory authority with departments focussing on specific functions (e.g., education, health) monitoring the related local activities under their jurisdiction acted on by local government and notably those delegated to local governments. The federal government has a similar interest in delegated services. With respect to the voluntary undertakings, a county committee comprised of county officials and the county chief executive officer, acts for the state governments to rule on the legality of municipal actions. As for other potential disputes about government action (intergovernmental or otherwise), the courts provide an avenue for resolution.

The intertwining of responsibilities across levels of governments and the interdependence of service delivery requires substantial negotiation and consultation if the federal system is to work smoothly. Intergovernmental consultation and efforts towards consensus building is a characteristic of the German system which can be typified as a form of co-operative federalism. It has been noted that those in the various governments recognize the individual and collective roles of the various levels in providing a comprehensive network of public services. Illustrative of the interrelatedness is the fact that it is not unusual for councillors from local governments to serve as members of the state legislatures. In addition to other services, associations of local governments play an important role as representatives of local governments in addressing intergovernmental concerns. It has been noted that “The system works despite its complexity, but not without a great amount of effort given to consensus formation...” (Norton, 1994, p 255).

Intergovernmental complexity among levels of government is parallelled at the local level itself where local governments have extensive flexibility in the available approaches towards provision of services. Local public services can be provided through government departments, own enterprises, arrangements with private organizations (both profit and nonprofit), and joint authorities. Intergovernmental agreements establishing joint authorities (verband) are widely used. In part, they provided an option to amalgamation when local governments were being consolidated but they grew out of a tradition of intergovernmental co-operation and shared services at the local level which allowed communities to realize enhanced service and cost savings despite small size. Joint authorities are extensively used to supply specific services such as water and sewerage, waste disposal, fire protection, schools, hospitals, residential homes, and recreational and cultural facilities. Counties also co-operate or work in conjunction with their member municipalities in providing such services as part of their complementary tasks. In metropolitan areas, regional associations of local governments overlapping counties frequently engage in various forms to create an integrated service network.

Given their freedom of self-administration, local governments have flexibility also in their internal organization. The organization of the executive varies substantially (largely regionally) and committees are largely organized to meet local requirements. Most states require that the local school administrations be autonomous (municipal like) in their organization. Meanwhile, the professional public servants are qualified through a national system of study and examinations. Salaries and benefits are also nationally determined. Local governments have control over appointments and promotion but not over dismissal. Once appointed, these senior officials have tenure.

2. Local Governments' Expenditures and Revenues

Local government expenditures in Germany are outlined in Table 1. They were commented on above and there is little to add to that discussion. Recall that most local expenditures are for broad social services (including public housing and housing assistance). Taxation, and the funding side generally, is the more interesting aspect of German local public finance.

Taxes provided 30.6 percent of local government revenues in 1996 (Table 2). Income and profit taxes account for almost 80 percent of local tax revenues. Those taxes are the constitutionally defined local (municipal) share (15 percent, after the solidarity levy) of the national personal and corporate income taxes that the federal and state governments also share (42.5 percent each). Through legislated arrangements, local governments also receive a small share (2.2 percent) of the VAT. National pensions are allocated 3.64 percent of VAT revenues as well and, after those two assignments, the federal and state governments share the remainder 50.5 and 49.5 percent respectively. Local governments levy a local business tax of which 15 percent is shared with the state governments and 5 percent with the federal governments. By one accounting, revenue from shared taxes accounted for 82.5 percent of local tax revenue in 1996.

The local business tax is the major tax of local (municipal) governments. The base is defined by the state governments and includes operating profit, working capital and (depending upon the state) total wages. Local governments have, within limits, some flexibility in setting the local business tax rates. Eighty percent of the revenue from this tax is retained by the local government and 20 percent is shared with the senior levels. The business tax represents about half of the total shared tax revenue of local governments or about 40 percent of local tax revenue. Not surprisingly, business taxes are a considerably more important revenue source for urban than rural local governments. The importance of this tax on business in local finance has been a lingering concern. In 1969, its role was reduced by about 40 percent in exchange for a one percent increase in the local share of income taxes (from 14 to 15 percent) and proposals to reduce its role further are regularly advanced.[12]

Other taxes are relatively minor. The property tax exists but is applied at low rates and accounts for only 6.4 percent of local revenues. For the agriculture and forestry sector, land is taxed but buildings are also taxed on other forms of property. Depending upon the state, various excise taxes (e.g., on beverages, entertainment) may also be levied. Such taxes generate very little revenue.

Nontax revenue, at one-third of the total, is a major source of local funds. Revenue from sales, fees and fines represents most of the nontax revenue and one-quarter of total revenue. There is an expectation that, where feasible and not contrary to social norms, charges will be relied upon. Local governments have discretion in setting fees and charges but they are not to exceed the costs of the service. Some fees, the real estate transfer fee for example, are state government regulated.

The sources of revenue referred to above are primarily municipal revenues. County governments do not share in the income and value added taxes. Their own taxes account for very little (e.g., three percent) of their revenues and they also generate limited fees. Instead, counties levy assessments on the municipalities within their boundaries at a rate (a uniform state approved share) of local taxes. Differences among municipalities in their reliance upon county services and county equalizing support of financially weaker municipalities contribute to some county-municipal controversy over these requisitions; a controversy partly moderated by some degree of cross membership between county and municipal councils. Counties rely heavily as well on grants from federal and state governments and upon compensation negotiated for required and other services.

Local governments obtain about one-third on their revenues from intergovernmental transfers. Almost all of these grants come from the state governments. The constitution limits direct federal government transfers to local governments to only those in aid of infrastructure. However, federal funds can and do flow to the state governments to assist state support of local operations. The states are responsible for adequate local government funding. The Basic Law requires that the state governments share a percentage of their general tax revenues with their municipalities and counties. The states determine what taxes are to be shared and the percentages. The percentages of state tax revenues shared have been significant, averaging about one-third during the 1970s, with some variation among the states. These funds are used for unconditional grants and are distributed on an equalizing basis. Unconditional funding represented somewhat over one-half (54 percent) of transfers to local governments in 1995. The states take account of revenue generating capacities and fiscal needs in allocating those funds among the local governments.

Conditional or specific purpose grants account for the remaining (almost half) of the transfers. Part of those funds goes to pay for those functions delegated to the local governments by the federal and state governments, part goes to support other activities, and about half may go to aid capital expenditures. Social assistance is a major delegated function which (indirectly via the states) receives federal support. Some insight into the funding and support of specific expenditure areas comes from the appended table (Table 7). Most, about three-quarters, of Germany's expenditure for education comes from the states with local authorities spending almost one-quarter. Of the local share, about 13 percent was funded by transfers in 1991. Local governments also account for about one-quarter of total transportation expenditures but, in this case, almost one-third of that is funded by transfers. Most of the national health spending is by the federal government (72 percent). Local governments' health expenditures represents 15 percent with very little (3.82 percent) of that funded by transfers. The major financial responsibilities for functions vary among governments and the grant support for the local government share of those expenditures also varies by function.

Denmark[13]

1. Local Governments and Their Relationships with Other Governments

Denmark is not a federal country. It has only the central and local levels of government. There are two levels (perhaps better, two types) of local government in Denmark; counties and the local authorities (municipalities). There are 14 counties and 275 local authorities (including in the latter the two capital metropolitan area jurisdictions of Copenhagen and Frederiksberg which hold the dual status of both county and municipality). Counties and municipalities are equals with different tasks. Counties do not supervise municipalities.

The numbers of local governments were greatly reduced as a result of amalgamations under the Local Government Reform legislation enacted in 1970. Counties were reduced from 25 to 14 and municipalities from 1391 to 275. A major consideration was to consolidate local governments into their respective social and economic communities. An objective was to create municipalities of adequate size to support a primary school of at least 175 students. Approximately 5000 persons was considered a minimum size. Currently, 241 municipalities are in the 5000 to 50,000 population range. Counties were to be of a size to support a modern hospital. Nine counties are in the 200,000 to 400,000 population range with only one smaller. Amalgamation was only one part of the reform. Following the amalgamations, greater responsibilities were placed on Danish local governments during the 1970s and 1980s. The subsidiarity principle was followed in the decentralization -- that is, devolve services to the most local level of government capable of providing the service competently. The objective was that the government responsible for a service would be as close to the citizens served as practical.

Local governments in Denmark have substantial responsibilities. Counties are responsible for hospitals, health insurance, upper secondary schools, care and education of the handicapped, intermunicipal transportation (roads and public), environment, planning and business development among other tasks. Municipal responsibilities include primary schools (up to age 16), day care, children's health, recreation and culture, care of the elderly (home care, day facilities, housing, etc.), social assistance to those not covered by unemployment insurance, transportation, environmental protection, water, sewerage and refuse, other public utilities, fire protection (police is a central government function), and planning and business regulation. In addition, the municipal governments activate and administer most social programs even if financed by the central government. For example, old age pensions and child allowances are managed by the municipalities but are centrally funded. Partial central support is provided for programs like sick pay and subsidized housing. Social security and welfare spending accounts for more than half (57.5 percent in 1998, Table 1) of combined local government expenditures.

