

**Draft**

# **Intergovernmental Fiscal Cooperation - International Experiences and Possible Lessons for Brazil<sup>1</sup>**

**Teresa Ter-Minassian and Luiz de Mello**

## **I. Introduction**

There has been increasing focus in recent decades on the importance of multi-level governance (MLG) in policy-making.<sup>2</sup> This trend reflects growing recognition that coordination failures among stakeholders undermine policy design and implementation, leading to sub-optimal outcomes. It also reflects the fact that increasing decentralization of spending and revenue responsibilities has strengthened the role of sub-national governments in the design and implementation of fiscal policy. Inter-governmental fiscal cooperation (IFC), which is a particularly relevant aspect of multi-level governance, is the subject of this paper, which focuses on the case for, and main obstacles to, IFC drawing on a range of international experiences. The paper concludes by identifying some possible lessons for reform in Brazil.

The paper is organized as follows. Section II provides an overview of the benefits of, and impediments to, IFC, as well as of its different forms on the basis of international experience. The section also discusses institutional and other factors that influence the forms that IFC takes in various countries. Section III focuses on the role of IFC in macro-fiscal management, whereas Sections IV, V, and VI discuss IFC's roles in the design and reform of inter-governmental fiscal systems, in implementing and improving sectoral policies, and in strengthening sub-national fiscal management, respectively. In each section, theoretical considerations are illustrated with country examples, drawn primarily on large federations.

---

<sup>1</sup> An earlier version of this paper was presented at a seminar in Brasília on 21-22 September 2015. The views and analysis reported in it are the authors' own and do not necessarily reflect those of the organizations to which they are affiliated or their member countries. The authors acknowledge gratefully the helpful inputs received from Isabelle Chatry (OECD) for the preparation of this paper, as well as the comments received from Claire Charbit, Dorothee Alain-Dupré and anonymous peer reviewers.

<sup>2</sup> A MLG framework has been formulated by the OECD and has been used in several related areas of work, including public investment, regional development, urban development, local finances, water governance, regulatory policy, or environmental issues such as climate change. See <http://www.oecd.org/gov/regional-policy/multi-levelgovernance.htm> for details.

Section VII presents a brief overview of the main features of the intergovernmental fiscal relations system in Brazil, and the authors' initial reflections on how to strengthen IFC in the country, drawing on lessons from the international experience. Section VIII provides some brief conclusions. The Annex includes brief summaries of key features of intergovernmental fiscal relations systems and cooperation mechanisms in a number of large federations, or quasi-federations.

## **II. The case for, and possible forms of, intergovernmental fiscal cooperation**

Cooperation across and within levels of government may require participant governments to pursue policies that are different from those that would have been selected in the absence of cooperation.<sup>3</sup> Therefore, to choose to participate in cooperation arrangements, governments must believe that the benefits of such arrangements outweigh the costs associated with the corresponding loss of decision-making autonomy.

Potential gains from cooperation involve a reduction of adverse externalities/spillovers, and a fuller exploitation of positive externalities and synergies from participants' actions and policies, as well as of economies of scale. As discussed in detail in the subsequent sections, IFC can be beneficial in different aspects of policy, namely:

- Macro-fiscal management;
- The design and reform of intergovernmental fiscal arrangements;
- Sectoral policies, including service delivery; and
- Sub-national revenue and expenditure management.

A further benefit of IFC is that it facilitates the exchange of relevant information among participant governments, leading to a better understanding of respective objectives and constraints, as well as the identification of viable policy synergies and trade-offs that can be taken into account in the design and implementation of reform packages. This exchange of information and experiences also leads to the identification of good and bad practices by peers who face similar policy challenges.

Despite its potential benefits, IFC typically faces significant political economy obstacles. An important one is the fragmentation of sub-national levels of government (especially the local one), which makes it difficult to manage multi-level cooperation fora effectively. Another obstacle is the heterogeneity of sub-national governments (SNGs) as regards size, level of socio-economic development, production structure, etc., which can make it difficult to identify win-

---

<sup>3</sup> Bakvis and Brown, 2010

win policy options. Also, differences in political affiliations of the sub-national governments may hinder cooperation among them.

These obstacles can nevertheless be attenuated by the use of horizontal cooperation to facilitate coordination within each sub-national level of government and represent it in vertical cooperation fora. The disincentives to cooperation stemming from economic, social or political differences may be alleviated in some cases by agreement to delegate redistributive decisions/recommendations (e.g., on the size and distribution of intergovernmental transfers) to independent institutions (like the Indian Finance Commission or the Australian Commonwealth Grants Commission, discussed further below).

IFC can take different forms:

- It can be vertical (i.e., among levels of government), horizontal (i.e., within each level, aiming at resolving issues of common interest and intra-level disputes, and at strengthening the influencing power of the level (advocacy function)), or both;
- It can be multilateral, or bilateral (between the central government (CG) and individual SNGs, or between specific SNGs);
- It can have broader or narrower coverage, encompassing the whole range of intergovernmental issues, or only a subset of them;
- It can be harder (i.e., when the decisions of the IFC forum are binding on its members, or when one level of government has veto power over certain decisions of the others), or softer (i.e., when policy adjustments are discussed and recommended, but not required); and
- It can take place primarily at the executive level or in the legislature.

As evidenced by country examples in the subsequent sections and in the Annex, the choice of forms of IFC reflects a variety of economic, social, institutional, political and even cultural factors. These include:

- The extent of diversity of SNGs. Typically, countries with more pronounced territorial disparities tend to privilege softer forms of cooperation, especially if the influence of the CG is relatively weak.
- The main characteristics of the intergovernmental fiscal system. Intergovernmental cooperation is typically more extensive in countries characterized by a less clear definition, or broader overlap, of spending responsibilities among the different levels of government. The same tends to happen when a level of government has statutory influence over the revenue-raising decisions of the other(s). As discussed further in the

Annex, Austria and Germany provide foremost examples of this type of “cooperative federalism”.

- The power balances among and within the different levels of government. In countries characterized by large vertical imbalances (i.e., a strong dependence of SNGs on transfers from higher levels of government), the CG (or the intermediate level of government) can put effective pressure on SNGs (or on local governments) to participate in cooperation fora and to accept the agenda set by it (as in the case of Australia). In these countries, the dominant level of government may also have greater power in enforcing decisions reached through multilateral or bilateral cooperation agreements. In contrast, countries in which SNGs have substantial revenue autonomy (e.g., Canada, Switzerland and the United States) tend to rely less on multilateral vertical cooperation and more on multilateral horizontal cooperation, and/or on bilateral vertical or horizontal cooperation agreements.
- The presidential or parliamentary form of government. Executive federalism, in which intergovernmental cooperation centers on the executive branch of the national and sub-national governments, is more frequently found in parliamentary regimes, in which the Executive typically commands a majority in Parliament and can thus effectively drive the cooperation agenda. By contrast, executive federalism tends to be less prevalent in presidential regimes characterized by strong separation of powers.
- The nature of representation of SNGs in the national legislature. In many countries, SNGs elect or appoint the members of the Upper House of Parliament. However, the prerogatives of this House vary significantly, ranging from a veto power on all legislation (as in the United States) or on all legislation affecting SNGs (as in Germany), to a merely advisory role. A strong role of the Upper House can promote horizontal cooperation among SNGs, to facilitate agreement on issues to be discussed in this House.

### **III. IFC in macro-fiscal management**

Unilateral action by different levels of government can have important spillovers on the other levels. For example, a cyclically inappropriate or unsustainable conduct of fiscal policy by the CG is likely to aggravate economic booms and busts and may eventually lead to fiscal crises, with adverse effects on regional and local economies and their governments’ finances. There are many examples of such spillovers, especially in emerging-market economies. To cite just a few: Mexico, in the aftermath of the tequila crisis of 1995; Russia after the 1998 default; and Argentina in the wake of the exit from convertibility in 2001. In all these cases, the fiscal turmoil at the national level was reflected in a spate of sub-national debt crises. There is also evidence

of significant fiscal stress in many SNGs in advanced countries in the wake of the global financial crisis and the Euro crisis in recent years.<sup>4</sup>

Moreover, the CG can adversely affect sub-national finances through specific tax policies. For example, if, to stimulate the economy during a recession, the CG cuts a national tax whose revenue is shared with the SNGs without compensating them, the SNGs will be forced to cut spending, if they are not allowed by fiscal rules or by financing constraints to accommodate the deterioration in their budget balance. This, in turn, will blunt the overall fiscal stimulus and may affect adversely the provision of important public services provided by the SNGs. Conversely, uncompensated increases in SNG revenue as a result of increases in national taxes that are shared with the SNGs, to cool excess demand or to improve the CG budget, can create room for additional sub-national spending, thus reducing the effectiveness of the national fiscal contraction.

