The System of Local Government Finance: A Study of Select Countries

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ABSTRACT
Public finance system is organized in different ways in different countries depicting the peculiar institutional arrangements and structure to manage the finances at each level in an inter-government system of polity. These institutional peculiarities give rise to different kinds of responsibilities with reference to (a) revenue generation, (b) expenditure making, (c) debt raising and (d) grants/ aid/ resource transfer. The differential settings of local government finance in different countries gives a glimpse of the operational arrangement spectrum. This paper performs a concise case study of the local government finance (in multi-tiered system) in Select countries of the world that give some implications to India, which has traditionally confined to the finances of upper two tiers/ stages of government.

Key Words
Public finance, Local Government, Revenue, Expenditure, Debt and Reform measures

JEL Classification: H71, H72, H74, H75, H76, H77

1. INTRODUCTION

Public finance system is an important and integral part of the functioning of governments in various countries. It is organized in different ways in different countries depicting the peculiar institutional arrangements and structure to manage the finances at each level in an inter-government system of political institutions. These institutional peculiarities of local government are embedded into the multi-tiered and hierarchical structure of government with different arrangement of powers to raise revenue, to incur expenditure and to finance the development activities.
Therefore, the various levels of government tend to pre-occupy with different kinds of responsibilities with reference to
(a) revenue generation,
(b) expenditure making,
(c) debt raising
(d) grants/ aid/ resource transfer and
(e) recent reforms.

The differential settings of local government finance in different countries gives a glimpse of the operational arrangement spectrum. In this paper a concise case study of the local government finance (in multi-tiered system) is done for four select countries of the world (Sweden, Denmark, UK and Australia). Leaving the peculiarities aside, the system of local government finance offers some implications to that in India, which has traditionally confined to the finances of upper two tiers/ stages of government, leaving the one at the third level (local government) to confine to limited amount of growth and development.

2. LOCAL PUBLIC FINANCE IN SWEDEN

2.1 Introduction

Sweden's area is 450,000 sq km and it has a population of 9 million Fifty percent of the population lives in cities and Fifty percent lives In metropolitan areas. It has a long tradition of local government with the foundation laid way back in 1860s. The local government system comprises 288 municipalities and 23 county councils and parishes that function autonomously Municipalities have population widely ranging from 3,000 to 7,00,000 inhabitants and the county councils have the population ranging 136,000 to 1.7 million inhabitants

The legal framework for local government has roots In the Swedish Constitution, which identified the local fight to taxation, and the Local Government Act 1992, which
lays out a governance framework dealing with matters such as organisation, decision making roles, referendums, redress and financial management

2.2 Expenditure Responsibility

Local governments are one of the important elements of the Swedish welfare state; they account for about 38% of total public sector expenses and 28% of Sweden's total employment. Education and social services (child care, care of elderly and disabled and assistance to Individuals and families) constitute close to 60% of municipal expenditures. The county councils predominant task is healthcare, which accounts for 75% of their total expenditures.

The expenditure responsibilities in above areas remain with local authorities but the responsibility for results achieved is shared between local and national governments and this is operationalised through a system of grants or transfers between national and local governments.

2.3 Revenue Generation

The three major sources of local government revenue in Sweden are taxes (67% of total), grants from central government (20%) and user fees (7%). There is no local property tax in Sweden, but local income tax is the major source with the tax base determined by national government and local government deciding tax rate. Tax collection, however, is the responsibility of national government. Local tax rate varied between 265 to 344% and tax base per capita varied from 71 to 173% in 1997.

2.4 Borrowing

The Local Government Act 1992 states that the local government economic performance should be in accordance with the sustainable economic development, implying the restriction of local government borrowing to capital expenditures only.
also seeks a balanced budget approach over a three-year period, which deters any borrowing. There were no national government restrictions on local government borrowings after 1977, but with the experience of economic difficulties because of municipal housing companies' being unable to pay interest payments on the debt, there was a re-imposition of restrictions on the capacity of local governments to borrow. The establishment of municipal bank, with its members being local governments and borrowings given to members, lending process has come to roll.

2.5 Inter-governmental transfer agreements

Grants form national government are an important revenue source for local governments which accounted for 26% total revenue of municipalities and 15% total revenue of county councils in 1992, i.e., local government revenue dependency on grants however varied widely from less than 10% to more than 50%. Until 1993, more than two-thirds of the grants were conditional directed at specific local government services, and remaining one-third of the grants were unconditional traditionally given to regions regarded as poor in terms of their capacity to make up for large differences in tax potential or costs.