The magnitude of local responsibilities, particularly with the substantial social programs, means that local government have large expenditures. As noted in Tables 1 and 2, the expenditures and revenues of local government represent just under one-third of GDP and more than half of consolidated government in Denmark. In a country where government is large (total government expenditures were almost 56 percent of GDP in 1998), local government is large as well. The revenues of local government come from central government grants (40 percent), nontax revenue (about 9 percent) and taxes (51 percent). Taxes revenues are almost entirely from locally levied personal income taxes.

The reforms initiated in 1970 were a comprehensive and systematic combination of amalgamations, decentralization of responsibilities, and financial reforms. The plan was to establish viable local governments, transfer responsibilities to them, and see that they had the resources to meet those responsibilities. The shift of responsibilities followed amalgamation. For example, during the 1970s and 1980s, responsibilities for hospitals and upper secondary schooling were shifted to counties and social security responsibilities were turned over to local governments. Local governments already played a major role that was supported in large part by conditional grants. Such specific purpose grants were considered unsuitable for supporting the expanded role of local governments. Consequently, the grant system was reformed with a few block grants replacing a number of specific purpose grants. Also, direct central reimbursements for local expenditures in specific areas declined. Local governments were expected to utilize their tax sources more heavily. Since 1978, the main change in the composition of local finances has been that conditional grants have shrunk while tax revenue has increased (Ahmad, 1997, p 195). The intention was to expand responsibilities but also to enhance and ensure local accountability for funding and performance. The increased burden largely fell on the local income taxes, taxes which local governments had utilized since 1904. Because local governments' fiscal capacities varied, the increased expenditure and revenue responsibilities would only work effectively and fairly if accompanied by a strong fiscal equalization system. Hence, considerable attention was paid also to equalization among local governments. Regulatory reform designed to afford local government greater flexibility and autonomy in coping with local issues has been part of the reform process.

The authority of Denmark's local governments comes from the country's constitution and dates back to 1849. The constitution recognizes the fundamental right of local governments to manage their own affairs subject to a measure of central supervision. While most powers are statutory, there is also recognition of the general competence of local government to act for the common good within their boundaries beyond the specific powers granted in legislation. Although most (one estimate is 90 percent) of local expenditures may be for services local governments are required to make, local governments are provided considerable freedom in making the arrangements to accomplish their tasks. One form of central supervision is the county supervisory committee which, in each county, consists of the central government's county perfect and four county councillors. This body rules on issues of legality of the actions of local authorities. Perfects are also involved in family law decisions and the county board of appeal that addresses social questions dealt with by local authorities. The Ministry of the Interior provides broader oversight. Providing information on local governments' finances and performance in comparison to that for similar authorities is a means used by the central government to allow local citizens to better assess their own local governments.

Potentially more important than direct supervision is the effort made to coordinate policy making with the central government and to avoid conflict. Annually, the National Association of Local Authorities and the Association of County Councils meet with the central government to negotiate budgets for the next year based upon expected revenues and expenditures of the local governments and the state of the economy and central finance. If the situation of local governments is expected to deteriorate, the central government is expected to provide the additional funds. If local authorities fortunes are expected to improve, the grants to them will diminish accordingly. Similarly, if tasks are transferred from one level to the other, the funds are to follow. For example, if a task were transferred to local government from a central department, the central budget would be reduced by the projected cost and transfers to local government augmented by that amount. Similarly, if central legislation impacts upon local budgets, there is to be compensation under the local budget safeguard rule. That is, for example, there is compensation for mandates but the compensation flows both ways. While the negotiations focus on budget matters, there must be consultation about new or changes to other legislation and there is also discussion about regulations and rules. This exchange provides substantial insight and feedback to all parties and assures much more integrated and coordinated policy and action although the agreements reached are primarily only recommendations to the individual local governments but ones that are intended to be achieved across all such arrangements.

Danish local governments are afforded considerable flexibility in how they accomplish their tasks. Councils can vary considerably in size to suit local requirements and preferences. Councillors are elected by proportional representation of the parties running candidates. Councils may run referendums but they are only advisory except, if one about school closure is defeated by 60 percent or more, it must be honoured by that council. Councils are required to establish a finance committee and a social welfare/services committee but may establish others as required. Counties will typically also have at least a hospital and a technical and environment committee and municipalities a school and a technical and environment committee. Committees have considerable authority delegated to them. The administrative structures of local governments are local decisions. Local governments can supply services through their own departments, operate enterprises, contact out to private firms, to nonprofit agencies or to other governments, enter into intermunicipal agreements for services, or other arrangements as they see fit. Public utilities must be self financing through user charges. Borrowing by local governments has been subject to varying restrictions over the years but is generally permitted for infrastructure needs.

2. Local Governments' Expenditures and Revenues

The distribution of local government expenditures in Denmark is reported in Table 1. Social security and welfare outlays account for 57.5 percent of the total. That, combined with 16.2 percent for health and 12.4 percent for education, makes a total of 86.1 percent for social programs and almost 90 percent if recreation and culture were included. Obviously, social spending dominates local spending. Relatively little of local outlay goes toward the "hard" or what are often referred to as property related services; that is, transportation (2.7 percent), economic affairs and services (2.2 percent), and protection (0.3 percent).

Further insight into the expenditure pattern is provided by Table 6 which shows the allocation among levels of government and distribution by function for each level for 1994. In financial terms, counties play a smaller role in the local government sector than do municipalities. County expenditures are dominated (about 60 percent) by health followed by that (almost 12 percent each) for education and for social policy. Municipal spending is primarily for old-age pensions (35 percent) which is closely followed by that for social policy (33 percent, largely for care of the elderly and social assistance). Schooling is the next largest item at 12 percent. Note that although unemployment is primarily a central (and a large central) responsibility, it is a recognizable outlay of the municipal governments (4 percent). Copenhagen and Frederiksberg have a combined county and municipality status. A somewhat different accounting for 1994 expenditures in OECD (1997, p 172) provides further insight into the responsibilities of the county and municipal governments. There, the majority of municipal expenditures are allocated to primary schools (21.2 percent), services to the elderly (19.5 percent), day institutions for children and youth (13.7 percent), social cash payments (13.4 percent) and administration (14.7 percent). The bulk of county outlays are shown as directed to hospitals (48.1 percent), health care (16.0 percent) and upper level schools (13.1 percent). Roads and environment together represented 3.4 percent of municipal and 2.1 percent of county expenditures. While there are some differences in the assignment of expenditures, the alternative perspectives provide insight. Note too that there is also some significant differences in levels of expenditure reported. For 1994, the IMF data (the source for Table 1 and 2) reports total local government expenditures of 314.7 billion kroner while the source for Table 6 reports 291.2 billion and the OECD source reports (revenue) of 267.5 billion. Apparently, although all the data comes from the Ministry of Finance and other government sources, some accounting differences exit; but more of that below.

Total local government revenue sources are reported in Table 2. That shows half (50.9 percent) coming from local taxes, 40.3 percent from grants and almost 9 percent from other sources. The data in Table 6, however, shows grants and taxes each accounting for almost half of total local government revenues. While the amounts of tax and grant funds correspond relatively well with IMF data for 1994, other (essentially the nontax) sources are essentially nil there. While the amount of taxes reported in the OECD (1997, p 171) source approximates that from the other two sources, it accounts for 55.2 percent of revenue with other sources being operating revenues (21.3 percent), general grants (13.6 percent) and refunding (for expenses from the central government, 7.8 percent) and other (2.2 percent). The OECD total revenue is only 267.5 billion kroner for 1994, versus 317.1 in the IMF and 291.2 in Table 6. These variations illustrate the need for care when using national data and the advantage of have the single consistent accounting across countries such as the IMF data provides.

Local taxes in Denmark are income taxes. In 1998, almost 94 percent of total local government taxes come from income taxes and 98 percent of those are personal income taxes. The local income taxes are locally determined single rate taxes applied on income above a basic personal exemption. The local tax is piggy-backed on the central personal income tax and is applied against the nationally defined taxable income base. In 1996, the average rate for counties was 10.54 percent and for municipalities it was 19.88 percent. In 1994, county rates varied from 8.9 to 10.4 percent and municipal rates from 15.5 to 22.5 percent. Tax revenues go only to the municipality of residence. Municipalities are responsible for personal income and business (but not corporate income) tax assessment following central rules. Numerous, especially small, municipalities have relinquished this responsibility to the central government. A share of corporate income tax and capital gains taxes come to the municipalities but those shared revenues make a very small contribution to revenues and are not regarded positively by central authorities as an alternative to grants.

Property taxes make a small contribution to local revenues. Property taxes in Denmark are on land only. The county rate is set centrally at one percent of the capital value while the municipal rates are permitted to vary between 0.6 and 2.4 percent. The same rates are applied to all properties, both business and residential. Capital value assessments are adjusted annually. Property taxes account for 6.3 percent of taxes, contribute 3.2 percent to revenues and represent one percent of GDP.