The CG can also adversely affect the sub-national finances through its expenditure policies. This is the case, for example, of wage and benefit policies for its civil servants, which frequently put pressure on the SNGs to follow suit; changes in rules for public employment or public pension systems; or investment location decisions. CG expenditure policies can also cause sub-national deficits by imposing unfunded spending mandates on SNGs by, for instance, setting minimum standards for the provision of public services in areas like health care, education or housing, without ensuring that the SNGs have adequate resources to meet the standards at an average level of efficiency.

Finally, non-fiscal policy instruments used by the CG can also have a bearing on sub-national finances. For example, incomes policies set at the national level, in particular changes in nationwide minimum wages, administered prices policies, monetary and exchange rate policies, and regulatory policies, can all have significant implications for the sub-national finances.

On the other hand, unsustainable fiscal policies by some SNGs can also have adverse spillover effects on other jurisdictions, and ultimately on the national finances. Such policies include excessive tax competition (i.e., “race to the bottom”), which leads to the erosion of tax bases; inadequate exploitation of assigned tax bases (the so called “fiscal laziness”) through excessive use of tax expenditures or weak enforcement; inappropriate employment and compensation arrangements, which bloat the government payroll; and serious inefficiencies and rigidities in current spending and investment. All these policies can lead to the accumulation of substantial deficits and ultimately to debt servicing difficulties.

Sub-national debt crises typically entail serious consequences, including disruptions in the provision of public goods and services to the population of the SNG in crisis, as well as adverse spillovers on other SNGs, and possibly the whole nation. Such spillovers are generally of a financial nature (e.g., increased market perception of financing risks, reflected in rising borrowing costs, and in some cases, propagation of debt rollover difficulties). They may also

---

<sup>4</sup> See e.g. Ter-Minassian and Fedelino, 2010; Vammalle and others, 2012; and Ahmad and Brosio, eds., forthcoming.

include social and political costs, especially for other SNGs (or even the CG) that are politically aligned with the jurisdiction in crisis.

The threat of such consequences frequently leads to bailouts of SNGs in distress by higher-level governments, often through gap-filling transfers or through the assumption and restructuring of their debt. Such bailouts are costly, not only because they entail additional financial burdens for the rescuer government, and, when large, they can jeopardize the latter's creditworthiness and medium-term fiscal sustainability, but also because they give rise to moral hazard, and thus further soften the sub-national budget constraint.

IFC can help improve both national and sub-national macro-economic management in a number of ways. In countries characterized by a well-established culture of fiscal responsibility and transparency, IFC can help reach agreement on an appropriate distribution of fiscal targets among the participant governments and increase the chances of effective enforcement of such targets through peer pressure. A good example in this respect was the Australian Loan Council during the 1990s-2000s.<sup>5</sup>

More generally, however, the effectiveness of IFC in deciding the allocation of fiscal targets, and in enforcing them, has been relatively weak. For example, as discussed further in the EU country profiles in the Annex, the record of effectiveness of their Domestic Stability Pacts has been spotty, and several of the countries have moved, in the wake of the Euro crisis, to translate into specific fiscal rules for each level of government the rules specified in the strengthened EU fiscal framework (the Fiscal Compact) for the general government as a whole.

The limited effectiveness of negotiated fiscal targets is not surprising, since such negotiations are often dominated by short-term political objectives. It is increasingly recognized, in both theory and international practice, that pre-commitment devices, such as fiscal rules, are superior instruments to promote national and sub-national fiscal discipline and sustainability. However, it is also clear that, to be effective, fiscal rules need to be: carefully adapted to the economic, social and institutional context of each country, and adjusted periodically to reflect structural changes in such context; sufficiently flexible to accommodate unforeseeable exogenous shocks and to avoid pro-cyclicality; and supported by appropriate monitoring, enforcement, and correction mechanisms, including in particular adequate public financial management (PFM) and fiscal transparency systems at all levels of government.

IFC can contribute to the effectiveness of a rules-based fiscal responsibility framework by facilitating agreement on a sound design, or on needed reforms, of the rules; by stimulating their enforcement through peer pressure; and by fostering progress on reforms of the intergovernmental fiscal system needed to improve sub-national fiscal sustainability (see Sections IV-V below).

IFC can also facilitate the exchange of information on global, national and regional macro-economic developments and prospects, and on fiscal and other policy variables (e.g., CG

---

<sup>5</sup> In the more recent years, however, the Council has focused primarily on improving fiscal transparency, to facilitate an effective working of financial market discipline on sub-national borrowing (see Annex for details).

transfers to sub-national governments, interest rates) needed for the preparation of realistic sub-national budgets and medium-term fiscal frameworks. For example, Germany has an intergovernmental Working Party on tax revenue forecasting that is responsible for the forecast and distribution of revenues shared between the federal government and the states. IFC fora in Austria, Belgium and Mexico, among others, have proven to be effective vehicles for the exchange of relevant macroeconomic and fiscal information among and within different government levels. In Italy, the national annual budget framework law is discussed within the Center-Regions Conference before being submitted to the national Parliament.

Finally, and importantly, IFC fora can provide needed venues for the CG and the SNGs to present, assess and discuss the repercussions of proposed policy actions of one level of government on the others, for example:

- The scope for the CG to support SNGs during cyclical downturns through increased transfers or financing of sub-national investments, as was done by a number of advanced and emerging-market economies in the wake of the global financial crisis; and conversely, the need and ways for SNGs to support counter-cyclical fiscal contractions by the CG in situations of demand overheating;
- The effects of tax policy changes by the higher levels of government on revenues shared with the lower ones;
- The repercussions of national spending policies (e.g., for pensions, subsidies or civil service) and of spending mandates for SNGs on the sub-national budgets;
- The implications of incomes policies (e.g., changes in the minimum wage) decided by the CG for the payroll spending of SNGs, and of the CG's administered price policies and proposed regulatory changes for the sub-national finances; and
- The implications of policy changes proposed by one or more SNGs for other SNGs and/or the CG.

#### **IV. IFC in the design and reform of intergovernmental fiscal systems**

This section explores the potential of IFC to facilitate a good design or needed reforms in the main aspects of intergovernmental fiscal systems; namely, expenditure and revenue assignments and intergovernmental transfers.

##### **1. Coordinating and reforming expenditure responsibilities**

Clarity in spending assignments to different levels of government is crucial for efficiency and accountability, but it is difficult to fully achieve in practice. International experience shows that the most important spending functions (e.g., education, health care, social assistance and infrastructure) are frequently concurrent, rather than exclusive (see Annex for country examples). A degree of clarity can be achieved by unbundling these broad functions, not only

those related to service delivery but also standard setting and regulation more broadly, into narrower areas assigned to different levels of government.

Moreover, expenditure assignments are more often shaped by history and motivated by political and social dynamics than by efficiency considerations (i.e., the principle of subsidiarity). As a result, asymmetric assignments, reflecting different capacities of individual jurisdictions within each level of government to carry them out, would be preferable but may not be politically feasible.<sup>6</sup> Finally, expenditure assignments may also need to be reviewed periodically to reflect evolving economic and socio-political circumstances, as well as sub-national capacities.

Vertical IFC can be useful in clarifying and reforming expenditure assignments, as well as in ensuring an effective management of concurrent spending responsibilities in specific sectors, as discussed in Section VI below. The dialogue and analyses in such fora may also facilitate the adoption of asymmetric assignments, when appropriate.

The importance of effective cooperation across levels of government in countries characterized by a high degree of overlap in spending responsibilities is highlighted by a number of country examples. As discussed in more detail in the Annex, vertical IFC arrangements in Australia, Austria, Germany and India provide good examples of such “cooperative federalism”.

Vertical IFC can also take the form of bilateral arrangements between the CG and individual SNGs to define respective responsibilities in concurrent spending functions. These arrangements are often embodied in performance contracts specifying expectations of both parties regarding financing and results of the spending programs covered by the agreement. For instance, France has *Contrats de Plan Etat-Régions* between the CG and its deconcentrated regions. These agreements (which are concluded with each region separately) have duration of seven years and aim at ensuring that evolving broad national priorities are appropriately reflected in regional investment plans, taking into account relevant regional specificities.<sup>7</sup> Since 2012 Colombia has introduced *Contratos Plan* with some of its Departments to coordinate public investment policies, with a view to promoting a more balanced regional development. The Chilean CG also uses *contratos-region* to agree investment plans with its regions.

Horizontal IFC tends to play a greater role in countries with lower degrees of spending overlap among government levels. This is, for example, the case in Canada (with the inter-provincial Council of the Federation and the Federation of Canadian Municipalities), Switzerland (with the

---

<sup>6</sup> Some countries (e.g., Colombia) have introduced a degree of asymmetry in spending assignment by requiring that SNGs wishing to take on given spending responsibilities show evidence of capacity (according to pre-specified criteria) to carry them out. Chile is also planning a gradual and probably asymmetric decentralization of spending responsibilities to its regions (which are currently deconcentrated units of the CG).

