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Chapter 1 : Intergovernmental Fiscal Transfers : Principles and Practice

The structure of these transfers creates incentives for national, regional, and local governments that have a bearing on fiscal management, macroeconomic stability, distributional equity, allocative efficiency, and public services delivery.

Introduction Intergovernmental fiscal transfers are an important tool of public sector finance in both industrialized and developing countries for three principal reasons. First, central governments have advantages over subnational governments in raising revenue from many types of particularly productive sources, while subnational governments have advantages in providing many types of public services. This reality invariably results in a mismatch between the costs of expenditures that subnational governments are expected to undertake and the resources locally available to them. Second, there are often substantial disparities in revenue-raising capacity across decentralized levels of government. If subnational governments were left to rely exclusively on their own resources, wealthier jurisdictions would be able to spend more on public services than lower-income jurisdictions. Such a situation has not only equity implications but efficiency implications as well. If decentralized governments are responsible for infrastructure and services that are essential production inputs, areas with lower resource levels may be unable to support local economic development. Third, resources from the central level can be used to ensure that basic national priorities will be met in all subnational jurisdictions. Typical priority sectors include health and education, but often extend to roads, water, and other services. Providing these services may promote both efficiency if externalities are involved and equity, and also support poverty reduction efforts. Asian Development Bank ADB , like other international development agencies, has been focusing more attention on supporting the reform of local government finance in recent years. This has occurred as part of a broader 2 Intergovernmental Fiscal Transfers in Asia paradigm shift in which the public sector is being decentralized and subnational governments have growing resource requirements. The decentralization trend is based on a belief that the participation of a variety of key local stakeholders, including subnational governments and local communities, is critical to realize development and poverty reduction goals. There has also been a growing recognition of the need for broader partnerships among the various levels of the public sector, the private sector, civil society, and international development agencies in promoting more equitable and sustainable development. The developing Asia and Pacific region as a whole has achieved unprecedented sustained growth and development in the past three decades, with many countries rebounding from the serious economic crisis in In South Asia, poverty rates declined moderately during the s, but the actual numbers of poor have increased. The Asia and Pacific region is thus central to the fight against global poverty, to which ADB is firmly committed. ADB believes that the countries of the region need to address the challenges of equitable growth in a systematic manner. Large investments are required in social services, such as education and health, and in other basic services, such as water, sanitation, and shelter, especially in the poorer countries. In addition, promoting the participation of all stakeholders in decision making and giving them equitable access to assets and opportunities are expected to help maximize the benefits of growth and make development more broad based. A key dimension of this approach involves strengthening capacity at subnational levels, including provinces, states, municipalities, and local communities, where stakeholders in development live and where development and poverty reduction occur. In this context, intergovernmental transfers play a critical role in providing resources, alleviating resource disparities, and creating incentives for improved performance by decentralized governments. Against this broader background of reform, this volume examines the achievements and challenges of intergovernmental fiscal transfers in Asia. The Role and Challenges 3 member countries are presented. Most of the cases focus on larger countries, including India, Indonesia, Pakistan, and the Philippines, but one smaller country with an emerging local government system, Cambodia, is also included. The chapters on India, Pakistan and the Philippines were commissioned specifically for an ADB study,2 while the papers on Cambodia and Indonesia were added to provide a broader set of comparative cases. The rest of this introductory chapter has four sections. First, we consider in more detail why there has been a growing international interest in reforming intergovernmental fiscal transfers in recent years. Second, we review the role of international development agencies, particularly Asian Development Bank, in supporting decentralization, including the reform of intergovernmental fiscal transfers. Third, we summarize some key trends and challenges involved in improving the design of intergovernmental transfer programs, drawing on material from the Asian cases included here. Finally, we briefly outline the contents of the rest of this volume. The Growing Interest in Intergovernmental Transfers International interest in developing efficient and equitable intergovernmental transfers has been growing in recent years for a number of interrelated reasons. First, many countries faced with deteriorating or uncertain economic conditions have been under major pressure to improve the overall fiscal performance of the public sector, including subnational governments. As central governments carve out