Nontax revenues provide 8.1 percent of local government revenues (Table 2). Most of this (5.8 of the 8.1 percent) comes from fees, sales and fines. Public enterprises and property generate only 1.2 percent. Public utilities like water and sewerage services, heating, electricity, etc. are required to cover their costs with user charges. Such enterprises are widely operated by local governments under a variety of arrangements.

Table 2 shows that about 40 percent of local governments' revenues come from central grants. Table 6 reveals more detail about these transfers. Almost half of total transfers (representing 60 percent of grants to municipalities) is compensation for old-age pensions paid by the municipalities. Old-age pensions outlays (and child allowances) are fully reimbursed by the central government. It is somewhat difficult to regard such transfers as grants and those expenditures as local expenditures when, in effect, the municipal government is simply the agent administering a central program. Other specific purpose transfers exist. Those are for social welfare and employment programs only. They are cost shared or reimbursed 50 percent and provide just under one-quarter of municipal grant revenue. Capital grants, a widely used specific purpose grant in many countries, are very rare in Denmark. General purpose grants represent the remainder (about one-sixth) of municipal grants and all of the transfers to counties. These grants are block grants and, where applicable, equalization grants. Block grants are allocated in recognition of certain broadly defined undertakings and are allocated by formula using objective criteria usually placing considerable weight on demographic factors.

It is useful to reflect briefly on Denmark's equalization system. The objective is to put local governments on equal terms with respect to their citizens' access to local public services. Both tax generating capacity and expenditure need is taken into account. Measuring expenditure needs is the more complex aspect of the process. For the most part, the equalization system is of the relatively unusual Robin-Hood (or fraternal) type. That is, the equalization takes from the "rich" or "have" jurisdictions to fund transfers to the "poor" or "have not" jurisdictions. That is, it equalizes both sides towards the middle. As of the mid-1990s, only the tax based equalization to municipalities was funded by the more common grant or paternal model by which the equalizing transfers to the "poor" jurisdictions is funded by a senior government leaving the well off jurisdictions untouched (and requiring equalization to the top if full equalization is to be achieved). Comparing pre and post equalization per capita tax bases and expenditure needs shows the Danish system to be very effective (Ahmad, 1997, p 199).

CROSS-COUNTRY COMPARISONS WITH THE AID OF A CONCEPTUAL FRAMEWORK

Having outlined the features of local government in five countries, the task is now to compare and assess the often quite different models that have been observed. This analysis is aided by appeal to a conceptual framework that has emerged from the experience of observing and analysing the performance of subnational (and particularly local) governments in many countries by many people; a framework built largely upon the theory of fiscal federalism. There is not space here to develop and rationalize that framework. The principles employed and guidelines being followed will largely have to be accepted. Those principles have been presented and argued elsewhere.[14] The following exercise will briefly sketch the widely accepted criteria applicable to a particular topic (e.g., functions, finances, etc.) and evaluate local government in these five countries to illustrate, demonstrate, and guide policy makers.

The Activities and Expenditures of Local Governments

What local governments do matters for determining intergovernmental fiscal relations. That is, the activities of local governments are critical to the determination of a structure of intergovernmental fiscal relations that will enable local governments to perform their tasks effectively. Indeed, the expenditure assignment, the revenue assignment and the transfers, which together comprise the core of the intergovernmental fiscal arrangements package, are closely integrated.

The responsibilities assigned to local governments vary greatly among countries. Table 1 shows local government expenditures ranging from 2.2 percent of GDP in Australia to 32.6 percent in Denmark. Among advanced economies, local government in Australia is uniquely small being confined essentially to the basic or core activities of local authorities; primarily roads, recreation, waste management, housing, and regulation of local activities. Other than for other Scandinavian countries, local government in Denmark is uniquely large. There local governments have extensive responsibilities for social services (notably social welfare as well a health and education) that are more commonly assigned to central governments or, in federations, possibly to state governments. Interesting to note, however, is that despite the vast differences in the share of local budgets devoted to transportation in the two countries (2.7 versus 27.5 percent), Danish local government spending on transportation is, as a percentage of GDP, larger than that in Australia; 0.9 versus 0.6 percent. Local government in Canada, Germany and the United States are similar in size as a percentage of GDP in the range of 8 to 9 percent. Even here, however, the responsibilities differ. School expenditures account for over 40 percent of local expenditures in Canada and the United States in contrast to 13 percent in Germany. German local governments allocate a much larger portion of outlays to health, social security and housing.

One would be hard pressed to demonstrate that the performance of local governments (or governments more broadly) operating with any one of these distinctly different expenditure assignments is clearly superior or inferior. Indeed, the only safe conclusion is that there is no single best expenditure assignment that can be recommended. What works effectively depends very much upon custom, culture, history, etc. and, importantly, the suitability of the fiscal arrangements.

Clearly there are a set of activities that are best performed by local governments. Beyond that, however, opinions as to the appropriate extent of decentralization or subsidiarity obviously vary. Local responsibility for many services offers the advantages of awareness and responsiveness to local interests but that often needs to be weighed against spillovers, economies of scale and scope, and decision-making costs. Allocative responsibilities (e.g., roads and transport, waste management, drainage, water and sewerage, recreation) -- that is, the provision of local services providing distinctly local benefits -- are widely regarded as more suitable for local government than those involving significant redistribution and (potentially) significant spillovers such as schooling, health, and particularly social assistance. The countries surveyed illustrate. Local governments in all but (perhaps overlooking public housing) Australia have significant expenditures in at least one social services area but these expenditures are subject to external support. For example, schooling, which is particularly important in local budgets in Canada and the United States has largely been provincialized in Canada and benefits from substantial state equalizing funding in the United States. In Denmark, where social security represents well over half of local expenditures, a large share of those outlays is really made up of centrally designed and funded programs administered by local authorities. Suitably structured intergovernmental relations can make manageable and relatively efficient important spillover generating and redistributive activities left to local governments that can benefit substantially from local management. On the allocative function side, local boundaries (due to obsolescence or for other reasons) need not always match well the effective service areas and communities of interest. Hence, boundaries periodically change, usually at the instigation of a senior government. Major consolidations of local governments have occurred in (at least some areas of) local government in the countries reviewed. To a large extent, these movements were concentrated in the 1950s and 1960s and resulted in considerable reductions in the numbers of local authorities. On the other hand, local governments are not entirely limited by their boundaries. Small jurisdictions especially often see and pursue opportunities for cost saving via shared service arrangements with neighbouring units, contracting with other governments or private firms for service, etc.

Many public services involve a continuum of interests at local, regional and central levels. Consequently, assignment of sole responsibility to a single level can detract from performance. The trick is to unbundle responsibilities for such services so that they will be effectively and responsively provided to citizens’ expectations. Because the services and the varying interests can be complex, it is not unreasonable to expect that intergovernmental relations may, in those cases, be somewhat complicated. Various approaches can be found; for example, division of responsibilities for different aspects of the same service (such as health care), cost sharing, joint production. At the extreme are senior governments making local authorities their agents for the provision of some services (e.g., the delegated responsibilities in Germany) and senior governments essentially providing the service (e.g., policing in Australia, Denmark and Germany; fire protection in Australia). The complexity experienced in the recognition of different interests can vary as demonstrated by the Danish and German approaches to (especially) social services. The intertwined interests of the three levels of German government lead to a very complicated system that demands extensive consultation and effort. The Danish structure, despite the greater role of local government, is more clear cut; probably due to arrangements for social assistance and the greater fiscal capacities (taxing powers) of Denmark’s local governments. The point is that senior governments may have legitimate interests in services provided by local governments and there are various ways for those to be engaged as seen from the experience of the countries examined. When there is senior government involvement, there need to be mechanisms to provide suitable accountability of local authorities to those governments as well as to their own citizens. In addition, where responsibilities are shared, there needs to be an appropriate assignment of those responsibilities, clarity as to who is responsible for what, and coordination of activities. While various important interests need to be recognized and accommodated, the result should not be confusing even if somewhat complex.

Local responsibilities can be divided among local governments. Local governments can come with varying powers. Counties in Denmark, Germany and the United States overlap and supplement municipalities in the provision of some services. To illustrate, counties in Denmark are responsible for hospitals and upper secondary schooling, in Germany they have senior schooling and vocational training and health insurance responsibilities, and, in the United States, social welfare is largely a county function. Combining county and municipal powers in a single jurisdiction is widely used in both Germany and the United States to provide local government in urban areas. Canada has some second-tier regional governments in some areas but such authorities are largely missing in Australia. Special purpose local authorities are widespread in Canada, Germany and the United States. Schools, for which there is a large local interest and which require large expenditures, often get special consideration. In Canada and the United States, school districts dominate this class and are a separate form of local government (although as more in Canada lose taxing powers, they increasingly become agents of the provinces). In Germany, the school committees are autonomous and municipal like. Typically less obvious but still important are the host of special purpose and often single authority bodies existing to provide a wide variety of other particular services such as water and sewerage, other utilities, drainage, conservation, fire protection, area wide recreational facilities, transit, health facilities, etc.. These authorities may appeal largely for their ability to realize economies of scale, to better correspond to natural service areas, and/or better match the beneficiaries with those meeting the costs. These special purpose bodies are particularly extensive in Canada, Germany and the United States. The United States has experienced a rapid expansion in the number of these bodies. In Germany, special purpose authorities jointly organized by neighbouring local governments are especially popular and apparently effective and have notable appeal where local governments are small and also in metropolitan areas. Local special purpose bodies are limited in Australia, likely because of the much greater roles of state governments there (e.g., the states provide schooling, fire protection, police services, transit, among others that local governments often engage in elsewhere).