<sup>7</sup> For example, for the 2014-20 period the contracts focus, as priority areas, on investments in environment, energy, multi-modal transport, and support to technological research and innovation.



inter-cantonal Presidents' Conference) and the United States (with various associations of state governors, state legislatures, and local governments).<sup>8</sup>

## 2. Reforming revenue assignments and preventing predatory tax competition

It is a well-known tenet of the fiscal federalism literature that SNGs need meaningful sources of own revenues (i.e., revenues for which they control at least the rate structure). A significant degree of revenue autonomy is necessary to promote sub-national fiscal responsibility, avoid soft budget constraints, foster accountability of SNGs to their electorates, and improve the correspondence of taxation with local preferences.

It is also well known, however, that there are significant obstacles to such autonomy, ranging from economic (e.g., greater mobility of sub-national taxable bases, which facilitates tax competition among SNGs) to social (e.g., unequal territorial distribution of tax bases), administrative (e.g., economies of scale in tax administration and increased compliance costs), and most importantly political economy ones (e.g., notably the unwillingness of CG to relinquish control of major revenue sources, and of the SNGs to sustain the political costs of taxing their citizens).<sup>9</sup> Therefore, the choice, design and reform of sub-national own revenue sources has to balance the benefits and costs of each potential revenue handle, taking into account the specific relevant economic, institutional and socio-political circumstances of each country.

IFC can play a useful role in this area by facilitating a dialogue among the different levels of government on respective revenue assignments, and their reform over time as circumstances evolve (e.g., as the capacity of SNGs to administer own taxes improves, or in conjunction with reforms of inter-governmental transfers, such as the introduction or strengthening of equalization transfers, to compensate the unequal distribution of tax bases over the national territory). Australia provides a good example of use of a vertical cooperation forum (the COAG) to build consensus for a major tax reform (introduction of a VAT shared between the Commonwealth and the States). In Germany, proposed reforms of shared taxes are discussed in various cooperation fora to minimize the risk of their being blocked by the Upper House of Parliament (the *Bundesrat*), whose members are designated by the states and which has veto power on reforms affecting the states. In Belgium, IFC was instrumental in ensuring agreement on a substantial sub-national tax reform in 2001 (the *Lambermont Agreement*). In Mexico, the 2013 proposed tax reform package was discussed in the various IFC fora (the *Reunión Nacional de Funcionarios Fiscales* and the *Comisión Permanente de Funcionarios Fiscales*) to secure the needed political consensus for its approval by the Congress.

Horizontal (or possibly vertical) IFC can also help prevent excessive tax competition among SNGs. As emphasized by second-generation theories of fiscal federalism, a degree of tax

---

<sup>8</sup> See Annex for details.

<sup>9</sup> See Bird (2010), and Fretes and Ter-Minassian (2014) for further discussions of the benefits and obstacles to revenue decentralization.

competition among SNGs can be efficiency-promoting, as individuals and especially companies move to locations that offer the best value (in terms of infrastructure and services) for their tax money. However, predatory tax competition can sharply impair the capacity of jurisdictions, in particular the poorer ones, to deliver adequate goods and services under their responsibility, or lead to unsustainable fiscal deficits. For IFC to work effectively to prevent predatory tax competition, it is essential that participants agree to abide by clear rules, in particular limits on tax expenditures granted, supported by full transparency and sanctions for non-compliance. The CG can also play an effective role in preventing excessive sub-national tax competition by basing its equalization transfers to SNGs on revenue capacities, rather than actual revenue performance, thus penalizing low revenue efforts.<sup>10</sup>

### **3. Reforming inter-governmental transfer systems**

In most countries, inter-governmental transfers constitute the backbone of sub-national finances, accounting for the bulk of sub-national revenues, especially at the intermediate (state/region) level of government.<sup>11</sup> They fulfil different objectives: filling the gap between sub-national own revenues and spending responsibilities (vertical imbalances), equalizing revenue capacities and spending needs among SNGs, and funding sub-national spending programs regarded as national priorities or as having positive externalities. Different types of transfers privilege one or the other objective: revenue sharing is the most commonly used instrument to fill vertical imbalances, whereas equalization transfers aim to reduce horizontal imbalances, and block and special purpose transfers seek to finance sub-national spending in priority sectors and programs.

The relative weights of the objectives vary from country to country, reflecting a range of economic, institutional and socio-political factors. Accordingly, inter-governmental transfer systems differ significantly across countries, as evidenced by the country profiles in the Annex. For example, shared revenues are very important in Argentina, Australia, Austria, Belgium, Colombia, Germany, Mexico and Spain, which are all characterized by large vertical imbalances. In other countries (e.g., Canada, India, and the US), block or special purpose transfers play more important roles. Moreover, the degree of conditionality attached to such transfers varies widely across countries, types of programs, and over time. Many countries have explicit equalization transfers, although the criteria for their distribution vary significantly,<sup>12</sup> whereas other countries (e.g., Argentina, Mexico and the US) do not.

Despite such diversity, sound systems of inter-governmental transfers should ideally display a number of characteristics, namely:

---

<sup>10</sup> This is the case in Australia and Canada.

<sup>11</sup> CG transfers to SNGs (excluding shared revenues, which in the national accounts are treated as taxes) account for about 37 percent of sub-national revenues on average in OECD countries (31 percent in OECD federal countries).

<sup>12</sup> For instance, the Canadian equalization transfer system only equalizes revenue capacities, while the Australian one aims at equalizing both revenue capacities and spending needs. Equalization systems also vary widely in terms of the complexity of formulas and indicators used, reflecting in particular countries' preferences for transparency and popular acceptability of the systems and the availability of relevant data.

- Adequacy (i.e., sufficiency to avoid unfunded mandates for SNGs);
- Minimization of discretionality, to avoid soft budget constraints;
- Flexibility, to help SNGs avoid pro-cyclicality and cope with exogenous shocks;
- Reflection of social preferences for redistribution;
- Creation of appropriate incentives for recipient governments to exploit own revenue potentials and to deliver efficiently public services of their responsibility;
- Transparency in design and implementation; and
- Simplicity, to avoid excessive complexity.<sup>13</sup>

In practice, actual transfer systems generally fall short of meeting one or more of these criteria, not least because their design or implementation is often shaped more by political economy considerations than by economic principles and fiscal soundness. Moreover, transfer systems tend to be the object of reforms, and thus change over time, even more so than other aspects of intergovernmental fiscal systems.

IFC can facilitate sound reforms of intergovernmental transfer systems by helping the search for win-win solutions to common challenges. For example, in 2001 the Belgian CG was able to pass an initially very contentious intergovernmental fiscal reform by combining increased regional tax autonomy (which was advocated by the Flemish region) with increased transfers for education (which were important to the Walloon region).

Such win-win outcomes are more likely to materialize when the CG is the driving force of reforms, as was the case with the *Lambermont* Agreement in Belgium and the above-mentioned VAT reform in Australia. The likelihood of success increases if the CG has some fiscal space to increase the overall envelope of transfers or to “sweeten the deal” for the SNGs in some other ways. For example, in both Austria and Switzerland the CG secured consensus among the states/cantons to proposed changes in equalization transfers by shouldering the cost of transitional arrangements designed to ensure that no SNG would see its nominal transfers reduced by the reform.<sup>14</sup> Likewise, Australia introduced financial incentives for the states as part of a redesign of special purpose transfers to make them more performance-oriented. These changes were agreed under the aegis of the top intergovernmental forum, the COAG, and their implementation is monitored by the independent Reform Council (CRC) established by the COAG in 2006.

## V. IFC in sectoral policies

IFC has probably the greatest potential payoffs in specific sectoral areas, especially those characterized by extensive concurrent spending responsibilities, and/or by significant negative

---

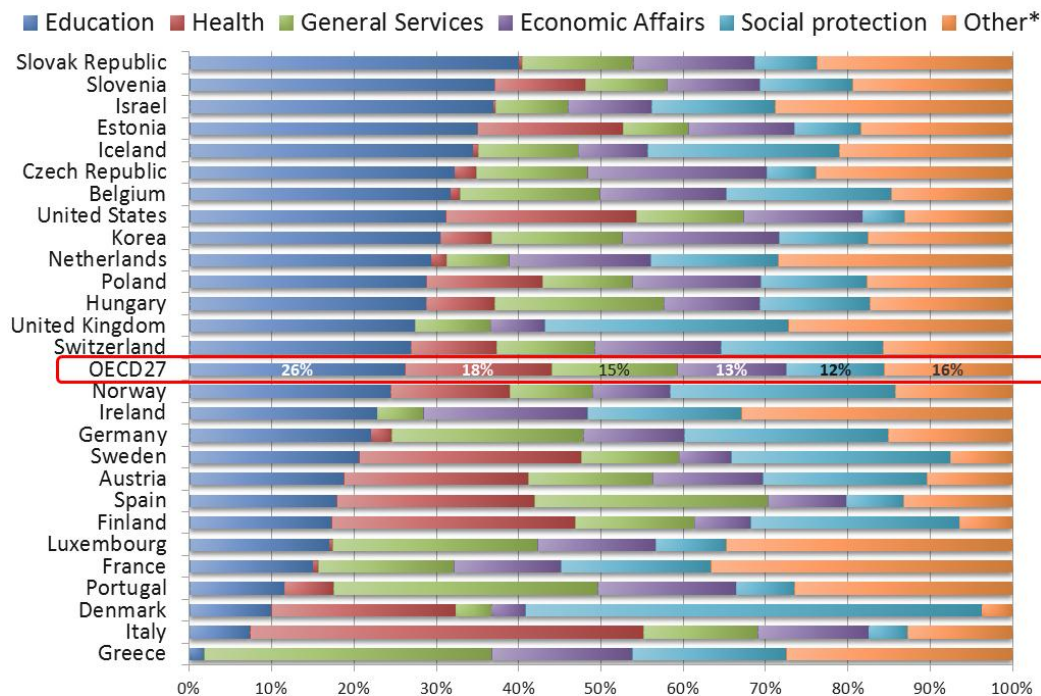
<sup>13</sup> There is a vast literature on the desirable characteristics of intergovernmental transfer systems (e.g., Boadway and Shah, 2007; Ahmad and Brosio, 2006).