stronger roles for subnational governments, national leaders need to make certain that adequate resources are placed at the disposal of local communities. Even countries with impressive growth have not carried the poorest elements of society with their rise, and poverty generally increased in the countries where growth has been weak. Improving the Fiscal Performance of Subnational Governments General economic and fiscal difficulties have been forcing central governments of developing countries to improve public resource management. The financing of adequate public services, which is widely recognized as critical to support economic growth and basic equity goals, has been a particularly great challenge for developing countries. Where subnational borrowing occurs, often in the form of loans from multilateral development banks re-lent by central agencies to lower levels, it is heavily and nontransparently subsidized, and local repayment is often highly inadequate. During this period, many donors and governments believed that subsidization would improve equity in service provision and help reduce poverty. Over time, intergovernmental fiscal arrangements came to be seen as unsustainable for a number of reasons. Second, excessive subsidization undermines incentives for subnational governments to recover costs, potentially resulting in overconsumption. Finally, there is increasing evidence that the poverty alleviation effects of subsidized services are exaggerated; in fact, subsidization as commonly practiced often primarily benefits higher income residents. Faced with these realities and structural adjustment pressures, many countries have undertaken major reforms of intergovernmental fiscal mechanisms. Schroeder ; Bahl and Linn , Ch. The Reemergence of Decentralization Two emerging realities collectively generated a growing interest in developing or reviving local government. Many countries had responded not only with the above-mentioned fiscal management reform, but also with efforts to off-load responsibilities to subnational governments, either purely to reduce national budget outlays or because subnational governments were seen as underutilized and possibly having untapped revenue potential. Second, changing political climates also encouraged the development of subnational governments in developing countries. As people became more educated, better informed about international trends through improved communications, and more aware of the problems of central bureaucracies, they desired to bring the control of government functions closer to themselves. Many countries had moved towards greater democracy as military regimes and dictatorships were forced to relinquish power and institute political reforms that increasingly included decentralization. The Subnational Role in Poverty Reduction and Local Economic Development With uneven development and poverty on the rise in many developing countries and the inadequate performance of many nationally managed programs on local economic development and poverty alleviation, some countries are turning to subnational governments to carry a greater burden in this important public function. Although redistribution is considered primarily a central government responsibility, there is growing recognition that subnational governments can play a role in intrajurisdictional redistribution and in implementing national policies. Under such circumstances, transfers from the center to support poverty alleviation can be very productive. More generally, there has been an increasing attention in recent 10 11 World Bank , Chapter 5. Huntington ; Diamond ; Manor The Role of International Development Agencies and ADB International development agencies have increasingly supported for more than a decade the new focus on a greater fiscal role for local governments. In India, for example, states have considerable autonomy and play a crucial role in the delivery of social services particularly public health, family welfare, social security, education, housing, and urban development and the 12 There is a substantial and diverse literature that focuses on the benefits of decentralization and its role in development. The Role and Challenges 7 provision of infrastructure particularly power, irrigation, flood control, and transport. The states are also responsible for executing federal government policies and programs, including those for alleviating poverty. While economic reforms introduced since have contributed substantively to enhanced efficiency, competition, and the potential for higher economic growth, the initiatives have been concentrated almost exclusively at the national level, with the pace and depth of reform generally lagging at the state level. This is among the most urgent challenges that India needs to address. Moreover, states are increasingly facing the possibility of a domestic debt trap, with new loans needed to service outstanding debt. Without strong measures at the state level, especially with regard to improved fiscal performance and sectoral policy reforms, the effectiveness of central government reforms in promoting sustainable development will be limited. ADB support includes assisting in reforms in budgeting and tax administration, intergovernmental fiscal relations, public enterprise restructuring, private sector participation, and subnational government capacity building. In Pakistan, similar types of changes and challenges are occurring. Several studies on intergovernmental fiscal relationships have been undertaken in recent years. In Indonesia, the central government is accelerating a newly instituted process of decentralization and local government reform as part of its economic recovery measures. These efforts are intended to help improve the responsiveness and efficiency of basic services at the local level, stimulate development, and alleviate poverty. The specific objectives of the program