However, in the early 1990s, the relationship between national and local governments has changed radically due to severe economic pressures and the striving for uniformity in the European Union. Some Six Parliamentary commissions were established to study and recommend changes to the grant system and these commissions have resulted in two dramatic sets of reforms - the first in 1993 and a second in 1996.

1993 Reforms

It reversed the proportion of conditional to unconditional grants with two-thirds of the grants now given to unconditional grants with two major reasons (i) to promote greater efficiency through promoting autonomy II1setting priorities (ii) to enhance equalization aspect of grant system. The total cost of tile new unconditional grant
was determined by national governments annual budget and its distribution was determined by three factors:
(a) Revenue equalization - grant as a guarantee above its tax potential
(b) Structural cost equalization - grant: to even out demand and cost differences for local services to be based on regression analysis of parameters
(c) Supplement for population reduction - supplement to 24 municipalities for experiencing population decrease more than 2%

However, criticism on parameters of structural cost equalization led to a new parliamentary committee which led to 1996 reforms

1996 Reforms

The committee conceived an equalization grant based on three elements
(a) a grant from central government to local governments based on population
(b) a revenue equalization feature based on Robin Hood Model i.e, local governments with above average per capita tax potential transfer funds to those below.
(c) a cost equalization feature, again based on Robin Hood model i.e, local governments with below average' standard' per capita costs transfer funds to those above

The Swedish inter-governmental fiscal arrangements are sophisticated and have been built on a system of local government that has been in place for over a hundred years. The taxing mobile factor like employment tax, shared jurisdiction in large spending items like education and health and Robin Hood model are some anomalies. However, with the recent changes over the last decade, these arrangements have moved closer to the 'ideal set of principles and best practices.

The following features, in particular, are noteworthy:
- the tax generation by local authorities of a high percentage of the revenue required for their expenditure responsibilities ie, a relatively small fiscal gap exists
- the wide use of user fees
• a trend to providing increasing autonomy to local governments to set priorities and manage inputs to achieve efficiencies and local needs increasing emphasis by the central government on results reporting increasing cooperation among the actors
• a political willingness to continue the process of reviewing and modifying the arrangements
• a transfer mechanism that meets most of the desired criteria, particularly equity, neutrality, predictability, autonomy and incentives for sound fiscal management

3. LOCAL PUBLIC FINANCE IN DENMARK

3.1 Introduction

Denmark is a small nation of 43,000 sq km and it has a population of 5.2 million with highly urbanized system (almost to the level of 85%) Denmark has a three-tiered structure of government - national and sub-national (counties and municipalities) There are 14 counties and 273 municipalities of differing sizes and populations, while Copenhagen and Frederiksberg enjoying the status of both county and municipality The number of local governments has come down heavily after the reforms in 1979 but the governance powers shifted more from central government to sub national governments.

Denmark is a comprehensive welfare state with several social services responsibilities lie with sub-national government, and therefore requiring significant financial resources. The sub-national governments are also responsible for spending which equals 20% of GDP and 55 per cent of total government expenditure, a rate much higher than that found in industrialized countries. The broad jurisdictional powers and responsibilities are set out in Danish Constitution and specific pieces of legislation concerning the programmes and services responsibility. The Local Government Act lays out the governance structures for local authorities as well as
rules for economic management and a means for supervising them, particularly with regard to the legality of local government activities.

3.2 Expenditure Responsibility

Local governments (or, sub-national governments) in Denmark are major public service actors providing wide range of services like health, education, social services, care for elderly, housing, public protection, fire, transportation and other traditional local services. The division of functions between the two counties and municipalities is determined largely by economic efficiency. Counties are responsible for medical care, hospitals, specialised social institutions, tertiary education and major roads. Municipalities are responsible for primary schools, day nurseries, social assistance, elderly care, public protection, fire protection, housing, infrastructure and local roads. Although most program expenditure responsibilities reside with sub-national governments, in practice, accountability is shared among three levels of government.

3.3 Revenue Generation Capacity

Sub-national governments in Denmark possess greater taxation powers that their counterparts in other countries. The three main sources of own revenue are - property taxes, local income taxes and user fees. While property tax is set, administered and collected by municipalities, personal Income tax is piggy-backed to national government and is sizeable in amount (about 40% of revenue and 15-16% of GDP). User charges received increasing attention after 1980s and account for 20% of own-source revenue for sub-national governments in Denmark and are designed to control excess demand and for cost recovery.