Local government in the five countries have considerable liberty to supply services in the best way that they see fit.[15] In recent years, there has been expanded interest in exposing local government production to market competition, largely through contracting out. The evidence suggests that this can be a valuable approach but it is not a panacea. Appealing to private (or even other government) suppliers requires careful contracting, monitoring and enforcement. Parallel movements have promoted improved efficiency in governments' own operations through programs to measure and reward performance and create better incentives for encouraging productivity. While by no means the only place that (local) public sector efficiency is being promoted, Australia has launched a national program to enhance local government performance.

Local Government Revenue and Own Revenue

Finance follows function. The own-revenue assignment needs to be matched in kind and magnitude to the designated responsibilities. In large part because of external interests in certain local government activities, own revenues are normally less than expenditures with the difference covered by transfers. Not surprisingly, Australian local government, which is small and focussed on local activities, is five-sixths funded from own revenues (and only one-sixth, 16.4 percent, by grants). Grants in Australia contribute half (or less) than grants do in the other four countries. Given the importance of social spending by Denmark's local governments, it is perhaps unexpected that own revenue is not less important there. That feature, however, is likely a product of Denmark's extensive and relatively unique use of local (income) taxes in combination with strong equalization. The composition of own revenues varies considerably among countries.

The benefit principle is fundamental to local government finance. That is, local residents should meet the costs of local public services providing local benefits. There should be a clear benefit-cost (expenditures-revenue) linkage. Local taxes should not be exportable. User or beneficiary charges are a practical way to conform to the benefit principle and to fund a number of local services. Local taxes, charges, fees, etc. should be determined by local governments. The ability to set tax rates (usually not tax bases) is critical. Local taxation contrasts with revenue sharing over which local government have no control and which, therefore, serve as a transfer rather than a tax. Widely accepted criteria for local taxes are that they be locally determined, stable (reliable) or at least predictable, visible (transparent), promote accountability, have low administration and compliance costs, be nondistorting, fair (equitable), and adequate.

Local Taxes

Local tax sources differ considerably among countries. An analysis of OECD countries reveals that many countries (predominately of British heritage) rely heavily upon property taxes, income taxes are the main source in a number of (largely northern

European) countries, and in some (mainly southern Europe) a mixture of property, income and consumption taxes prevails (McMillan, 1995/2001). Among the five countries reviewed here, property (and property related) taxes dominate in Australia, Canada and the United States (with modest property taxes found in Denmark and, less so, Germany). Particulars of the property tax bases (land versus land and improvements and capital versus rental value) differ among and within these countries but the tax bases are defined by senior governments. By most of the criteria for local taxes noted above, property taxes are well suited to local governments. The lack of buoyancy (automatic increases in the base, due to inflation for example) has been a criticism but the now widely utilized computer-based mass-assessment methods keep assessments current and diminish that concern. Concentrations of business or industrial property can raise equity issues. Despite their extensive use to fund schooling in Canada and the United States, property taxes are not regarded as an especially successful method to raise revenues to finance social services. High property taxes, such as the levels required to contribute substantially to social programs, meet strong resistance as witnessed in both Canada and the United States where they prompted expanded transfers predominately for schooling.

Denmark and Germany both usually are classified as countries with local governments having a high reliance on local income taxes. Denmark has a true local income tax. The German case, as shall be seen, must be qualified. The Danish local governments receive over 90 percent of their tax revenues and over 45 percent of their total revenues from single rate personal income taxes with the rates set by the individual county and municipal governments. Administration is simplified by piggybacking the tax on the national personal income tax. Because the income tax is seen as better related to ability to pay than the property tax, it is a superior tax for funding social programs that are so large in the Danish local government jurisdiction. Income taxes have a potential disadvantage in that they are less stable than alternatives such as the property tax. In contrast, the local "income taxes" in Germany are actually shared revenues. That is, the municipalities receive a constitutionally specified share (15 percent since 1980) of the national personal and corporate income taxes paid by their local residents. The local governments have no say in these income taxes so they are actually shared revenue, not local taxes, and so rank low when it comes to transparency and accountability. Note that, local (personal) income taxes are relatively common in the United States. While they do not provide a large share of local tax revenue overall (about 6 percent), where utilized, they are a much more important. School districts have access to income taxes in three states. Where not integrated with the state income tax, the administration and fairness is at times subject to some criticism. Canadian local governments had access to local income taxes before World War II.

Business taxes are prominent in Germany. Indeed, the local business tax is (at 40 percent) the major tax source for German local governments. The tax base is operating profit, working capital, and (varying with states) total wages. The local governments have considerable discretion in setting the business tax rate. Forty percent of the revenue is shared with state and federal governments. This tax is widely criticized for its adverse (distorting) effects on business and its lack of transparency and accountability to local residents (e.g., Zimmerman, 1986). Various efforts, some partially successful, have been made to reduce the role of this tax. A variety of local business taxes are levied in most Canadian provinces and they account for about 10 percent of local taxes. At about 40 percent of business property taxes in Canada, they are significant. As in Germany, the Canadian business taxes are subject to criticism for like reasons. Their popularity relates to the perception (at least partially valid overall) that business taxes shift the tax burden beyond the community. Because business taxes are not found to be justified by the cost of services to business property, they undermine the cost-benefit linkage of the local tax-expenditure system.

Among the five countries, local sales taxes are most significant in the United States. Local sales taxes there have been discussed above. Note here that local taxes on goods and services represent 8.1 percent of local government revenue in the United States which far exceeds the contributions from that source in the other four countries where it is almost negligible. Local sales taxes are subject to a number of criticisms. For example, their potential is very uneven among localities, the links to benefits or ability to pay are unclear, avoidance and economic distortions are problems, and multiple levies by overlapping jurisdictions can occur. On the other hand, sales taxes are a popular form of local taxation in the United States (seemingly largely because it is believed to shift some of the tax burden to nonresidents) and they do raise a significant amount of revenue.

A variety of tax sources are found across the five countries but, as is usually the case, a single source dominates in each. With a heavy reliance upon shared taxes (tax-like revenues) and a local business tax, the German system corresponds least well to the criteria for local taxes. Otherwise, while certain criticisms can be aimed at selected revenue sources (especially in Canada and the United States) and there is no shortage of recommendations for improvements, the local tax systems in the other countries fare rather (or, at least, relatively) well. Most assessments rank well designed and implemented property taxes and personal income taxes as attractive for local governments. Indeed, the two in combination would create the potential (with adequate equalization) for local governments to undertake an extensive range of services. Local sales general taxes (and more so local excise taxes) score less well by the customary criteria. Local taxes specifically directed at business (i.e., beyond the property tax), and especially local corporate income taxes, fall at the bottom of the list. If sales taxes and business or corporate income taxes are to be directed towards local governments, it is better to use them as a source of contributions to revenue-sharing programs.

Nontax Revenues

Nontax revenues show the most variation of the revenue sources across the five countries. It represents a third of local revenues in Germany and Australia, a quarter in the United States, one-sixth in Canada and one-twelfth in Denmark. Despite its low share of total revenues, as a share of GDP, Denmark's nontax revenue ranks second after Germany and ahead of the United States (with all three in the 2-3 percent of GDP range). In Denmark and Germany, charges are expected to cover the cost of most utility type services. Local governments in Canada have been somewhat "behind" in using charges to cover the costs of many of their utility and utility-like services. In the United States, almost half of the nontax income comes from enterprise profits and property income. In contrast, in Germany and Denmark, charges are not to exceed costs. In general, there has been a widespread movement to increase the use of charges, fees, etc. rather than resort to taxes. User charges meet many of the criteria of good taxes; for example, visible, accountable, fair in that the beneficiaries pay, often easy to collect; plus they both reveal demand and may constrain demand. Where there are not important social reasons otherwise, they are attractive. While distribution and access can be a concern, criticism of charges and fees on distributional grounds often pay insufficient attention to the distributional implications of the alternative funding sources required in their place.

Intergovernmental Transfers

As in other developed countries, transfers in the countries surveyed for this analysis make significant contributions to local governments budgets. The smallest contribution is about 16 percent in Australia, followed by 33 percent in Germany and approximately 40 percent in Canada, Denmark and the United States.