are to i help restore economic activity and reduce poverty; ii support ongoing decentralization efforts; iii increase the capacity of local governments to implement local public works; iv improve the level and sustainability of basic public services; v empower villages and civil society to participate more fully in 8 Intergovernmental Fiscal Transfers in Asia local development; and vi improve transparency, governance, monitoring, and accounting procedures at the local level. In the Philippines where the decentralization program is rather advanced, ADB has placed an emphasis on supporting local development projects in particular regions rather than national-level policy development. In addition, ADB is the major source of loans in the Philippines for rural infrastructure projects, and it has been supporting efforts to promote private sector participation in local government infrastructure development projects. This program also seeks to promote the development of effective mechanisms for coordinating decentralization activities among government ministries, among international agencies providing related assistance, and between the government and the international agencies. The assistance to these developing member countries to improve decentralization and intergovernmental fiscal transfers is a recent development for ADB. Challenges in Designing and Implementing Intergovernmental Transfers The discussion above indicates that intergovernmental transfers play a critical role in the system of public finance in most developing countries for good reasons that have become even stronger in recent years. Transfers, however, are often controversial, and they can be challenging to design and implement effectively. A number of concerns are important. First, even if national officials recognize that stable sources of revenue are necessary for subnational governments to meet their increasing responsibilities, many worry about the macroeconomic implications of institutionalizing major intergovernmental transfer programs. Second, intergovernmental transfers are often intended to meet a variety of difficult, and sometimes conflicting, objectives. Choices have to be made about priorities, and different types of programs are often required to meet different objectives. Third, devising mechanisms to allocate intergovernmental transfers to meet particular objectives can be challenging. Selecting appropriate allocation criteria is difficult, and measuring them appropriately can be even more problematic. Fourth, transfers commonly suffer from political and institutional interference that compromises their ability to meet their intended objectives. Finally, the overall effect of intergovernmental transfers and other The Role and Challenges 9 national policies related to subnational governments on broader development goals is difficult to determine. Each of these concerns is discussed briefly as they relate primarily to countries covered in this volume. Macroeconomic Concerns Historically, there has been considerable concern in many countries that macroeconomic problems can be created if too large a percentage of central resources are guaranteed to subnational governments each year. In some cases where the volume of resources being transferred to subnational governments is substantial, these fears are not unfounded. Fixed arrangements reduce central government control over the disposition of public resources, and a substantial proportion of subnational governments in many developing countries have weak capacity and may not use resources well. The potential dangers of guaranteed allocations, however, must be balanced against the value of providing subnational governments a reasonably stable revenue base and the potential microeconomic gains of decentralized service delivery. Despite potential concerns about the loss of fiscal flexibility of central government and the performance of local governments, most of the cases have elected to institutionalize a fixed percentage of a major tax, a group of taxes, or total domestic revenues as the pool of resources to be allocated to subnational governments through intergovernmental transfers. In some cases, this percentage is very substantial and fixed by legislation. In Pakistan, the pool of resources devoted to the main intergovernmental transfer program is also high. It is comprised of Rather than being fixed by law, the definition of the pool can change based on the recommendations of a periodically constituted National Finance Commission. Cambodia, however, only elected its first local governments in Their responsibilities are initially 10 Intergovernmental Fiscal Transfers in Asia modest, and international agencies provide substantial additional resources to the transfer fund. There is no danger of macroeconomic problems at current levels of funding, and there is plenty of room for growth as Cambodia has one of the smallest public sectors in the world. While the institutionalization of significant transfers increases the legitimacy, stability, and financial viability of subnational governments, problems can arise from deficiencies in the structure of the transfer systems. The contribution of state governments in India to the overall public sector deficit, for example, has been steadily growing in recent years, and this is found to be attributable in part to incentives imbedded in the national transfer programs. Transfers in the Philippines have greatly improved the overall access to revenues of subnational governments, but in a way that appears to aggravate fiscal imbalances among the various types of subnational governments. Disbursement problems and, in some cases, continued revenue shortfalls in Pakistan have induced the provinces to resort to borrowing, while there are concerns in Indonesia that local governments are actually receiving more resources from the center than they require and can manage responsibly.