3.4 Sub-National Borrowing

The central government heavily regulates the borrowing by local authorities in Denmark and they are provided with loan bracket by central governments corresponding to the permitted investments in areas financed by user fees such as water, electricity and sewage etc. Municipal investments for energy saving
measures, slum clearance and certain homes for the aged are also included in the loan bracket calculation. The sub-national governments are, however, permitted to borrow from any lender and since their financial systems are strong, they hardly face any difficulty in accessing capital. In 1995, total long-term debt of local authorities in Denmark as a percentage of total local tax base was 9.6%.

3.5 Inter-government Transfer Agreements

Transfers from national government are a minor source of revenue to sub-national governments in Denmark. These transfers equal approximately 22% of annual income for municipalities, 9% of annual income for counties. The vertical gap in Denmark is quite small, equaling only 20 per cent of total local government expenditure. However, two-thirds of transfers are general purpose and remaining one-third conditional; equalization is earned out based on both revenue potential and expenditure needs. However, sub-national governments in Denmark strongly resist revenue sharing as an alternative to own-source revenue for two reasons: (a) revenue sharing constrains the ability of a sub-national government to alter tax rates, and, (ii) the grant mechanism will always miss some particularly need and can be influenced by political interests.

General Purpose Grants

The Danish equalization system is structured in a manner very similar to Swedish system to comprise three main elements:

- a general purpose grant to all municipalities and counties based on their proportion of the total municipal tax base, which amounted to about 10% of total revenue of local authorities
- a revenue equalization feature based on Robin Hood principle i.e. local governments above average per capita tax potential transfer funds to those below it (although equalization is less than 100%)
- an expenditure equalization feature, again based on Robin Hood principle, whereby local government with below average expenditure needs per capita
transfer funds to those with above average expenditure needs per capita (again equalisation is not 100%)

The overall amount of general purpose grant is fixed by the Ministry of Finance after approval by the Parliamentary Finance Committee. The amount is based on the previous year grant adjusted by three factors: (i) any changes to responsibilities assigned to local governments, (ii) changes in market-sensitive areas like employment schemes or social security benefits and (iii) developments in prices and wages. However, budget security was sought in the reform in 1995 by opting for a 'guaranteed' tax base and associated equalization amount, based on the most recently completed fiscal year. If the actual tax base and equalization fall below the guaranteed amount, then central government pays the difference; however, if the tax base turns out to be higher than the guaranteed level, then central government pockets the extra income.

3.6 Conclusions

The Danish intergovernmental fiscal arrangements are strongly entrenched, highly efficient, and, for most part, they enable each of the players to achieve their goals. Many features of this model meet the ideals, some these include.

- the use of both expenditure needs and revenue means factors in the transfer model
- a low vertical gap (sub-national expenditure responsibilities closely macro revenue generation capacities)
- the high degree of sub-national autonomy (and accountability), due to high levels of own source revenues and independent tax-setting
- a 'neutral' equalization model, a method designed to minimise the impact of cuts (when necessary) without significantly undermining the premise of equalization
- regularized, collaborative dialogue over transfers, taxes and fiscal policy in general
- joint technical assessments of sub-national government finances
The specific configuration of sub-national governments to achieve economic efficiencies and an 'almost' full equalization model - Willicll helps to ensure that incentives exist for accurate assessments of tax base by sub-national governments.

Yet, the Danish model has complex expenditure formulas that are not easy to understand which renders it with charges of politically favored allocation. The matching grants might affect local priority settings and the borrowing capacity of sub-national governments is restricted by central government regulations.

4. LOCAL PUBLIC FINANCE IN UNITED KINGDOM

4.1 Introduction

The United Kingdom is a unitary state with 58.4 million population over an area of 242,000 sq km that includes England, Scotland, Wales and Northern Ireland. The UK has a long history of local governance with powerful shire authorities although sub-national government structures in England, Wales and Scotland differ slightly. England has a two-tier system made up of city/town councils and regional councils, whereas Wales and Scotland moved to a one-tier system of local government since 1996. The powers provided to local governments, however, are essentially the same in each of the three nations.

The Councils are created by the Acts of Parliament, abolished by them and their powers are determined by Parliament. These acts also provide a scope to the local government duties - mandatory acts lay down specific duties to be carried out by local governments and permissive and adoptive acts lay down the activities that a council may do if its councilors wish. Since the early 1980s, central-sub-national financial relations in the UK have operated within an agenda that has emphasized fiscal restraint for all public services and the official policy laid emphasis on the desire to preserve the discretion of local authorities to determine their own spending priorities within overall limits set by the central government.
The sub-national governments have responsibilities that result in 36 per cent of total government spending and generate through own source revenue less than 20 per cent of their total expenditure, leaving a large mismatch (or, vertical gap) between expenditures and revenue capacities.