Intergovernmental transfers can be motivated by various economic or other objectives. One of the economic objective for which grants may be employed is to improve efficiency by correcting for interjurisdictional spillovers (externalities) which otherwise cause inefficient levels of output. This case calls for conditional (specific purpose) grants directed to support the externality generating activity yielding positive effects. The problem is that many of the externalities for which corrections are sought are difficult to measure, often because part of the externality has to do with distributional considerations. Closing fiscal gaps because of a mismatch between the expenditure and revenue responsibilities is a second reason. Central to such grants is determining the magnitude of the gap(s) which, ideally, should be based upon estimating the difference between revenue capacity and expenditure need for each local authority. These transfers should be unconditional (general purpose). Also, because they represent a vertical fiscal gap or disparity between levels of government, the funds should come from the senior government(s). Funds designated for revenue-sharing are a potential source. Because local authorities differ in their abilities to meet their fiscal responsibilities a third rationale for grants is horizontal fiscal equalization. Although typically considered as justified on equity grounds, this type of grant can also enhance efficiency. Like the vertical gap-closing grant, these transfers should be based on estimates of differences in fiscal capacity and expenditure need. Consequently, the magnitude and distribution of such grants needs to be over-arching in that consideration is given to other grants. Typically, equalization grants are determined and paid by senior governments but occasionally one finds transfers from rich to poor (i.e., among) local governments themselves; that is fraternal rather than paternal. Political reasons for transfers are numerous and often dominate the economic considerations. In practice, unfortunately, the purpose of grants are often difficult to distinguish as a blend of purposes may underlie the initiative.

As with taxes, intergovernmental transfer programs have criteria against which they can be evaluated. Indeed, there are overlapping criteria. Good grant programs should have a clear purpose, funds be allocated objectively, be non-negotiable, be relatively simple and transparent to all, ensure accountability, provide the autonomy and flexibility necessary for effective utilization, be stable and, as required, be equalizing. Intergovernmental grant systems should be very much about getting the incentives right. With the correct incentives, local government will work better. If they are wrong, they will not help and can detract from performance. There can be significant rewards to getting the fundamentals right.

The diversity in grant practice is reflected in the five countries. The grant programs can be considered broadly under general purpose and specific purpose grant categories. The German revenue-sharing program, the funds of which are (as in the data here) commonly counted under taxes, is actually a gap-reducing transfer that primarily allocates 15 percent of national personal and corporate income taxes to the originating local governments. The majority of Australia's Commonwealth grants destined for local governments had their origins in revenue sharing. Those transfers are allocated by state grant commissions to local authorities for general purpose use according to clearly defined criteria involving revenue generating capacity and expenditure need. Those funds represent about 40 percent of the total aid to Australian local governments. The German states assign substantial but varying shares of their revenues to local governments, again using equalization formula. Those grants represent about half of the grants to local authorities. Both the Australian and the German state government programs blend fiscal gap-filling with equalization. In Denmark, there is not what might be considered a gap-filling grant program. Rather, there is a strong and effective horizontal equalization program with the fiscally advantaged localities funding (almost entirely) transfers to the fiscally disadvantaged municipalities. Such inter-local transfers are not common. In Canada and the United States, significant gap-filling and equalization transfers are primarily found in school finance where they are quite extensive although with substantial province to province and state to state differences. Municipalities in Canada and the United States, which are similar to but have relatively more responsibilities than their Australian counterparts, receive about 15 percent and 25 percent respectively of their revenues from grants. Among general purpose local authorities, there are no parallels to the national Australian and (constitutionally required) German programs. Again, there are tremendous variations across the provinces and states which are by far the major (almost exclusive) source of support to municipal governments. In Canada and the United States, general purpose grants for general purpose local governments typically are not a priority. In Canada, for example, unconditional support is less than 20 percent of the total and in only three provinces do unconditional transfers exceed conditional. Although general support funds are normally distributed using some, usually rather limited, equalization criteria, past studies suggest that, largely due to lack of adequate funds, the equalization achieved is limited.

While there are undoubtedly exceptions among the provinces and states, general purpose local government neither gets the level of total support or the extent of general purpose funding that is found for local governments in Australia, Denmark and Germany.

Specific purpose grant programs are important in all five countries. In Canada and the United States, grants for schooling (to school boards) are multiples of the amounts of total grants to local general purpose governments. Even among grants for the general purpose local authorities, specific purpose grants typically dominate. As in many other countries, reform of the specific purpose grant systems (through a move to block funding) has tended to reduce the number of grants and simplify the conditions making the specific purpose grant system much more tractable. In Australia, about 40 percent of the Commonwealth grant to local authorities is specified as a road grant and that is distributed according to road related criteria but, when distributed, the funds are untied. Meanwhile, the 50 percent of grants to Australian local governments coming from the states are specific purpose; primarily for housing and community amenities and for transportation. In Germany, also about one-half of transfers to local government are designated for specific purposes but much of that goes to compensate for responsibilities delegated by the federal and state governments (as in the social services). Senior governments in the United States and Canada have been much less generous in providing compensation for the functions which they have mandated to local governments. In Denmark, a single transfer dominates the transfer package. Over 60 of total transfers go to reimburse municipalities for outlays under the central old-age security program that local authorities administer. This is not unlike what school transfers in Canada are increasingly becoming. Of the remainder in Denmark, about 40 percent are for other specific purposes.

An anomaly of local public finance is that while transportation (notably roads and streets) is a major expenditure category of local governments, local governments do not (or rarely) have access to motor fuel taxes or license fees that relate to those expenditures. This situation is not surprising because the mobility of purchasers make the application of such user charges (less so for licenses) by individual local authorities problematic. In some cases, the collection of such revenues by state or federal governments may go to fund transportation grants but often there is no direct linkage. This situation makes a good case for revenue sharing of transportation related taxes and charges by central and provincial/state governments with local governments. A share of such funds could be turned over to local governments either as a specific purpose grant or, probably more logically, as an effectively untied grant such as the Australian Commonwealth road grant. In Canada, a few provinces share some motor fuel taxes but with only selected local governments.

Specific purpose transfers have often been in support of capital spending. This has been particularly so in Canada and the United States. In Germany, federal grants to local governments can only be to support infrastructure. In Denmark, however, capital grants are rare. Donors of capital grants have been criticized for providing the upfront or initial cost but ignoring the ongoing operating needs. In addition, capital grants can be distorting by biasing expenditures towards capital versus maintenance.

Grant systems differ considerably among countries but the basic types of grants are similar. There is sufficient information to make a normative judgement about the unconditional funding provided across these countries. It would require extensive and detailed study to determine whether specific purpose grants were better designed or implemented in one over another. However, the governments in Canada and the United States seem to place an unnecessarily heavy reliance on specific purpose (versus unconditional or general purpose) transfers to their general purpose local governments. A common problem with grants is that transfers from senior governments are often unstable and unreliable and, with local governments being at the end of the fiscal line, little can be done to moderate the impacts. To illustrate, there was the coming and going of the revenue-sharing program in the United States. In Canada, the fiscal austerity of the 1990s saw grants to municipal governments decline from 23 percent to 15 percent of revenues within a decade.

A Note on Fiscal Imbalance

It is not uncommon to find reference to fiscal imbalance, especially in discussions of local government. In the simplest form, fiscal imbalance refers to situations in which a government's expenditures exceeds the revenue from its own sources. One can refine that definition to relate to the more difficult to measure concepts of expenditure requirements to meet expected services and own revenue generating capacity but the simple expression is adequate here. Fiscal imbalance implies grants, the source of funds covering the deficiency between expenditures and own-source revenues. Often, fiscal imbalance is associated with arguments for need of expanded tax capacity, additional transfers, reduced responsibilities, and may come with negative connotations or a negative spin such as those relating to poor management on one side or unreasonable demands or burdens on the other.

The point to be made here is that fiscal imbalance as expenditures exceeding own revenues is not a meaningful concept. One could have situations in which local governments' own revenues equal expenditures and (despite good management) local public sector needs are attended to poorly. Alternatively, one could have situations where there is a large gap between the two and the local public sector is sufficiently funded and well managed. For example, if local government is responsible for provision of a service having substantial spillovers, balancing expenditures with own revenues will result in inefficiencies and under provision of that service. There is nothing necessarily magical about local own revenues matching expenditures. The question of fiscal (im)balance is more complex.

Rather than raise the spectra of fiscal imbalance, the more relevant approach is to determine the most appropriate fiscal balance in particular circumstances. As noted, finance follows function. If responsibilities are extensive, revenue sources need to match both in terms of providing the capacity for adequate revenue and in terms of providing an appropriate cost-benefit link between taxes and expenditures. Are local authorities provided revenue sources that will allow own revenues to meet expenditures (even if spillovers are not an issue)? It is possible that charges and the property tax, for example, will be insufficient and access to an additional tax source such as a local income tax may need consideration. Alternatively, if other tax sources are deemed inappropriate, a fiscal gap-filling transfer is necessary. The issue then is the suitability of the amount and distribution of the transfer. Similarly, if a local government with little revenue generation capacity and larger expenditure requirements receives equalizations grants, that does not imply a faulty fiscal system that removing the fiscal imbalance would rectify. And again, if important externalities exist, corrective grants are called for. Thus, "fiscal imbalance" (as the deficiency of own revenues to cover expenditures) may exist for legitimate reasons. The valid assessment of fiscal imbalance has to address whether the total fiscal arrangements -- expenditure responsibilities, revenue sources, amount, allocation and type of transfers -- is appropriately structured to provide local services efficiently and effectively to community expectations. Such assessments must be carefully done and can be complex tasks. It is possible that the outcome might be smaller or larger transfers. Simply noting that transfers exit and their relative magnitude reveals nothing about fiscal (im)balance.