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The design of these transfers is of critical importance for efficiency and equity of local service provision and fiscal health of subnational goverments. Taxonomy of grants For the purpose of economic analysis, grants can be broadly classified into two categories: Non-matching transfers may be either selective conditional or general unconditional. Selective non-matching transfers offer a given amount of funds without local matching, provided they are spent for a particular purpose. If the recipient is already spending an amount equal to grant funds, some or all of the grant funds may be diverted to other uses. In theory, due to fungibility of funds, increase in expenditures on the specified category would only at the limit equal to grant funds; in practice it is possible that the lumpiness of investments in areas such as infrastructure may result in increases in expenditures exceeding grants. If the non-matching grant is unconditional or general, no constraints are put on how it is spent and unlike conditional grants, no minimum expenditure in any area is expected. Since the grant can be spent on any combination of public goods or services or to provide tax relief to residents, general non-matching assistance does not modify relative prices and is the least stimulative of local spending. This is referred to as the "flypaper effect. Selective Conditional Matching Transfers: Selective matching grants or cost-sharing programs require that funds be spent for specific purposes and that the recipient match the funds to some degree. Hence both effects stimulate expenditures on the assisted category. Such transfers can be open-ended no limit on matching funds or closed-ended. Matching transfers may distort local priorities and be considered inequitable in that richer jurisdictions can raise matching funds more easily. But the latter problem can be offset, if desired, by varying matching rates with jurisdictional wealth and the former may be the desired outcome when the transfer is intended to e. The Conceptual Impact of Conditional Grants Economic rationale for transfers and implications for grant design We can identify five broad economic arguments for central-state transfers each of which is based on either efficiency or equity, and each of which may apply to varying degrees in actual federal economies. The fiscal gap An imbalance between the revenue-raising ability of subnational governments and their expenditure responsibilities the "vertical imbalance" might arise for two reasons. First, there may be often inappropriate assignment of taxing and spending responsibilities such that expenditure needs of subnational governments exceed their revenue means. Second, many taxes are more efficiently collected at the central level responsibilities to avoid tax competition and interstate tax distortions, so transfers are necessary to enable local levels to carry out their expenditure responsibilities. Fiscal inequity A country which values horizontal equity i. Subnational governments with their own expenditure and taxation responsibilities will be able to provide their residents different levels of services for the same fiscal effort owing to their differing fiscal capacities. If desired, these differences may be reduced or eliminated if the transfers to each jurisdiction depend upon its tax capacity relative to others, and upon the relative need for and cost of providing public services. Fiscal inefficiency The argument for such transfers is reinforced by the fact that the same differentials which give rise to fiscal inequity also cause fiscal inefficiency. Interstate spillovers This is the traditional argument for matching conditional grants. Normally, subnational governments will not have the proper incentive to provide the correct levels of services which yield spillover across jurisdictions. In theory, a system of matching grants based on the expenditures giving rise to the spillovers will provide the incentive to increase expenditures. In practice, the extent of the spillover will be difficult to measure so the correct matching rate to use will be somewhat arbitrary. Fiscal harmonization To the extent that the central government is interested in redistribution as a goal, there is a national interest in redistribution that occurs via the provision of public services by the subnational governments. Expenditure harmonization can be accomplished by the use of non-matching conditional grants, provided the conditions reflect national efficiency and equity concerns, and where there is a financial penalty associated with failure to comply with any of the conditions. In choosing such policies