<sup>14</sup> Financial incentives have also been used by CGs to promote consensus on other types of intergovernmental reforms, for instance by Denmark and Finland to encourage mergers of small municipalities, and by Canada to promote harmonization of provincial VATs.

or positive externalities. Horizontal cooperation can help minimize conflict (e.g., over scarce resources); reduce adverse spillovers from a jurisdictions to others, especially neighboring ones; exploit potential economies of scale; and promote favorable demonstration effects and learning from relevant diverse experiences. Vertical cooperation, in addition to facilitating all the above-mentioned outcomes, can help avoid cost-shifting through the establishment of inappropriate standards and regulations by higher-level governments on their lower-level counterparts. Therefore, it is not surprising that most countries have a variety of intergovernmental sectoral cooperation fora, although the potential for such cooperation is still far from being fully exploited.

Specifically, IFC can be very beneficial in a number of public expenditure areas, in which SNGs are responsible for relatively large (and frequently rising) shares in many countries (as evidenced for OECD countries by Chart 1 below).

**Chart 1: Functional composition of sub-national expenditures in OECD countries, 2013**



\* Other: Defence; Public order and safety; Housing and community amenities; Recreation, culture and religion; Environment.

Source: OECD.

The case for IFC is quite strong in the education area, which accounts for over a quarter of sub-national spending on average among OECD countries. Due to citizen's mobility across the national territory, there is a potential for significant spillovers of the benefits of good education provided by one SNG onto the labor market and productivity in others. Similarly, shortcomings in education quality in one jurisdiction can subsequently affect adversely labor productivity in other jurisdictions, and ultimately nationwide. Therefore, there is a strong case for the

adoption of common national minimum standards, supported as needed by well-designed equalization transfers.

Specific fora for intergovernmental cooperation in the education area can provide useful venues for the discussion of, and agreement on, standards that should be well adapted to economic and social realities. These fora can also promote the sharing of good practices and lessons from failures among sub-national education officials, as well as facilitate agreement on needed reforms. Many of the countries reviewed in the Annex have intergovernmental fora in the education area.

Arrangements for intergovernmental cooperation are also quite frequent in health care, especially in countries in which SNGs have concurrent spending responsibilities with the CG in the delivery of services. Such arrangements can be especially useful in the prevention and care of contagious diseases, which, by their nature, have spillover effects across local or regional borders, as well as in the dissemination of good practices in the design and implementation of health care programs. Examples in this area include the intergovernmental health forums at the ministerial level in Argentina and Australia, and the health and social issues commission of the National Governors' Association in the United States.

Intergovernmental cooperation fora can also have beneficial effects in various infrastructure areas, for example:

- Water resource management, to facilitate agreement on building of waterways from water-rich regions to more arid ones, on efficient utilization of scarce water resources among different users, and on the avoidance of upstream pollution. A notable example in this area are the Australian Intergovernmental Agreement of 2004 on the National Water Initiative and the one on the management of the Murray-Darling Basin of 2013, both concluded under the auspices of the COAG mentioned above.<sup>15</sup> Brazil's Pact for the Management of Water Resources, which includes the CG, the states and water basin councils, is another case in point.<sup>16</sup>
- Environmental management and conservation, given the substantial potential for regional and even national spillovers of local activities in this area.
- Energy management, distribution and conservation. Again, Australia offers a good example in this area with a National Partnership Agreement on Energy Efficiency, sponsored by the COAG in 2009.
- Interregional and intermodal transport infrastructures, to maximize synergies between transport projects undertaken at the local and regional level, with a view to improving connectivity.

Intergovernmental cooperation in all the areas above is especially important among the municipalities comprising large metropolitan areas. Indeed, most such areas have created joint

---

<sup>15</sup> Details on these agreements can be found on the COAG's website [www.coag.gov.au](http://www.coag.gov.au).

<sup>16</sup> See OECD (2015a) for more information and discussion on the Brazilian experience. The Delta Program in the Netherlands is another interesting case, given the status of the Dutch Water Boards as a separate level of administration.

institutions (including jointly owned enterprises in some cases) for the management of public transport, water and sanitation, and other major utilities in the area.<sup>17</sup> In New Zealand, the nine municipalities in the Auckland area have formed a joint Council, which now decides on all matters of common interest and constitutes a powerful interlocutor of the CG. In several European countries, local governments have set up specific vehicles for the delivery of local services, ranging from transport to waste water management and solid waste disposal.<sup>18</sup> France and the United Kingdom provide good examples of inter-jurisdictional cooperation in metropolitan areas.<sup>19</sup>

However, there is significant scope for further progress in this area. Local governments have in general yet to extend these cooperative arrangements beyond service delivery, to include policy coordination functions, which is particularly challenging at the local level, given the diversity and fragmentation of local governments.

Finally, there can be significant benefits from intergovernmental cooperation in the area of regional economic development. It is increasingly evident from the international experience that sustainable and territorially balanced development requires the emergence of development poles/hubs in the less developed area. These hubs can promote the catching up of lagging regions to their more developed counterparts based on their respective comparative advantages (e.g., natural resources, agricultural potential, tourism, or the manufacturing of high value-added goods).

The creation of such hubs requires, in turn, extensive physical and social infrastructure to attract both private investments and skilled labor. For both, a coordinated approach between the CG and the regional and local authorities in the area concerned is essential to maximize synergies, avoid duplications of spending and/or work at cross-purposes. Cooperation is also important with the governments of other localities that are in the region but outside the hub, so as to maximize the connectivity that allows such localities to benefit from the development of the hub. The existence of permanent fora for dialogue among SNGs can also help prevent excessive competition among them in the form of, ultimately self-defeating, attempts to influence investment location decisions through fiscal or financial subsidies, and/or through overly accommodating regulatory regimes.

## **VI. IFC in strengthening fiscal management**

SNGs frequently suffer from significant shortcomings in their management capacities on both the revenue and the expenditure sides. Main weaknesses in revenue administration include limited audit capacities, delays in enforcement of overdue tax payments, and, especially at the local level, incomplete and outdated property cadasters.

---

<sup>17</sup> See Bahl, Lynn and Wetzel, 2011; and de Mello and Lagos-Peñas, 2013.

<sup>18</sup> De Mello (2010) provides various examples in this area.

<sup>19</sup> See OECD (2015b) for various examples of intergovernmental cooperation in metropolitan areas.

The list is even longer as regards weaknesses in sub-national public expenditure management, although it must be recognized that there are also examples of sound public financial management systems in many states and cities, especially in advanced countries. These weaknesses include:

- Frequently unrealistic budget projections, inadequately developed budget classifications, little or no analysis of fiscal risks;
- Lack of medium-term frameworks and transparency of future spending obligations (for example pensions of sub-national civil servants);
- Limited or non-existent systems of budgeting for results, with adverse effects on the quality of the goods and services provided by most SNGs;
- Inadequate systems of selection and execution of public investments;
- Lack of single Treasury accounts and modern financial management information systems (IFMIS), as well as inadequate monitoring of the budget execution;
- Lack of uniform accounting and reporting standards; and
- Weak internal and external control and auditing systems.

IFC can be very useful in addressing these shortcomings. One important example of vertical cooperation in tax administration is represented by piggy-backing mechanisms (i.e., the levying of sub-national surcharges on national taxes). In these cases, SNGs use the same bases as national taxes and may delegate to the national tax administration the collection of the surcharges. For example, in Canada this is the case with the provinces that have adopted the Harmonized Sales Tax (HST). This is also the case of VAT in Australia, which is collected by the CG on behalf of the states, whereas in Chile the national tax administration is responsible for the collection and enforcement of the municipal property tax.