Infrastructure[16]

Local governments provide a number of capital intensive services. Roads and streets, public transit, water and sewerage systems, and drainage probably dominate the list but capital facilities are also important to recreational and cultural activities, schooling, health care, etc. in which local government is frequently also involved. Overall, local governments typically account for about half of total government capital spending.

Local capital expenditures are usually financed from a combination of own funds, transfers and debt. Own funds are normally reserves that have been accumulated from taxes, charges and other sources of revenue. It is not at all uncommon that many specific purpose grants are designated for specific capital expenditures;

for example, roads, public transit facilities, school buildings. Among the countries reviewed, Denmark is relatively unusual in that capital grants are not common. Capital grants may appeal for a variety of reasons -- visible, assist in funding potentially lumpy expenditure demands, aid to localities -- but capital spending programs (even at the local level) are often less irregular than suggested; if aid for capital outlays is justified, aid for operations likely has equal merit; aid biased towards capital outlays can discourage maintenance. Infrastructure assistance needs to be thought through carefully. Debt finance can be used to stabilize demands for local funds and is a means of distributing the cost of capital services over its life and onto the beneficiaries as they change over time.

Local government borrowing is almost always restricted to financing for capital facilities. Borrowing to cover unexpected operating or current account deficits normally must be repaid in the next budget year. Local borrowing is monitored in many ways and is rarely left solely to the discipline of the market. In Australia and Germany, local capital requirements are assessed in conjunction with those of the state governments in their negotiations with the federal authorities. Danish local authorities collectively negotiate limits to local borrowing with their central governments. In Canada and the United States, market discipline is a more important determinant of local borrowing but still there are a variety of controls and monitoring by the provinces and states.

Local governments may be able to borrow directly from capital markets but senior governments will typically supervise and in some cases provide support in arranging loans. Some provinces in Canada borrow to lend to their municipal governments through provincial municipal finance corporations. This arrangement affords the province direct supervision and, with the strength of the provincial authorities, enables the municipalities to secure financing at better rates than they could individually in the market. In parts of western Europe, municipal development funds (with central support) have had a long history as financial institutions serving local governments. In many cases, these are evolving into more independent and commercial ventures.

Direct assistance in meeting debt obligations is not unusual. The tax exemption for interest on (state and) local debt in the United States is a large and significant form of aid to (state and) local government. Other forms of assistance to local authorities to meet debt obligations, in the United States and elsewhere, are not uncommon but are typically less systematic and are often occasional. It is important that aid not undermine financial discipline. Good resource use and sound financial management require that local governments not be permitted to borrow and spend indiscriminately in expectation of a bailout from a senior government. Budget constraints must be hard; that is, no bailouts. If some assistance is necessary as a result of a borrower's mistake, it needs to come at a significant price. While exceptions exist, local governments in the five countries use debt responsibly because they are held accountable for their decisions. While accountability promotes responsible use of funds and debt, it is also necessary that local governments have a sufficiently appropriate matching of expenditure responsibilities and revenue sources that they are not pressured towards the use of unsustainable debt.

Accountability

Successful local governments are accountable to their citizens, their senior governments (as needed), and their lenders. Internally, the local public service must be accountable to the local politicians. Accountability requires information. The different lines of accountability require different kinds of information but, generally, information should be accessible to all.

One need of information is for resource management. This aspect is about making the best use of the resources available. Effective resource use has two aspects. One is about allocating resources among programs to best serve the community. In part, this involves forward planning as well as current activities. The other aspect is about making the best use of the resources within each program. The two, of course, are intertwined. Good, but somewhat different, information is essential for both.

Information is necessary for financial management and control. This information is directed at ensuring that resources are used as intended. Avoiding corruption and misappropriation of resources is, of course, important but also important is simply avoiding careless management of funds. Senior governments are interested in assessing the need for their grants and tracking the utilization of those funds, especially conditional transfers. Independent external audits are essential for control but internal control mechanisms are vital as well for an effective system.

Local governments should be making information on their finances and operations public on a regular, timely basis to promote accountability and public awareness. One set of criteria for public disclosure is that it be complete, comprehensible, comparable, verifiable, and public. Senior governments have an interest in and they can do much to promote consistent and reliable local government information systems through combinations of regulations and incentives and they can do much to ensure public disclosure. Senior governments are in a unique position to provide information about local governments on a comparative basis to aid assessment. Australia's initiatives in this direction received special note. In part because of the efforts of senior governments but also partly because of local needs and demands, local governments in the five cases considered above have extensive and high quality information systems reporting internally, to citizens, to other governments, and to the public generally. Undoubtedly, this exposure contributes to the performance of local governments in those countries.

To perform their tasks effectively, local governments require a civil service that has competence, integrity and motivation. The civil service needs to be accountable to local elected officials. Accountability does not imply political appointees. Rather, the call is for a skilled and trained public administration whose recruitment, advancement and retention is based on their performance in meeting the programs and policies of the council. Germany is somewhat unique among the countries examined in having the more formalized training programs for local bureaucrats but also for permitting the local authorities the least control over that staff in lacking the authority to dismiss.

Local autonomy also contributes to effective performance. Management autonomy or flexibility in the local approaches to problem solving is the main focus here. Generally speaking, local governments among these countries have considerable flexibility in determining how to solve local problems. While many do not have general competence powers, may be bound by the strings of conditional grants in some programs, and may be constrained in their revenue sources, there is still reasonable flexibility, if not autonomy, in addressing issues. This is not to argue that, in cases some relaxation of restrictions might be helpful. Appropriate independence not only enables accommodation to local circumstances but also encourages innovation.

Local governments in the five countries are primarily responsible to their citizen-voters. The organization of elections, councillor representation (e.g., wards versus at large), terms of office, number of representatives, etc. varies substantially and there are wide-ranging views of the pros and cons of the numerous alternatives but the elected representative system is common and vital. Senior governments typically, at least within guidelines, provide the basis for the representative structure. Public participation in local government goes well beyond elections. Hosts of citizen groups and interest groups with varying degrees of formal organization plus concerned individuals serve to monitor, evaluate, advocate, reveal preferences, etc. and, thus provide input into and influence the political processes and decision making. Information is, of course, important to the roles of voters and citizen groups.

LESSONS AND CONCLUSIONS

This review of local governments focussing on regional-local government fiscal relations affords a number of lessons. The inspection of local government situations in Australia, Canada, the United States, Germany and Denmark is valuable in that there is a great diversity in arrangements but all rank relatively well in terms of performance. This latter comment is not to suggest that there is not potential for improvements for, indeed, most analysts in the field would have suggestions in each instance. Those possibilities, however, help define the lessons. Not surprisingly, the lessons noted here parallel closely what would emerge from the study of many more countries. As is to be expected of a concluding section, the points made here can only highlight major conclusions. The lessons focus upon the results of the comparative analysis.

1. Finance follows function. There is no single best model for the assignment of expenditure responsibilities. Responsibilities can be bundled many potentially workable ways. Hence, there is considerable diversity in the functions and size of local governments. Once the expenditure assignment is made, however, the role of the revenue assignment is to structure a set of revenues that will enable local authorities to meet those duties efficiently and fairly.

2. In some cases, reassigning expenditure responsibilities may be the best way to match (better) finance with function.

3. The imposition of unfunded mandates can create problems for local governments. Quite different approaches are found in the different countries to the financial implications of mandates imposed on local governments. In Denmark and Germany, compensation for costs is given priority.

4. Own revenues (i.e., taxes and charges primarily) are preferred to transfers in the first instance but own revenues may be inadequate or inappropriate for financing some functions. Where taxes or charges are not suitable, transfers are called for but consideration may be given instead to expenditure or revenue reassignment.

5. The benefit principle is particularly important at the local level, and particularly for municipal governments, both across households and across communities.

6. Especially for municipal governments, careful (if not first) consideration should be given to beneficiary (user) charges that could provide a reasonable matching of benefits and costs. Where those are found inadequate or inappropriate, then turn to consider taxes and then transfers.

7. Local governments typically rely upon a variety of revenue sources and generate revenue from a number of taxes but, usually, a single tax dominates other tax sources. A tax is a local tax if the local government can set the tax rate (i.e., control the revenue). Local governments need control of their own revenues; that is, the ability to set their tax rates and charges.

8. Different taxes generate different distributions of costs and may be better suited to the finance of different services. Property taxes may correspond well to the benefits of services related to property but a local personal income tax may be better suited for funding services for which ability-to-pay is felt to dominate the benefit criterion or benefits are related to income; for example, hospitals and schooling as in Denmark.

9. Special business taxes (beyond the property tax) have mixed merits. On the one hand they may have the potential to match better taxes with the costs of associated services but, on the other, they appear to be used more often to shift or export the tax burden and mask costs to local residents.