there will always be a trade-off between uniformity, which may encourage the free flow of goods and factors, and decentralization which may encourage innovation, efficiency and accountability. As Bahl and Linn show and as discussed earlier, the most appropriate form of a transfer depends in large part upon its objective. See Chart Regardless of the particular design, however, experience demonstrates that good intergovernmental transfer programs have certain characteristics in common: Transfers are determined as objectively and openly as possible, ideally by some well-established formula. They are not subject to hidden political negotiation. The transfer system may be decided by the central government alone, by a quasi-independent expert body e. They are relatively stable from year to year to permit rational subnational budgeting but at the same time sufficiently flexible to ensure that national stabilization objectives are not thwarted by subnational finances. One system that appears to achieve this dual objective is to set the total level of transfers as a fixed proportion of total central revenues, subject to renegotiation periodically say, every years. The formula or formulae, if there is more than one grant are transparent, based on credible factors, and as simple as possible. Unduly complex formulae are most unlikely to prove either feasible or credible in developing countries because there are often serious disputes on fundamental issues such as regional population sizes. If several of the objectives discussed earlier are applicable - for example, some degree of equalization is desired while at the same time there are clear national policy objectives, e. Revenue Sharing Many countries attempt to achieve various of the objectives ascribed above to transfers through systems variously described as "tax sharing" or "revenue sharing. First, if they are partial, that is, do not apply to all national taxes but only to a subset of such taxes, they may bias national tax policy. Second, if - as is often the case - they share the revenues from origin-based production taxes to the jurisdictions from which the revenues are collected, they break the desirable link between benefits and costs at the local level and hence reduce accountability and the efficiency of decentralization. Third, since in such systems tax rates are invariably set by the central government, and in addition since the sharing rate is often applied uniformly throughout the country, once again the accountability link is broken and subnational governments have no incentive to ensure that the amount and pattern of their spending is efficient. In addition, if, as in some of the transitional countries, such taxes are collected by local governments and then supposedly shared with national governments - and in this case perhaps especially if the sharing rates are higher more flows upwards for richer areas - either an undesirable disincentive for collection effort is created or, more usually, the temptation to "cook the books" is likely to be overwhelming. Practical guidance on the design of these transfers is summarized in the following: Criteria for the design of intergovernmental fiscal arrangements Autonomy Subnational governments should have complete independence and flexibility in setting priorities, and should not be constrained by the categorical structure of programs and uncertainty associated with decisionmaking at the center. Revenue adequacy Subnational governments should have adequate revenues to discharge designated responsibilities. Equity Allocated funds should vary directly with fiscal need factors and inversely with the taxable capacity of each province. Efficiency The grant design should be neutral with respect to subnational government choices of resource allocation to different sectors or different types of activity. The current system of transfers in countries such as Indonesia and Sri Lanka to finance lower level public sector wages contravenes this criterion. The formula should be easy to comprehend so that "grantmanship" is not rewarded, as appears to occur with plan assistance in India and Pakistan. Incentive The proposed design should provide incentives for sound fiscal management and discourage inefficient practices. There should be no specific transfers to finance the deficits of subnational governments. This is accomplished by proper monitoring, joint progress reviews, and providing technical assistance, or by designing a selective matching transfer program. The various criteria specified above could be in conflict with each other and therefore a grantor may have to assign priorities to various factors in comparing policy alternatives.