Even when SNGs maintain responsibility for collection of their own taxes, there is generally significant scope for strengthening both national and sub-national tax administrations through:

- Systematic exchange of taxpayer information (e.g., through the sharing of taxpayer registries), use of a common taxpayer ID number, and sharing of income tax returns and/or of electronic VAT invoices, when available;
- Joint audit and enforcement efforts; and
- Sharing of experience, good practices and know-how, including in particular in the design and maintenance of modern property cadasters.

IFC can also contribute importantly to strengthening SNGs' capacities to fulfil effectively and efficiently the spending responsibilities assigned to them. CGs can help SNGs strengthen their systems and procedures for budget preparation and execution, as well as monitoring and improving the efficiency and effectiveness of spending programs, and especially of public

investments. In particular, CGs can support, including financially when necessary, the adoption by SNGs of improved financial management information systems (IFMIS).<sup>20</sup>

The CG should require whenever legally feasible, and otherwise encourage, the adoption by SNGs of common accounting norms, consistent with the relevant international standards, and of high fiscal transparency standards.<sup>21</sup> The increasing emphasis placed by the EU institutions in the aftermath of the Euro crisis on the adoption of common accounting standards for all entities in the general government underscores the importance of this point. In Mexico, the above-mentioned *Comisión Permanente de Funcionarios Fiscales* is responsible for monitoring the conformity of the states' fiscal accounting and reporting practices with the standards mandated by the recently passed fiscal responsibility legislation.

Finally, IFC fora, both vertical and horizontal, can prove to be very useful vehicles for disseminating good practices in both tax administration and PFM, highlighting the costs of bad ones, and promoting positive demonstration effects. Most of the fora discussed in the Annex include organizational structures specifically devoted to this function.

## **VII. Some tentative lessons for Brazil**

### **1. Salient features of the Brazilian federation in an international perspective**

The Brazilian federation is characterized by a degree of political and fiscal decentralization that is relatively high by international comparison, although the balance of powers among the different levels of government has changed over time, with ebbs and flows of centralization.

On the political level, not only the states but also the municipalities have a constitutional status of members of the federation, implying no hierarchical subordination of one level of government to another. The 1988 Constitution marked a shift of powers and resources to the municipal level, at the expense of the states and, especially, the federal government. Moreover, the federal government has increased its direct interactions with local governments in recent decades, especially in service delivery.

Brazil has a presidential form of government, with clear separation of functions among the three branches of government (Executive, Legislative, and Judiciary), although the balance of powers among the three has varied over time. The federal parliament, the Congress, is bicameral. The states have equal representation in the Senate, regardless of their geographical, social or economic characteristics. Both Chambers of Congress have equal powers on most issues of concern to SNGs. However, the Senate sets the limits on sub-national debt.

---

<sup>20</sup> In some cases, especially smaller or poorer SNGs may find it less costly to execute their budgets through the national IFMIS. It should be noted that such a choice need not involve any loss of budget autonomy by the SNGs in question.

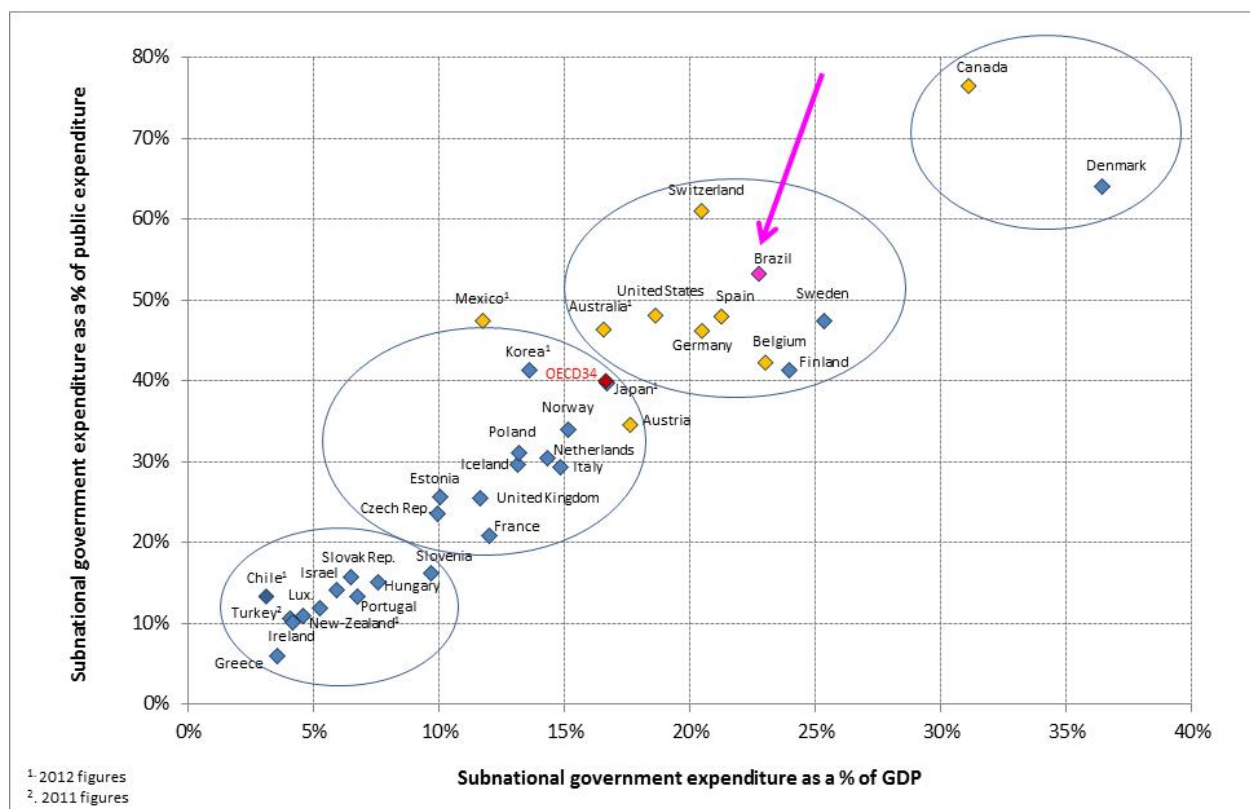
<sup>21</sup> The CG can set a useful example in this respect by undertaking a fiscal transparency assessment based on the newer methodology of the IMF (IMF, 2014).



The federation is characterized by large disparities among the sub-national jurisdictions, regarding geography, population size and density, and level of economic development. Nevertheless, Brazilian federalism is largely symmetric, applying the same approaches to the assignment of spending responsibilities and revenues to all SNGs, regardless of level of government, while lacking a comprehensive equalization transfers system. Arguably, this exacerbates the federative conflicts that tend to characterize relatively heterogeneous countries.

Although in principle expenditure assignments follow subsidiarity criteria, in practice there is substantial overlap of spending responsibilities in the main functions of government (including education, health care, social assistance, and law and order). Moreover, the federal level of government exercises significant regulatory powers in a number of areas of state and local responsibility, and in doing so it imparts substantial rigidities to sub-national spending. For example, federal laws regarding the minimum wage and the indexation mechanisms for social assistance benefits have a significant impact on sub-national spending, as do constitutional minimum spending requirements on education and health care. Notwithstanding this caveat, SNGs in Brazil carry out relatively large shares of spending, compared with most OECD countries (Chart 2).