10. Local sales taxes are more common than the survey here suggests but they have problems -- for example; border problems, tax exporting problems, uneven tax base problems, and lack of clarity of the benefit-cost linkage.

11. Local taxes should be stable (reliable), visible (transparent), promote accountability, have low administration and compliance costs, be nondistorting, fair (equitable), and adequate.

12. Transfers can have a legitimate purpose. Those roles are to correct economic distortions due to spillovers (externalities), close fiscal gaps, and equalize fiscal

capacities. The political role of grants may also be legitimate.

13. Grants should have a clear purpose, be allocated objectively, be non-negotiable, be relatively simple and be transparent (especially in regard to purpose and allocation), ensure accountability to donor and recipient, allow the autonomy and flexibility needed for effective utilization, be stable, be adequate to cover needs, and, when required, be equalizing.

14. Specific purpose grants, which are usually best suited for correcting externalities, are often over or miss used and often could be replaced by less restrictive funding.

15. If grants are for gap closing, the main issues are; what is the gap?, what revenue should be shared?, and how is the revenue to be distributed?

16. Intergovernmental transfers especially, and some would say the whole question of fiscal federalism, is about getting the incentives facing governments right.

17. Often, grants are unreliable and unstable revenue sources which change depending upon the donor's circumstances. Where workable, local taxes may be a more stable alternative.

18. Fiscal imbalance, a measure of the gap between own revenues and expenditures, is itself not a meaningful concept. The problem of fiscal (im)balance is more complex.

19. Local government is responsible for a disproportionate share of infrastructure investment. Funding that investment often requires borrowing. If not for other reasons, borrowing creates the potential for default and that invites supervision by senior governments. Senior governments can aid (especially small) local governments access the capital markets but they should promote responsible borrowing by enforcing hard budget constraints and by not being available for bailouts.

20. Accountability is essential for effective local government. Local governments must be accountable to their citizens, to senior governments (as needed), and to lenders.

21. Accountability requires information if the oversight of citizens, other governments, and lenders is to be effective. Information is also necessary for resource management and financial control.

22. Local governments need a civil service that has competence, integrity and motivation, that is evaluated on merit, and that is accountable to the council for implementing the council's programs and policies.

23. Ongoing and broadly based public participation is required and representatives need to be motivated to be attuned to that by the prospect of electoral defeat.

These lessons emerge primarily from investigation of the assignment problems; that is the assignment of expenditure and revenue responsibilities. Regional (senior) governments play an important role in defining the outcomes to these and a broader set of problems. That is, the regional governments have a major role in creating the institutions in which local governments operate and the development of these institutions is very much what regional-local relations are about. In thinking about these institutions and their development, regional and local governments need to contemplate a broad set of problems. Because arrangements, assignments and institutions themselves evolve from the interaction of many interests, an important consideration and objective is having meaningful intergovernmental relations where views are exchanged and alternatives considered. Other objectives that need be considered are achieving clarity of the mandates of each level of government, provision of adequate resources, allowing sufficient management discretion, and ensuring political accountability. Regional-local relations that pay attention to these matters will go some way towards having institutions and arrangements that will enable local governments to perform effectively.

Table 1

Local Government Expenditures, Selected Countries, 1998[a]
(Percentage Distribution and Amount)

	Australia	Canada	Denmark	Germany (1996)	United States
General Public Services	13.7	5.5	3.9	7.4	5.7
Public Order and Safety	2.4	9.1	0.3	3.4	10.9
Education	0.4	42.0	12.4	13.0	43.3
Health	2.1	1.4	16.2	14.5	8.9
Social Security and Welfare	6.3	7.0	57.5	24.6	7.8
Housing and Community Amenities	18.7	5.5	1.0	15.3	2.0
Recreation, Culture, Religious	17.7	6.4	2.9	5.7	3.4
Fuel and Energy	0.2	3.4	0.0[b]	0.1	0.0
Agriculture, Forestry, Fishing	1.3	0.3	0.0[b]	0.6	0.6
Transportation and Communications	27.5	11.3	2.7	6.0	6.0
Other Economic Affairs and Services	3.9	3.1	2.2	4.1	0.5
Other	5.8	5.1	0.7	5.3	10.9
TOTAL					
- percent[c]	100.0	100.0	100.0	100.0	100.0
- millions (domestic currency)	12,846	73,988	379,479	329,900	750,980
- as % consolodated gov't expenditure	6.1	18.1	59.2	18.0	26.2
- as % of GDP	2.2	8.1	32.6	9.2	8.8
Other Government Expenditure as a % of GDP[d]					
- state	15.7	19.2	---	10.6	4.3
- federal/central	15.5	18.3	24.8	31.8	17.9
- total government	33.4	45.6	55.9	51.2	30.9

Source: Calculated from data in the Government Finance Statistics Yearbook, (Washington, D.C.: International Monetary Fund, 2001).

Notes: a) Except Germany which is for 1996.
b) Negligible amounts.
c) May not sum to 100.0 due to rounding.
d) Expenditure net of grants to other governments.

Table 2

Local Government Revenues, Selected Countries, 1998[a]
(Percentage Distribution and Amount)

	Australia	Canada	Denmark	Germany (1996)	United States
Total Tax	44.8	43.2	50.9	30.6	38.9
- income and profit	---	---	47.7	23.9	2.4
- property	44.8	40.3	3.2	6.4	28.4
- goods and services	---	0.0[b]	0.0[b]	0.3	8.1
- other taxes	---	2.8	---	0.1	---
Non Tax Income	32.6	17.5	8.1	32.8	23.9
- enterprise and property	3.0	2.9	1.2	3.4	10.8
- fees, sales, fines	24.3	13.9	5.8	24.7	11.7
- other non tax	5.3	0.7	1.1	4.7	1.4
Capital Revenue	6.2	---	0.7	4.2	0.1
Grants	16.4	39.3	40.3	32.5	37.0
Total Revenue					
- percent[c]	100.0	100.0	100.0	100.0	100.0
- millions (domestic currency)	12,572	73,049	361,943	321,240	774,290
- as % of consolidated gov't revenue	5.9	17.9	54.3	18.8	25.0
- as % of GDP	2.1	8.0	31.1	8.9	9.0
Other Government Expenditure as a % of GDP					
- local	1.8	5.0	18.6	6.1	5.7
- state	10.1	18.6	---	10.1	9.4
- federal/central	23.9	21.5	38.6	31.6	21.1
- total government	35.8	45.1	59.8	47.7	36.1

Source: Calculated from data in the Government Finance Statistics Yearbook, (Washington, D.C.: International Monetary Fund, 2001).

Notes: a) Except Germany which is for 1996.
b) Negligible amounts.
c) May not sum to 100.0 due to rounding.

Table 3

Australian Local Government Revenue, Expenditure and Grants, 1999-2000

Revenue	Millions	Percentage
Taxation	6,001	37.2
Sale of Goods and Sevices	5,143	31.9
Interest	406	2.5
Grants and Subsidies	2,050	12.7
Other Revenue	2,529	15.7
Total Revenue	$16,129	100.0

Expenditures			Supporting Grants		
	Millions	Percentage	Commonwealth and State Grants Millions	Commonwealth Specific Purpose Grants (2000-01) Millions	Total Amounts as % of Expenditure Millions
General	2,588	17.4	20	---	7.7
Public Order and Safety	281	1.9	65	---	23.1
Education, Health and Welfare	1,051	7.1	16	68.1	8.0
Housing and Community Amenities	3,390	22.8	900	---	26.5
Recreation and Culture	1,938	13.1	128	---	6.6
Transport and Communication	4,378	29.5	549	39.7	13.4
Other	1,212	8.1	782	3.7	19.9
Total Expenditure	$14,838	100.0	$2,460	$111.4	17.3

Source: Australia, National Office of Local Government (2001, Ch 2)

Table 4
Revenues of Canadian Municipal Governments and School Boards, 1998

	Municipal Governments	School Boards
Property Taxes	56.7	21.8
Other Taxes	1.2	---
User Fees	20.7	3.1
Investment Income	4.9	0.1
Other	1.1	0.1
Total Own-Source Revenue	84.6	25.1
Unconditional Grants	2.9	---
Conditional Grants	12.4	74.9
- provincial	11.8	74.7
- federal	0.7	0.2
Total Revenue		
- percent	100.0	100.0
- millions of dollars	42,914	31,074
- % of GDP	4.7	3.4

Source: Kitchen (2000)

Table 5

Revenues of School Districts and General Purpose Local Governments in the United States, 1998 (Percent)

	School Districts (1997-98)	General Purpose Local Governments (1998)
Taxes		
property taxes	28.9	26.8
taxes on sales		10.3
income taxes		4.0
other taxes	1.1	2.3
Contributions of parent gov't	8.4	-6.0
Charges	2.6	25.0
Miscellaneous	3.4	10.8
Intergovernmental Transfers		
federal	6.6	1.9
state	49.0	24.4
Total Revenue		
percent	100.0[a]	100.0[a]
dollars (billions)	$327.2	$467.1
% of GDP	3.8	5.4

Source: Authors Calculations from US Bureau of the Cenus, Annual Survey of Government Finances http://www.census.gov/

Note: a) May not sum to 100.0 due to rounding.