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Chapter 3 : Intergovernmental Transfer

Intergovernmental fiscal transfers are a dominant feature of subnational fiancÃ© in most countries.

Backlogs, by South African Province Simulation 1: Backlogs, by South African Province Simulation 2: Sound public sector management and government spending help determine the course of economic development and social equity, especially for the poor and other disadvantaged groups, such as women and the elderly. Many developing countries, however, continue to suffer from unsatisfactory and often dysfunctional governance systems that include rent seeking and malfeasance, inappropriate allocation of resources, inefficient revenue systems, and weak delivery of vital public services. Such poor governance leads to unwelcome outcomes for access to public services by the poor and other disadvantaged members of the society, such as women, children, and minorities. In dealing with these concerns, the development assistance community in general and the World Bank in particular are continuously striving to learn lessons from practices around the world to achieve a better understanding of what works and what does not work in improving public sector governance, especially with respect to combating corruption and making services work for poor people. The Public Sector Governance and Accountability Series advances our knowledge by providing tools and lessons from practices in improving efficiency and equity of public services provision and strengthening institutions of accountability in governance. The series xv xvi Foreword highlights frameworks to create incentive environments and pressures for good governance from within and beyond governments. It outlines institutional mechanisms to empower citizens to demand accountability for results from their governments. It provides practical guidance on managing for results and prudent fiscal management. It outlines approaches to dealing with corruption and malfeasance. It provides conceptual and practical guidance on alternative service delivery frameworks for extending the reach and access of public services. The series also covers safeguards for the protection of the poor, women, minorities, and other disadvantaged groups; ways of strengthening institutional arrangements for voice and exit; methods of evaluating public sector programs; frameworks for responsive and accountable governance; and fiscal federalism and local governance. This series will be of interest to public officials, development practitioners, students of development, and those interested in public governance in developing countries. They are used to ensure that revenues roughly match the expenditure needs of various levels of subnational governments. They are also used to advance national, regional, and local objectives, such as fairness and equity, and to create a common economic union. The structure of these transfers creates incentives for national, regional, and local governments that affect fiscal management, macroeconomic stability, distributional equity, allocational efficiency, and public service delivery. This book reviews the conceptual and empirical literature to distill lessons for policy makers looking to design fiscal transfers in a manner that creates incentives for prudent fiscal management and effective service delivery. It covers new ground by providing practical guidance on designing output-based transfers that emphasize bottom-up, client-focused, and results-based government accountability and equalization transfers to ensure regional fiscal equity as well as the institutional arrangements for implementing such transfers. This book advances the World Bank Institute agenda on knowledge sharing and learning from cross-country experiences with a view to supporting public governance better. It is intended to help policy makers make more-informed choices about strengthening public sector governance and improving social outcomes for their citizens. Roumeen Islam Manager, Poverty Reduction and Economic Management World Bank Institute xvii Acknowledgments This book brings together training modules on intergovernmental fiscal transfers prepared for the World Bank Institute learning programs over the past three years. These learning programs were financed by the governments of Canada, Italy, Japan, the Netherlands, the Republic of Korea, and Switzerland. The editors are grateful to the leading scholars who contributed chapters and to the reviewers, especially Sandra Roberts, who provided comments on all chapters. Maria Lourdes Penaflor Gosiengfiao provided administrative support for this project. He provides expert advice xxi xxii Contributors on fiscal federalism, decentralization, and local public finance to the Council of Europe and the World Bank Institute. He also advises Swiss cantons and the federal government of Switzerland. She is the author of Federal Intergovernmental Grants and the States: Managing Devolution and numerous scholarly articles in tax and public finance journals. She coauthored a report by the Transportation Research Board of The National Academies that reviews the long-term viability of the fuel tax for transportation finance in the United States. He has published widely on public finance, local and regional government organization, and service delivery. He has advised governments in both industrial and developing countries on a range of fiscal system reform and local governance issues. His research interests are in applied macroeconomics and econometrics. He has published widely in international academic journals. His research interests are in public economics, particularly urban and local economics, fiscal federalism, and the demand for and supply of public goods and services. He has served on the editorial board of the Canadian Tax Journal. He is assistant director of the Special Court for Sierra Leone legal clinic, which conducts legal research for judges of the Trial and Appeals Chamber in Freetown. He is also executive director of The Future Group, a nongovernmental organization that combats human trafficking. After completing his graduate research, he will serve as a law clerk to Justice Marie Deschamps of the Supreme Court of Canada. He has published on fiscal equalization, tax competition, the theory of voting, and the economic implications of various Australian constitutional arrangements. His research interests include public finance and fiscal policy, fiscal federalism, and state and local finance. He has written numerous articles on intergovernmental fiscal relations and tax policy. He has also worked for the Office of Tax Analysis of the U. Department of the Treasury and as a technical adviser to the Organisation for Economic Co-operation and Development in Paris. He is currently organizing an international cooperative project designed to evaluate alternative strategies for dealing with fiscal problems facing large central cities. His fields of research include fiscal federalism, tax policy, and social security. While working for the government of Alberta, he was responsible for designing provincial fiscal transfers to local governments. While at the federal Ministry of Finance in Ottawa, he was responsible for designing and administering federal fiscal xxiv Contributors transfers to the provinces, with primary responsibility for the Canadian Fiscal Equalization Program. She is president of