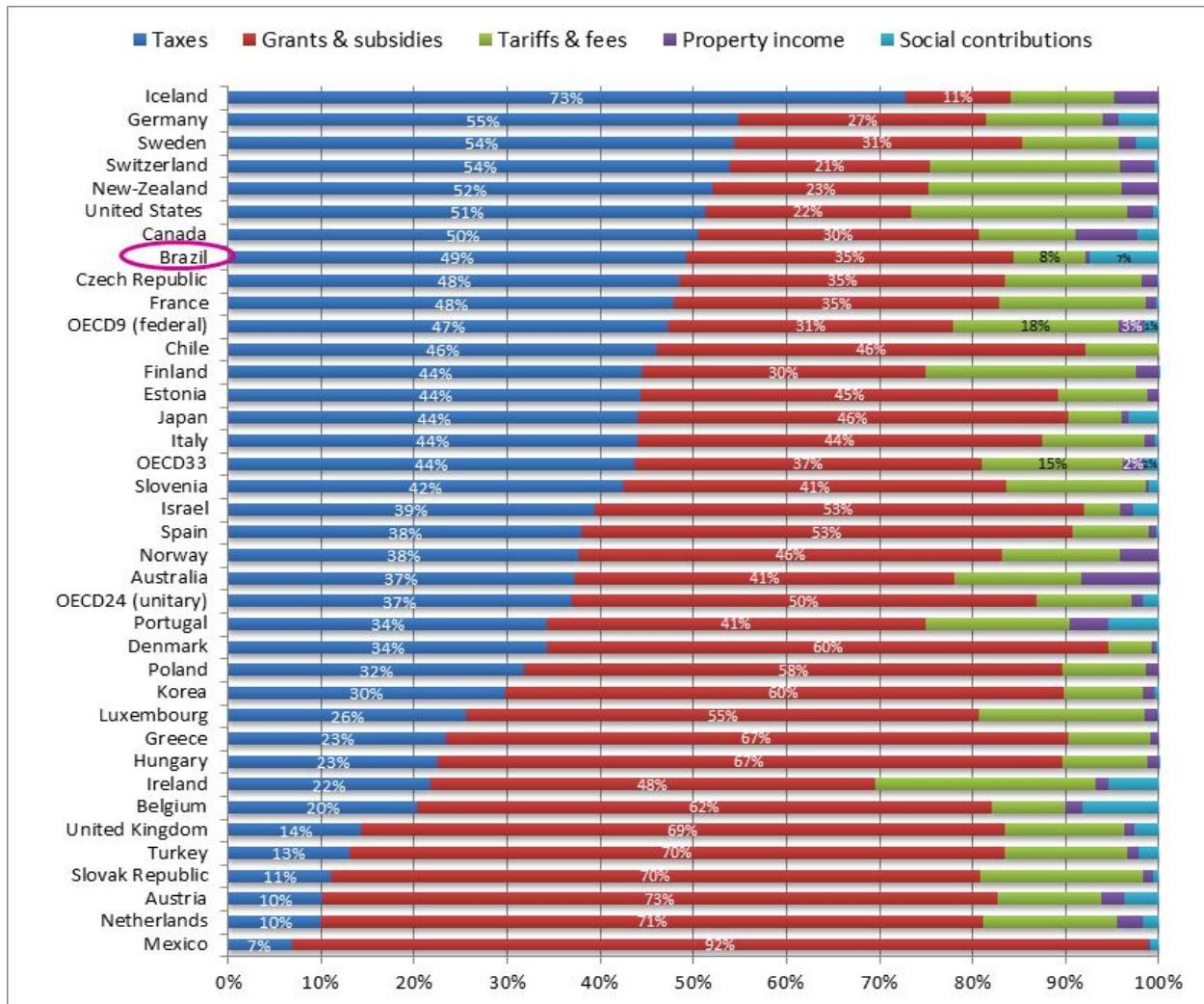
**Chart 2: International comparison of spending decentralization**



Source: OECD database

SNGs also enjoy greater revenue-raising autonomy in Brazil than in the OECD average (Chart 3), although they are broadly on par with the average of other federations in the area.

**Chart 3: International comparison of the composition of sub-national revenues, 2013**



Source: OECD.

However, the Brazilian sub-national tax system is fraught with significant flaws, which are widely recognized to affect adversely efficiency, equity and competitiveness. The main problem is the heavy reliance of state finances on a mixed origin/destination-based VAT (the *ICMS*), with a large dispersion of effective rates across goods and services, and the national territory, which has led to predatory tax competition (the so-called fiscal war), de facto cascading, and high compliance costs for taxpayers.

Reform efforts to date have been stymied in particular by the fact that a shift to a more neutral destination-based VAT with a uniform base across the nation would entail significant losses for the states that are net exporters to the rest of the country. However, the urgency of such a reform is becoming more apparent to the state authorities, as they see their revenues eroded by the “fiscal war”, and as the competitiveness of Brazilian enterprises is hampered by the cumulateness and high compliance costs of the *ICMS*.

At the local level, many municipalities do not appear to exploit adequately the important tax bases (services and urban properties) assigned to them. This reflects, in addition to weaknesses in the property cadasters, a lack of political will to tax property effectively, as a result of transfers to municipalities being relatively large and not structured to provide incentives to own-revenue raising efforts.

The intergovernmental transfer system has significant pros and cons. On the positive side, it is largely formula-based, thereby reducing discretion and the scope for political bargaining. On the negative side, the linkage of a large share of the transfers to federal revenues that are unadjusted for the economic cycle can lead to pro-cyclicality in sub-national fiscal policies; the coefficients for horizontal distribution of shared revenues have been fixed for decades; and, even after recent reforms, the underlying formulas are not appropriately equalizing either in terms of revenue capacities or of spending needs.<sup>22</sup> While the block grants for education (*Fundeb*) and health care are redistributive, they are small in relation to the constitutionally mandated transfers, and they also fall significantly short of being adequately equalizing of the capacities of different SNGs to provide these important services.

As regards macro-fiscal aspects of the system, the Fiscal Responsibility Law (the FRL) of 2001 stipulates uniform ceilings for the debt of the states and of the municipalities, but, except for a few outliers, these ceilings are non-binding. Instead, the binding constraints on SNGs’ borrowing are set in the contracts agreed with the federal government in the context of the sub-national debt restructuring of 1996-97 and related debt service requirements, which until 2009 implied the need for most SNGs to run primary fiscal surpluses. In the last few years, however, these constraints were eased through discretionary authorizations by the federal Treasury for some states to borrow.

As a result, the overall sub-national primary balance has been on a deteriorating trend, currently aggravated by the recession and related downturn in own and shared revenues. The aggregate net debt of the states, after falling through the previous decade, has been rising in the more recent period, and is currently equivalent to around 10 percent of GDP. Municipal debt amounts to under 2 percent of GDP. There is, however, wide variance in the size of the debt of individual SNGs, relative to their revenues.

---

<sup>22</sup> A more detailed discussion of the shortcomings of Brazil’s sub-national revenue system can be found in Ter-Minassian, 2012.

The FRL instituted strict accounting, reporting and transparency requirements for the Brazilian SNGs. The CG supported in various ways the states' and municipalities' efforts to strengthen and modernize their financial management and information systems in order to meet such requirements. As a result, Brazil's performance in this area is largely on a par with those of the best-performing advanced countries. Considerable effort has also been put in strengthening state tax administrations, including through vertical and horizontal cooperation. However, the administration of local property taxes remains quite weak, reflecting high levels of informality in housing markets and outdated cadasters in many municipalities.<sup>23</sup>

The main current vertical fiscal cooperation forum is the *Conselho Nacional de Política Fazendária (CONFAZ)* presided by the federal Minister of Finance (or the Vice Minister) and including the Finance Secretaries of all the states. The main responsibilities of the *CONFAZ* relate to tax policy and administration: the Council is responsible for approving all tax concessions under the *ICMS*, for promoting improvements in state tax administration, and for the management of an information system on state revenues (*Sistema Integrado de Informações Econômicas e Financeiras, SINIEF*). It is also responsible for coordinating with the National Monetary Council on state debt policies. In 2012, the states created a horizontal cooperation forum comprising their secretaries of finance (*the Conselho de Secretários de Fazenda, or CONSEFAZ*), to promote coordination of state positions on issues to be taken up by *CONFAZ*. Both fora are supported by a technical secretariat.

There are also a number of other horizontal inter-governmental cooperation fora:

- Nineteen sectoral ones at the state level, which cover most areas of state spending;
- Several associations of municipalities, including for the state capitals and the large municipalities, with primary advocacy functions; and
- Many inter-municipal consortia, aiming to exploit potential synergies in selected spending areas by neighboring municipalities. This form of cooperation is particularly widespread in the case of health care, especially hospital management, as well as education and culture, and environmental management. Indeed, almost half of Brazil's local governments participate in inter-municipal consortia for health care.

## **2. Possible approaches to strengthening IFC in Brazil, in the light of international experience**

In comparison with the other large federations mentioned in this paper, IGC appears to be currently rather limited in scope in Brazil. Particularly notable is the absence of high-level cooperation fora, both vertical and horizontal, at the state level. There are no equivalents of

---

<sup>23</sup> See Bonet, Munoz, and Pineda Mannheim (2014).

the Australian COAG, the Spanish Conference of the Presidents, the Canadian Council of the Federation, or the US National Association of Governors.<sup>24</sup>

While there are a number of sectoral horizontal cooperation fora among the states, the experience with them has yet to be assessed in detail, especially as to the extent that they influence policymaking and promote the dissemination of good practices among the states. It appears that they tend to act independently, failing to articulate consistent cross-sectoral strategies, including vis-à-vis the federal government. In the specific fiscal area, the mandate of the *CONFAZ* is relatively narrow, focusing primarily on the *ICMS*.

Horizontal cooperation appears better developed at the local level, where various municipal associations carry out a significant advocacy role. However, there would seem to be scope for further progress in the role of these associations in the analysis of policy issues of relevance to the municipalities, the promotion of consensus on them, and its articulation in vertical cooperation fora. Heterogeneity among the local governments, which is broader than for the states on account of the vast disparities in size and socio-economic characteristics of the municipalities, poses an obstacle to effective cooperation at the local government level.