4.2 Expenditure Assignment

In the UK, sub-national governments are responsible for education, housing, social services, public protection, fire, transportation and other sundry local services - the lower tiers of sub-national governments have housing, environmental services and local transport responsibilities and higher tier governments have education, police, fire, social services and structural planning responsibilities. Health service provision is national government responsibility.

Sub-national government spending as a proportion of total government spending has been falling in the UK; it fell from 42 per cent in 1979 to 36 per cent in 1994. The major factors of this reduction are related to broader public service reform issues e.g., privatisation, elimination of subsidies and services. They are primarily driven by strong central government concerns about public sector over-expenditures. In 1994, the central government also imposed new overall restrictions on local government spending.

4.3 Revenue Generation Capacity

The central government in the UK has power over all taxes and controls all those taxes that generate greatest revenue e.g., personal and corporate income taxes, excise and customs duties and value added taxes, whereas the sub-national governments possess few taxation powers like national non-domestic tax (or business property tax) and a council tax (a residential property tax). The national non-domestic tax is a shared tax but 100% distributed to local governments. It is set at a uniform rate annually by central government based on the valuation surveys carried out by the fictional revenue authority. The council tax is based on the
valuation of houses and apartments in eight broad bands according to their approximate market value.

4.4 Borrowing

The sub-national governments are prevented by law from borrowing for current expenditures but can do so for capital expenditures - both from private or public sector as well as by issuing bonds. The central government manages the borrowing by setting annual capital spending guidelines, which act as de facto borrowing limits.

Another way of limiting the borrowing is done by central government - local authorities are required to devote 75 per cent of receipts from sales of government owned properties toward redeeming existing loans and only 25 per cent of capital receipts from housing may be used for capital expenditure.

Another even more stringent control is through the basic credit approval, which allows local government to borrow up to a certain limit, based on the annual capital guidelines for each sub-national authority. These guidelines set spending guidelines based on estimated local capital expenditure. Supplementary credit approvals are issued on occasion to cover one-time expenditures.

The Public Works Loans Board is a statutory body that acts as a lending agent for sub-national governments in the UK and the bulk of borrowing by them is channelled through this board (71.5% of outstanding sub-national government debts are held by this body). It borrows money from the National Loans Fund and lends to local authorities at advantageous interest rates due to the advantage of scale of operations.

4.5 Inter-Governmental Transfer Agreements

Central governments have historically played a major role in financing the expenditures of sub-national governments through grants system comprising a block grant (or, Revenue Support Grant) and a number of specific grants.
Block grants

Block grants represent over 80 per cent of total grants and are largely based on the Standard Spending Assessment (SSA), which is the government's estimate of what each local authority should be spending on public services and is based on the goal of achieving a common standard of services across the country. The SSAs are calculated by the Government based on a Total Standard Spending (TSS) rate for the entire envelope of sub-national expenditure, which, in turn, becomes an overall target for transfers.

The TSS formula is based largely on historical factors with the base of previous year's total for the nation as whole and adjustment made for four factors:

- inflation
- shifts in responsibility between the levels of government
- any expenditure arising from new national policies efficiency
- savings potential

The TSS is then divided into functional categories, according to the government's assessment of relative spending needs at local level, which is again carried out for the whole country.

Specific grants

Specific grants were initiated as a means of delivering on central government priorities and ensuring (through rigorous conditionality provisions) that the money was spent as it was intended. They are paid in addition to block grants to be meant for boosting expenditure for the relevant expenditure, which as a whole represent less than 20 per cent of the UK sub-national government's operating revenue. Although 71 per cent of the monies go toward police and court related services, recent reforms have slowly increased the proportion of specific grants in the total transfer envelopes.
During the 1980s, with an objective of reducing the role of government and its expenditure, rate capping was established as a mechanism to judge whether a given local government's absolute expenditure was excessive; if so, the central government could cap local tax rates. Although not applied rigorously, it is enough to keep local governments on hold.

4.6 Institutional mechanism for coordination, conditionality and accountability

The British central government has wide de jure and de facto levers of control over sub-national government expenditures. Apart from general and specific grants and the capping, it has established indirect conditionality mechanisms like Audit Commission and accountability mechanisms in the form of the Local Government Ombudsmen.