her own consulting firm, which specializes in municipal, education, and intergovernmental finance. She advises governments and private companies on property taxes, intergovernmental transfers, and other local finance issues. She has coauthored four books and published numerous articles on urban public finance. He has written extensively on tax policy and fiscal federalism. He has served as vice president of the University of Frankfurt and as a consultant to numerous research institutes and international organizations, including the International Monetary Fund, the World Bank, the United Nations, the Council of Europe, and the European Commission. He has published widely in scholarly and policy-oriented journals and lectured and provided expert advice to governments in nearly 50 countries. Her research is in public economics, with emphasis on fiscal federalism and tax policies toward entrepreneurs, venture capitalists, and multinational corporations. She has worked as a consultant and researcher for the Canadian International Development Agency, the federal Department of Finance, and the Institute for the Economy in Transition in Moscow. He has served as an economic adviser to the government of Kenya and the Malaysian Institute for Economic Research. His research focuses on public economics and the economics of developing countries. Overview r o b i n b o a d way a n d a n wa r s h a h A part from small city-states, every country has more than one level of government. In some cases, the structure of government is explicitly federal, in the sense that different levels of government have autonomous responsibilities typically enshrined in a constitution. In other cases, subnational levels of government are creatures of the national government and may be ultimately dependent on them for their authority. Regardless of the political or constitutional definition of the nation, subnational governments are almost never self-sufficient financially. Their revenue-raising responsibilities fall short of their expenditure responsibilities, forcing them to rely on financial transfers from the national government. This volume examines the role of intergovernmental transfers, in both theory and practice. Practices governing intergovernmental transfers vary widely. The structures of multilevel government, the responsibilities exercised by each, and the relative importance of transfers differ widely across countries. The way in which transfers are used by transferring governments to achieve their policy objectives, as opposed to simply closing the vertical fiscal gap, differs across nations as well. Describing these commonalities helps provide some context for the overview of the volume that follows. Patterns of Expenditure Decentralization The assignment of expenditure functions across levels of government is broadly similar across nations. It is influenced by efficiency considerations in the delivery of public goods and services as well as benefits from allowing subnational governments discretion in choosing programs best suited to their constituent communities. Federal governments typically assume responsibility for national public goods defense, foreign affairs, money and banking, national infrastructure as well as some elements of social insurance pensions, unemployment insurance. Intermediate governments hereafter referred to as states are often assigned the provision of important public services, such as health, education, and welfare, in addition to state public goods, such as roads and police protection. Local governments provide local public goods and services, including water and sanitation, local roads, and recreational facilities. These patterns of decentralization are found in nonfederal nations as well. An important feature of this assignment of responsibilities is that higher levels of government have some interest in the manner in which expenditure programs are designed and delivered, for efficiency or equity reasons. On efficiency grounds, three sorts of arguments apply. First, program benefits may spill over to other communities. Second, decentralized decision making can lead to inefficiencies, because they distort cross-boundary transactions in products or factors, either intentionally or unintentionally. Third, fiscal competition among subnational governments may lead to inefficient choices of program spending. Equity issues particularly apply to state-level governments, which are responsible for providing public services such as health, education, and welfare, which fulfill redistributive roles that may be of national interest. Given this, most systems of intergovernmental transfers include design features intended to influence how subnational governments deliver these programs. More generally, the degree of discretion states have in designing these important social programs varies from federation to federation, as does the manner in which that discretion is constrained. Overview xxix Revenue Decentralization While on the expenditure side the proportion of government spending that is decentralized is reasonably similar across federations, the extent of revenue decentralization varies widely. Indeed, from a budgetary perspective, differences in fiscal decentralization are largely differences in revenue decentralization, or equivalently, differences in vertical fiscal gaps. The main distinction between centralized and decentralized fiscal federal systems is the extent to which state governments have discretionary access to broad-based taxes. In decentralized federations such as Canada, India, Switzerland, and the United States, state-level governments have full access to broad-based taxes such as income, sales, and payroll taxes. In more centralized federations, such as Australia and Germany, much less own-source tax revenue is raised, although in both cases, revenue-sharing applies to federal taxes. A high degree of revenue decentralization does not mean there is no significant vertical fiscal gap. On the contrary, even in the most decentralized federations, intergovernmental transfers play an important role. More generally, the vertical fiscal gap is not something that is or can be determined by assignment. It is the outcome of more or less independent fiscal choices made by all levels of government. Whether one level can be considered dominant from this point of view is an important question that is addressed at various points in this volume. While one might at first think that the federal government plays a leadership role in determining the vertical fiscal gap by choosing its preferred level of transfers as well as how much tax room to occupy, it is certainly conceivable that the states can have some influence on the amount of money the federal government transfers to them. Equalizing Transfers Fiscal decentralization inevitably leaves states and municipalities with different financial abilities to provide public services to their citizens. Different jurisdictions will have different needs and costs of providing public services and different revenue-raising capacities with which to finance them. As a consequence, intergovernmental transfers usually have an equalizing element to them, with higher per capita transfers going to jurisdictions with lower fiscal capacities. The form and extent of equalization differ considerably across nations, and there may or may not be one general transfer that is dedicated to equalization.