The lack of effective state cooperation fora has a number of negative consequences:

- Policy decisions at each level of government are often taken without a careful analysis and due consideration of their possible adverse spillover effects on other levels of government (or other governments within the same level). Examples in this respect are federal policies regarding shared taxes, civil servants' wages and the minimum wage, or public employment legislation. There are currently several pieces of legislation under debate in Congress that could have significant repercussions for the state finances.
- The states do not have a formal and permanent venue for discussion of cross-cutting issues of relevance to them, and for the formulation of common positions on proposed actions by other levels of government. The absence of such a venue makes it also more difficult to identify potential trade-offs and workable compromises in areas where the interests of different states diverge, reflecting the above-mentioned heterogeneity of the Brazilian federation.
- The advocacy power of the states vis-à-vis all three branches of the federal government, and also vis-à-vis the better coordinated large municipalities and state capitals, is reduced, and so is the effectiveness of efforts to disseminate knowledge and best practices.

In the light of these considerations, it would seem important to put in place more effective cooperation mechanisms for the states. Ideally, it would be best to create both a vertical and a

---

<sup>24</sup> Recent press reports suggest that an agreement may have been reached among state governors to constitute a high-level horizontal cooperation forum, but no details are yet available on its mandate and procedural arrangements.

horizontal cooperation forum (for example, on the model of the Australian COAG and Council of Australian Federation, respectively).

The former would be a forum for discussion and, to the extent possible, formation of consensus between the Chief Executives of the federal and state governments (the President and the Governors, respectively) on major issues of a federative nature (e.g., reforms of the intergovernmental relations systems, implications of major policy decisions of one level for the other). Consideration should be given to how to include representatives of the local level (possibly the heads of the major municipal associations) in such a forum, for example by inviting them to attend the meetings of the forum as observers, and possibly with a voting power on the deliberation of issues of immediate relevance to the municipalities.

The high-level forum could be chaired by the President, with possibly a Vice-President chosen on a rotating basis among the Governors, and would play a broad oversight role over sectoral (ministerial-level) vertical cooperation fora in key spending areas, as well as over a cooperation forum in the fiscal area.

This latter forum could be chaired by the federal Minister of Finance, and include the Secretaries of Finance of the states. While the membership of the forum could mirror that of the current *CONFAZ*, its mandate would be substantially broader, encompassing all aspects of intergovernmental fiscal issues, including the effects of fiscal policies of one level of government on the others. This forum could be constituted by expanding the current mandate of the *CONFAZ* and possibly re-naming it the “*Conselho de Gestão Fiscal*”, along the lines envisaged in the 2001 Fiscal Responsibility Law (but with a broader mandate). An important potential advantage of such a forum would be the scope it would create for identifying packages of reforms of different aspects of intergovernmental fiscal relations that would facilitate the compensation of losses from individual reforms (for instance offsetting some losses from state tax reforms with gains from changes in the distribution of shared revenues).<sup>25</sup>

The horizontal high-level cooperation forum among the states could focus on the analysis and deliberation on major cross-cutting policy issues of relevance to them. It would aim to promote the formation of common positions on such issues, with a view to advocating them in the national Congress, the Supreme Court (STF) and within the relevant Executive-level vertical cooperation fora. This Governor-level forum would provide an umbrella for the existing ministerial (*Secretários*)-level fora, including the *CONSEFAZ* -- whose mandate should be expanded in line with that of the *CONFAZ* --, with the objective of ensuring consistency across policy areas.

### **VIII. Some brief conclusions**

The analysis in the previous sections indicates that there is a strong theoretical case for IFC in both federations and unitary states, especially in light of the trend in many countries towards

---

<sup>25</sup> See Ter-Minassian, 2012 and Khair, 2011

the decentralization of responsibilities for the delivery of important public goods and services to sub-national levels of government. Well-functioning IFC arrangements can help the different levels of government recognize and attenuate adverse externalities from their policies, better exploit economies of scale in the provision of certain public services, reduce the risk of spreading of contagious diseases, improve citizen's security and environmental quality, and maximize connectivity, to cite just some of its potential benefits.

However, as demonstrated by the country experiences mentioned above, and further detailed in the Annex below, there is no easy recipe to ensure well-functioning IFC. The effectiveness of IFC fora is strongly affected by a range of economic, socio-political and institutional factors, including constitutional provisions that reflect the history of decentralization in each country, power balances among the different levels of government, the design and actual practice of intergovernmental fiscal relations (in particular the degree of spending and revenue autonomy of SNGs), and the extent of regional economic, ethnic and social disparities which can, and often do, give rise to conflictual attitudes and prevent constructive dialogue among SNGs.

These considerations suggest that effective models for IFC need to be very much tailored to individual countries' circumstances, and that lessons from other countries' experiences can be useful in shedding light on the advantages and disadvantages of possible design options, but they cannot be imported uncritically. Among the lessons from international experiences, the following ones appear worth emphasizing:

- Different IFC fora serve different purposes and require different compositions. For example, sectoral fora need to include policy makers and specialists in each specific area; fora to promote cooperation in strengthening revenue and expenditure management should include tax and Treasury officials, respectively; and fora to discuss fiscal policy reforms need to include the highest level (Ministers or Secretaries of Finance) responsible for the national and sub-national public finances. However, there is also a need to ensure that the different fora do not work at cross-purposes. This highlights the desirability of an overarching forum, involving the Chief Executives of the national and intermediate levels and a suitably high-standing representation of the local level, to promote consensus on the main policy issues of an inter-governmental nature.
- Vertical cooperation is most likely to be successful when the Executive branch of the national government is relatively strong and can exercise effective policy leadership.
- Horizontal cooperation fora can usefully complement vertical ones and are especially needed for the relatively fragmented local level. Horizontal cooperation is likely to be the main form of IFC in federations characterized by substantial revenue and expenditure autonomy of the constituent states vis-à-vis the national government.
- There is also a potentially useful role for cooperation among relevant subsets of the sub-national levels of government, for example among the municipalities encompassing a metropolitan area, to coordinate the provision of services like public transport, roads, and water management, and to minimize predatory tax or regulatory competition.
- The effectiveness of IFC fora is clearly likely to be reduced by tensions of an ethnic nature, or arising from very sharp differences in natural resource endowments, levels of

development or economic structures across a national territory, or more generally by a history of perceived unfairness by the national government in the distribution of resources among SNGs. Even in such contexts, however, it can be argued that dialogue in an institutional IFC forum can be useful in the search for win-win packages of policy reforms, as it can help identify trade-offs and compensations between winners and losers from such reforms.



## Annex- Selected short country profiles

As a background to the analysis in the text above, this Annex briefly summarizes the salient features of intergovernmental fiscal relations and the main intergovernmental fiscal cooperation channels in selected countries, mostly large federations, inside and outside the European Union.

### I. Non-EU countries

#### 1. Australia

The Australian Federation comprises the federal (Commonwealth) government, six states, two self-governing territories, and over 700 local governments, which vary significantly in size, population, and geographic and economic characteristics.

Respective spending responsibilities are defined clearly by the Constitution. Sub-national expenditures account for nearly half of general government spending. However, the Commonwealth's extensive constitutional regulation powers in areas assigned to the states result in substantial de facto overlap of spending responsibilities. This blurs accountability to the Parliament and the electorate, and has led to duplication and inefficiencies.<sup>26</sup>

Most taxation powers are concentrated at the federal level, which accounts for over 80 percent of total tax revenues. The resulting large vertical imbalance has facilitated an extensive use of conditional grants, reducing the states' autonomy and accountability in areas of their responsibility. There are also substantial equalization transfers, funded by VAT revenue. The system, which is administered by the independent Commonwealth Grants Commission, aims to address both differences in revenue capacities and spending needs of the states,<sup>27</sup> but it utilizes formulas widely seen as excessively complex and costly to administer.

There are no statutory borrowing limits; borrowing is primarily constrained by financial market discipline, supported by strict transparency requirements. States' debt, which had declined to around 3 percent of GDP in the mid-2000s, has risen again in the more recent years, to nearly 9 percent of GDP.

Australia has a long and extensive tradition of intergovernmental coordination fora, concentrated at the Executive level. These include:

---

<sup>26</sup> See for example COAG (2013) and Koutsogeorgopoulou and Tuske (2015).

<sup>27</sup> The states also provide equalization transfers to their municipalities.

- A Premiers' Conferences which pre-dated the establishment of the Federation in 1901, and was replaced in 1991 by The Council of Australian Governments (COAG), as the highest-level instance of policy coordination between the Commonwealth and the states and territories;
- A number of Intergovernmental Ministerial Councils in different sectoral policy areas;
- The Loan Council, initially created to discuss and agree borrowing limits, but now primarily focused on ensuring transparency of borrowing policies;
- The Commonwealth Grants Commission, mentioned above; and
- The Council of the Australian Federation (CAF), a horizontal coordination forum among the states.

The general assessment in the literature is that these fora have been instrumental in promoting intergovernmental consensus on important tax and spending reforms, as well in facilitating policy coordination in sectoral areas (e.g., water management and health), but they present some shortcomings:

- They are not "institutionalized" (i.e., have no legal basis);
- The timing and agendas of the COAG and the Intergovernmental Ministerial Councils meetings are driven by the federal level, and their proceedings have limited transparency; and
- Their respective responsibilities are not sufficiently clear, and there has been a need to reduce both the number of sectoral fora and their tendency to "delegate upwards".