The Audit Commission was existent in the UK for a very long time since 1700s but it assumed a major role after 1982 when local government auditing in England and Wales was brought under its control. It was also given the responsibility of the production of annual comparative indicators of local authority performance and for measurement of them based on the collected data. The Audit Commission reports are kept in public. In addition, the Commission has a mandate to conduct independent analyses of the impact of central government legislation, action or advice on local governments.

The Local Government Ombudsmen investigate complaints of injustice arising from maladministration by local authorities and certain other bodies in England. The objective of this system is to secure, where appropriate satisfactory redress for complainants and better administration for the authorities. There are three Local Government Ombudsmen who deal with complaints from different parts of the country. They investigate the complaints about the council matters including housing, planning, education, social services, consumer protection, drainage and council tax. Since 1989, it has been assigned the power to issue advice on good administrative practice in local government based on experience derived from their investigations.

4.7 Recent Reforms
Significant changes have taken place in the UK in the recent years e.g., decline in sub-national spending by 6 per cent since 1979 due to reforms like privatisation and sale of sub-national government assets. There has been establishment of new private governing associations e.g, one such for new housing development, that are directly funded by central government. In spite of their overlap with that of local councils, there is no coordination mechanism present. The other reforms include the improvement of local government capital expenditure system through 'Challenge Fund, a new Initiative to pit sub-national governments in competition for conditional grants from the fund. Although community charge (or, poll tax) was imposed, it was considered regressive and repealed only after two years.

British intergovernmental fiscal arrangements have some of the attributes of ideal intergovernmental fiscal regimes. The Audit Commission is one such feature that promotes transparency, information sharing on best practices and voicing criticism about central government policy. Other such features include:

- a high level of general-purpose grants in the system
- a 'neutral' equalisation system based on both revenue and need factors
- a pooled borrowing scheme for sub-national governments that enables them to borrow at low interest rates
- the Local Government Ombudsman, who acts as a key public accountability mechanism
- flexibility to allow local government structures to differ in different jurisdictions (one and two tier governments)

Unfortunately, the British system falls to meet the ideal in other ways. the most obvious being the large vertical gap and the central government exercises significant control over the sub-national governments, which gives impression of a lack of confidence in local governments.

Other drawbacks include:

- a low level of sub-national government autonomy caused, in part, by a high degree of shared jurisdiction
a major gap between expenditure responsibilities and own-source revenue capacity with little incentive for local governments to seek ways of generating more own-source revenue

- a growing number of special purpose bodies at local level
- Rate capping - an intrusive force on sub-national government;
- City Challenge Fund and allocation of grants are perceived to be becoming more political than not

5. LOCAL PUBLIC FINANCE IN AUSTRALIA

5.1 Introduction

Australia has a population of 18 million over a land mass of more than 7.7 million sq km with a majority of it situated in urban centres. It has the Westminster model of government, handed down from British, which has three tiers - commonwealth, state and local. There are six Australian states and 900 local governments, in addition to two territorial governments that have the same expenditure responsibilities and revenue bases as the states. Also, like the Canadian model, the vast majority of government powers reside in the upper two tiers of government leaving the local government with few powers and no constitutional standing. The two layers were also provided with reservation of own tax bases.

5.2 Expenditure Responsibility

State governments in Australia carry the majority of expenditure responsibilities in the system - almost 59 per cent of total government outlays. The expenditure responsibilities include health, education, social security and social assistance, welfare, economic services (roads, transport industry assistance, water resources) and other services (housing and urban renewal, regional development and disaster relief).
5.3 Revenue Generation

The Commonwealth government dominates the field of revenue generation, controlling the four main sources of revenue - personal income tax, customs and excise duties, corporate taxes and sales tax.

Own tax revenues constitute an average of 40 per cent of state government revenue with payroll taxes as the largest revenue source followed by property and land taxes, goods and service taxes, motor vehicles, gambling and insurance taxes. State governments also make up an average of 12 per cent of their revenue from proceeds from publicly owned enterprises through use charges. The tax bases and sources of revenue are similar for each state, although the amounts and proportions vary somewhat in two of the less affluent states.

The Australian system exhibits a high vertical fiscal imbalance (or, vertical gap). The commonwealth government collects 67 per cent of total revenue and is responsible for 33 per cent of expenditures, while state governments collect about 28 per cent of total revenue and are responsible for 59 per cent of expenditures.