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But where no single equalization transfer is made, equalizing elements are typically built into more-specific transfers, including shared-cost ones. That influence can take several forms, some more intrusive than others.

Chapter 4 : 14 Theory and Practice of Intergovernmental Transfers : Reforming China's Public Finances:

Intergovernmental fiscal transfers finance about 60 percent of subnational expenditures in developing countries and transition economies and about a third of such expenditures in OECD countries (29 percent in the Nordic countries, 46 percent in non-Nordic Europe).

Chapter 5 : Intergovernmental Fiscal Transfers: Principles and Practices - Google Books

The design of intergovernmental fiscal transfers has a strong bearing on efficiency and equity of public service provision and accountable local governance. This book provides a comprehensive one-stop window/source of materials to guide practitioners and scholars on design and worldwide practices in intergovernmental fiscal transfers and their implications for efficiency, and equity in public.

Chapter 6 : A Practitionerâ€™s Guide to Intergovernmental Fiscal Transfers

Intergovernmental fiscal transfers: principles and practice (English) Abstract. The design of intergovernmental fiscal transfers has a strong bearing on efficiency and equity of public service provision and accountable local governance.

Chapter 7 : Intergovernmental fiscal transfers : principles and practice (English) | The World Bank

Intergovernmental Transfers in Practice In general, the existing design of grants in developing countries is not consistent with economic principles enumerated earlier. General nonmatching transfers, tax base sharing, and revenue-sharing mechanisms to deal with fiscal gaps.