Table 6

Expenditure and Revenue of Denmark's Governments, 1994 (Billions of Kroner)

	Central Government	Counties	Municipalities	Copenhagen & Frederiksberg	Total Local Government	General Government
Expenditure						
Social Policy	7.8	6.5	65.6	12.8	84.9	92.8
General Old-Age Pensions	-1.8	---	69.3	10.7	80.0	78.2
Unemployment	57.3	0.8	8.2	1.3	10.3	67.7
Health	3.1	34.4	3.0	6.2	43.6	46.7
Education	25.7	6.5	23.3	2.2	32.0	57.7
Interest	62.8	-0.3	0.2	0.5	0.4	63.2
Other	93.0	8.5	26.1	5.2	39.8	132.8
Total Current and Capital Expenditure	247.9	56.5	195.8	38.9	291.2	539.1
Revenues						
Taxes						
Income Tax	105.1	38.5	79.6	16.7	134.8	239.9
Property Tax	---	3.2	5.1	2.0	10.3	10.4
Value-Added Tax & Excises	141.0	---	---	---	---	141.0
Other Taxes	28.6	0.0	0.8	0.1	0.9	29.5
Total Tax Revenues	274.8	41.8	85.5	18.8	146.1	420.8
General Grants to Local Governments	-34.7	12.3	18.3	4.2	34.8	0.0
Compensation for Old-Age Pension Expenditure	-77.5	---	67.0	10.4	77.4	0.0
Other Specific Grants	-28.9	0.0	25.2	3.6	28.8	0.0
Total Grants	-141.0	12.3	110.6	18.2	141.1	0.0
Fees and Charges	43.1	---	---	0.2	0.2	43.3
Interest	16.7	---	---	---	---	16.7
Borrowing Net	52.8	0.5	1.1	1.9	3.5	56.3
Other Income	1.6	2.1	-1.5	-0.2	0.4	2.0
Total Revenues	247.9	56.5	195.8	38.9	291.2	539.1

Source: Ahmad (1997, p 189)

Appended Table (Table 7)
Relative Government Expenditures for Selected Countries, 1993

	Expenditure by Level (%)					
	Central	State / Provincial	Local	Government Expenditure as % of GDP	Local Government Expenditure as % of GDP	Percentage of Local Government Outlay Funded by Transfers
Total General Government						
Australia (1993)	51.1	42.6	6.4	41.2	2.6	18.6
Canada (1991)	40.8	40.4	18.9	50.8	9.6	43.3
Denmark (1992)	46.0	---	54.0	60.9	32.9	42.7
France	81.3	---	18.7	53.7	10.1	34.7
Germany (1991)	61.3	21.4	17.4	45.4	7.9	27.0
Netherlands	69.8	---	30.2	57.8	17.5	69.2
United Kingdom	72.6	---	27.4	45.6	12.5	73.2
United States	55.9	19.9	24.2	36.2	8.8	39.3
EU - Average	66.2	21.4	29.5	52.7	16.2	49.4
Average	61.0	31.1	24.7	49.0	12.7	43.5
Education						
Australia (1989)	9.8	90.0	0.2	4.6	0.0	60.6
Canada (1991)	4.4	33.7	61.9	6.3	3.9	67.4
Denmark (1992)	54.1	---	45.9	7.7	3.5	8.8
Germany (1991)	1.9	75.1	23.0	3.2	0.7	13.0
United Kingdom	27.3	---	72.7	5.6	4.1	8.3
United States	4.2	24.1	71.7	5.3	3.8	52.6
EU - Average	27.7	75.1	47.2	5.5	2.8	10.0
Average	16.9	55.8	45.9	5.4	2.7	35.1
Health						
Australia (1989)	41.7	57.5	0.9	5.2	0.0	2.5
Canada (1991)	2.0	90.3	7.7	7.2	0.6	46.3
Denmark (1992)	8.1	---	92.0	5.4	5.0	0.6
Germany (1991)	71.8	13.3	14.9	6.9	1.0	3.8
Netherlands	93.6	---	6.4	7.8	0.5	8.3
United Kingdom	100.0	---	0.0	5.8	0.0	---
United States	46.4	40.1	13.6	5.7	0.8	16.9
EU - Average	68.4	13.3	28.3	6.5	1.6	4.2
Average	51.9	50.3	19.3	6.3	1.1	13.1

Appended Table (Table 7) cont'd

Transportation & Communication						
Australia (1989)	11.0	61.8	27.2	2.4	0.7	16.4
Canada (1991)	30.2	32.3	37.5	2.7	1.0	24.8
Denmark (1992)	53.7	---	46.3	2.1	1.0	0.3
Germany (1991)	57.2	17.0	25.8	2.0	0.5	32.2
Netherlands	46.4	---	53.6	2.5	1.4	30.0
United Kingdom	38.5	---	61.6	1.2	0.7	0.5
United States	20.9	45.0	34.0	1.6	0.5	25.7
EU - Average	49.0	17.0	46.8	1.9	0.9	15.7
Average	36.8	39.0	40.9	2.1	0.8	18.5

Sources: Government Finance Statistics Yearbook, (Washington, D.C.: International Monetary Fund, 1995).

Notes: 1. Data are for 1993 except for Australia, Canada, Denmark, and Germany, which are 1989, 1991, 1992, and 1991 respectively.
2. Expenditures are net of transfers to other governments.
3. For the Netherlands, the interpretation of education spending is uncertain. In 1993, central education grants exceed provincial and local spending on education. As a result, the data is excluded.
4. For France, transfers to local governments have not been identified by function since 1985.

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ENDNOTES

1. Extensive discussion of Australian local government are found in Australia, National Office of Local Government (2001) and Jones in Hesse (1991). For a broader perspective on Australian government and public finance and the role of local government within that, see Craig in Ter-Minassian (1997), Mathews and Grewal (1997) and OECD (1997). While Norton (1994) does not specifically focus on Australia, a number of useful insights into the Australian system can be found there.

2. Data from the IMF, like that in Tables 1 and 2, provides information that is internationally comparable. Domestic data is often compiled in ways that vary somewhat across countries and can make cross-country comparisons based on such data questionable. Domestic sources, however, often provide additional useful information. Hence, as here, resort is made to both domestic and IMF sources.

3. Among other potentially interesting data, the appended table (entitled Table 7 for convenience) shows the share of certain local government expenditures which are funded by intergovernmental transfers. However, because the information exists for only three expenditure subcategories and dates back to the early 1990s, the table is relegated to appendix status.

4. For a broad discussion of local government in Canada see Higgens in Hesse (1991), Norton (1994), OECD (1997) and Tindal and Tindal (1995).

5. Ontario is somewhat of an exception in that local governments there carry a much larger responsibility for social services/assistance than in the other provinces.

6. Sources of information include Gunlicks in Hesse (1991), Norton (1994), OECD (1997), Ter-Minassian (1997), Fisher (1996), International City/County Management Association (2000), Tax Foundation (2000) and U.S. Bureau of the Census (2001).

7. See, for example, Berman in International City/County Management Association (2000).

8. See Table 439 of the U.S. Census Bureau's *Annual Survey of Government Finances* at http:www.census.gov/gov/.

9. For example, see Dumcombe and Yinger (1998) and, for a general discussion, McMillan (2001).

10. Particularly valuable references include Bennett and Krebs in Gibson and Batley (1993), Gunlicks (1989), Hesse (1991), Norton (1994), OECD (1997), Spahn and Fottingre in Ter-Minassian (1997), Wurzel (1999) and Zimmerman in King (1992).

11. Local councillors are elected through proportional representation but with considerable personal voter discretion over the composition of the party lists that they ballot. The option of appealing to a referendum is available to council and to the public but with usually only if a relatively large percentage of voters (e.g., 15 percent) petition for it.

12. Spahn and Fottinger in Ter-Minassian (1997, p 229) refer to the possibility that the tax on working capital (a small part of the total business tax) might have disappeared after 1998 if proposed legislation passes. The revenue loss of municipalities would be offset by an expanded share of the VAT.

13. Information sources include Hesse (1991), Lotz in Ahmad (1997), Lotz in Rattso (1998), National Association of Local Authorities in Denmark (1999), Nissen in Batley and Stoker (1991), Norton (1994), OECD (1997) and Oulasvirta in Gibson and Batley (1993).

14. The criteria adopted here are outlined and illustrated in McMillan (forthcoming). Those criteria which form the conceptual model employed here emerge from many sources as the numerous references in McMillan (forthcoming) demonstrate. Valuable

references include Ahmad (1997), Bird and Vaillancourt (1998) and Ter-Merassian 1997).

15. In Canada, the extension of natural person powers of local government across more provinces should facilitate and extend local governments' options.

16. For some further discussion specific to local infrastructure finance, see Ter-Minassian and Craig in Ter-Minassian (1997) and von Hagen et al. (2000).