5.4 Borrowings

State government borrowing in Australia was tightly controlled by Commonwealth up until 1984 in the form of debt ceilings each year for each province, administered through a National Loan Council. Since 1984, reforms were introduced to enable the states to take greater responsibility for their own borrowing - states were enabled to offer bonds, refinance securities and loans etc. The Loan Council plays primarily a 'watch dog' role by creating and enforcing reporting requirements which primarily enhance fiscal transparency. It seeks the borrowing estimates from all governments and assesses their relevance to make adjustments based on macro economic objectives.

There are three types of inter-governmental transfer arrangements in Australia: the Commonwealth Grants Commission, the General purpose grants and the Special purpose grants, each of them are described below.
The Commonwealth Grants Commission
It was established to report on application by individual states of Commonwealth for special assistance act as an autonomous arbiter of distribution aspects of fiscal federalism in Australia. It chiefly recommends on the distribution of all general purpose funding to the states on the basis of the principles of horizontal fiscal equalization. Although the CGC has no official decision-making control over transfers, its recommendations are usually accepted and implemented by the Commonwealth government and its power in fact ascended over the last century.

General Purpose Grants
The General Purpose Grants in Australia have evolved more or less similar to that in Scandinavian countries and they constitute 45 per cent of payments from the Commonwealth to the states that are further subdivided among the states. From the initial set-up to act as an administrative structure to manage a claimancy system for general purpose grants, the CGC has taken the role of calculating the grants based on formula-driven models for determining transfers. The CGC calculations are subject to review in joint forums among representatives of each state, which once is complete a final recommendation report is given to the Commonwealth Cabinet for review. Cabinet usually makes some small revision based on its own view of fiscal needs and upcoming expenditures, and the final determination are made at annual Premier’s Conference.

Special Purpose Grants
Transfers from the Commonwealth comprise 40 per cent of state revenue and up to 60 per cent in some states. The specific purpose payments (SPPs), conditional grants dedicated to both current and capital needs, represent over 50 per cent of the transfers, which has been growing over the past 20 years. The formulas underlying the specific purpose grants are not complex but derive primarily from historical patterns and political perceptions of need. States in Australia have a relatively high degree of discretion over the allocations of the SPPs, yet the central government attaches lot of conditions to grants to demonstrate its interest in and participation. The conditions applied to SPPs vary widely and some of these include
• General program requirements (guarantees of free public hospital treatment in exchange for hospital grants)
• Agreements covering service provision and program delivery
• Mechanisms
• Detailed conditions on the operation of joint expenditure programs
• Matching expenditure requirements

5.5 Recent Reforms

Until 1984, the National Loan Council coordinated and controlled borrowing by all governments in Australia but revisions made at that time due to pressures from states to make them more responsible for their own borrowing. The states were responsible for financing and refinancing but borrowing limits were still imposed upon them by the Council. However, the intended controls were continuously circumvented by the states and the system was replaced by a two-pronged approach in 1992-93. The approach uses transparency and moral suasion as its key operating principles but still recommends borrowing limits set out by the National Loan Council and made open to public. The key elements of the new system include:

• The Commonwealth and each state government must now submit its net financial requirements every year, and, if the submissions raise concerns, the Loan Council has the right to demand that the government concerned modify its strategy.
• The reporting requirements on day-to-day basis have also been enhanced. If a government exceeds a 3 per cent difference between its plan and the actual situation at any given moment, that government is compelled to explain it to the Loans Council.

5.6 Conclusions

The Australian inter-governmental fiscal regime is progressive and effective in several aspects and some good features include:

• The use of revenue means and expenditure needs factors in determining the equalization payments
- The 'relativities' formula, which meets a number of equity and distributive tests, and which is particularly applicable among jurisdictions with widely varying degrees of revenue generation capacity
- The 'independent neutral' CGC and its role in equalization framework
- The National Loan Council structure is effective as manager and facilitator of access to capital among sub-national governments: The recent reforms promoting financial transparency have proven efficient and effective in promoting accountability
- The regularized and structured system of discussing the equalization system between the Commonwealth States and the CGC.

The Australian System's limitations include
- A high vertical gap, which shows few signs of abating
- An equalization system which some view as excessively complicated and open to public political manipulation
- Slate governments possess few tax powers, many of which are regressive
- A high (and growing) proportion of special purpose grants, which, in the opinion of some experts, impose an unnecessary degree of Commonwealth government influence over state areas of jurisdiction, and which are subject to far less rigorous formulae than general purpose grants are
- Minimal state influence over the structure of the transfer system. In particular, the size of equalization pool is largely determined by the Commonwealth government
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