More generally, there is growing recognition that the system of inter-governmental fiscal relations suffers from significant shortcomings and is in need of comprehensive reform. COAG has commissioned the preparation of a White Paper to outline options for such a reform. The paper is expected to be released and discussed by COAG in 2016.

## **2. Canada**

The Canadian federation is widely regarded as a model example of fiscal federalism, combining separation of functions and taxation powers with a significant degree of territorial solidarity. The federation comprises, in addition to the federal government, ten provinces, three territories and a multitude of local governments, which are under provincial jurisdiction. Canada also provides a significant example of asymmetric federalism, with special regimes for the territories and the province of Quebec.

The Constitution assigns a number of exclusive functions to the federal government and the rest to the provinces, which in turn choose which functions to delegate to their respective municipalities. Concurrent functions are quite limited (mostly immigration, agriculture, and environmental protection). Sub-national expenditures account for nearly 70 percent of total government spending.

The provinces and territories have extensive revenue-raising powers sharing income and consumption tax bases (among others) with the federal government. State and local taxes account for nearly half of total tax revenues. The provinces are also assigned revenues from non-renewable natural resources. As a result, the aggregate vertical imbalance is relatively low, compared to most other federations.

However, given substantial differences in the distribution of natural resources and other tax bases, as well as in spending needs, there are substantial horizontal imbalances. These are addressed primarily through formula-based transfers aimed at equalizing revenue capacities, and through block grants for health and social services. Equalization is only partial, given the budgetary resource constraints of the federal government, a fact that explains continuing redistributive tensions within the federation.

There are no federally imposed restrictions on provincial borrowing, but given the long history of no bailouts from the federal government, some provinces have adopted their own borrowing constraints. Sub-national debt, which had been broadly stable at under 50 percent of GDP prior to the global financial crisis, has risen significantly in recent years, approaching 60 percent of GDP. In recent years, the Parliamentary Budget Office has been providing assessments of sub-national (as well as federal) finances in their annual Fiscal Sustainability Reports.

Canada does not have any formal vertical cooperation forum. The main intergovernmental cooperation fora are horizontal ones: the Council of the Federation that includes the Premiers of all the Provinces and Territories,<sup>28</sup> and the Federation of Canadian Municipalities.

The Council of the Federation is chaired by one of the Premiers on a rotating basis, meets twice a year, and is supported by ad-hoc committees of ministers, a steering committee at deputy-ministers level and a small secretariat. The Council's main mandates are to:

- Serve as a forum where members can exchange viewpoints, information, knowledge and experiences;
- Promote a coordinated approach to federal-provincial relations on the basis of shared analysis and discussion; and
- Analyze actions or measures of the federal government that, in the opinion of the Council members, have a major impact on provinces and territories.

The main areas in which the Council has promoted coordinated policies include: ensuring unfettered internal trade, promoting innovation in health care, the management of water resources, energy and national transportation strategies.

The Federation of Canadian Municipalities acts as a coordination forum among the local governments and as an advocacy group; it has no formal power but significant ability to influence debate and policy at provincial and even federal levels.

---

<sup>28</sup> More details can be found at <http://canadaspremiers.ca>.

### 3. India

The Indian federation includes 29 states, seven territories and a very large number of urban and rural local governments. It is a bi-cameral democracy; the members of the Upper House are elected by their respective states. The federation is characterized by wide disparities in ethnic, religious and socio-economic characteristics. This has favored a strong centralizing role of the federal level of government (the Union), which has only modestly been reduced in line with the decline of the traditionally dominating Congress party.

Expenditure assignments are exclusive or concurrent, with the latter covering major social and economic areas (including health care, education, energy and environmental regulation). Although the states carry out the bulk of spending in most areas, the Union has overriding powers and can even dismiss state governments deemed not to carry out their functions in compliance with the Constitution. The Union's influence is further strengthened by the provision that states indebted to it (in practice all the states) have to obtain its authorization for new borrowings.

Different levels of government are assigned different tax bases, with the most productive ones assigned to the Union. The states' main revenue source is a sales tax, traditionally fraught by substantial distortions but now in the process of being reformed. As a result states are highly dependent on transfers from the Union.

Of these transfers, the current ones are based on criteria set every five years by an ad-hoc independent Finance Commission. The Commissions have traditionally set them with broad equalization objectives, but also to fill ex-post resource gaps, a fact that promotes inefficiency in spending, discourages own revenue efforts and generates moral hazard. Capital transfers and loans are decided by the Union through its Planning Commission, in line with the objectives of successive National Plans.

The Union and most states have adopted fiscal rules targeting the current balance but have a relatively poor record of implementation. States and territories have been running an aggregate deficit in excess of 2 percent of GDP. The general government debt is around 65 percent of GDP.

There are several fora for intergovernmental fiscal coordination, most notably:

- The Interstate Council.<sup>29</sup> This council is rooted in Art. 263 of the Constitution, but was only established in 1990. It is chaired by the Union's Prime Minister and includes the Chief Ministers of states and Territories, plus selected Union's Cabinet members. It is supported by a Standing Committee and Secretariat. It meets on an ad-hoc basis

---

<sup>29</sup> [www.interstatecouncil.nic.in](http://www.interstatecouncil.nic.in)

to discuss high-level federative issues and can issue non-binding but influential recommendations on such issues.

- The National Development Council.<sup>30</sup> This council was created in 1952. It has a composition similar to that of the Interstate Council. Its main functions relate to the development, review and monitoring of implementation of the National Plan.
- Six Zonal Councils, which were created in 1956 to promote dialogue and cooperation among neighboring states and territories.
- Various sectoral inter-ministerial councils to promote vertical and horizontal cooperation in selected functional areas.

There is broad agreement in the literature that these fora have had limited effectiveness so far. The main reasons are probably the strong predominance of the federal government, large vertical imbalance and other institutional flaws resulting in soft sub-national budget constraints, which have fostered reliance by the states on bilateral dealings with the Union, instead of multilateral coordination mechanisms.

There is also broad consensus that IFC needs to be strengthened to face the challenges posed by changing political landscapes, increasing horizontal imbalances among the states, and the need to remove still significant barriers to interstate commerce. However, no institutional initiative has been taken so far to this end.

#### 4. Mexico

The Mexican federation includes the federal government, 31 states and the Federal District, and 2445 municipalities, which are subject to both federal and state laws. The decentralization of spending responsibilities is substantial (in 2012, subnational spending accounted for nearly 50% of total public expenditure), although it has recently been reduced by a recentralization of education, necessitated by the inadequate financial control of such spending by the states. Nevertheless, the federal government wields substantial influence over decentralized expenditures through regulation and conditional transfers to finance major spending categories (the so-called *aportes*).

The Mexican SNGs enjoy very limited revenue autonomy; the main sources of own revenues of the states are a payroll tax, a vehicle tax and some charges for services (*derechos*). The municipalities also rely on *derechos*, as well as on a poorly utilized tax on real estate. The states receive around 20% of federal revenues (*participaciones*) as well as the above-mentioned *aportes* and other specific discretionary federal grants. The municipalities receive state transfers.

---

<sup>30</sup> For more details, see <http://interstatecouncil.nic.in/Ndc.html>.

The heavy (over 90%) dependence of Mexican SNGs on transfers is identified in the literature<sup>31</sup> as an important source of soft budget constraint, as evidenced by repeated bailouts by the federal government of states in financial difficulty. It is rooted in a political system in which state governors wield substantial powers in Congress, and the federal government uses the financial dependence of the states to secure support for the passage of important legislation.

To reduce the need for such bailouts, the federal government has recently enacted new fiscal responsibility legislation setting ceilings on the ratio of state debt to revenue, and requiring the harmonization of fiscal accounting and reporting standards throughout the federation. It is also stepping up efforts to better monitor the evolution of state finances through the *Unidad de Coordinación con las Entidades Federativas (UCEF)* in the Ministry of Finance (*SHCP*), and it is contributing to the funding of programs to improve state and local financial information systems and capacities (in particular through the *Instituto para el Desarrollo Técnico de las Haciendas Públicas (INDETEC)*).

The legal framework for IFC in Mexico is set out in a Law of Fiscal Coordination, first promulgated in 1978 and repeatedly amended thereafter<sup>32</sup>. The law mandated the creation of several fora for IFC, including a high-level *Reunión de Funcionarios Fiscales* that includes the federal Minister of Finance and the Finance Secretaries of the states, and meets at least once a year to discuss main issues in intergovernmental fiscal relations; and a *Comisión Permanente de Funcionarios Fiscales*, in which eight representatives of the states (chosen on a rotating basis) meet more frequently with the Revenue Secretary of the *SHCP* to: monitor the implementation of the revenue sharing system; review developments in state finances; and discuss proposed reforms of the intergovernmental fiscal system. The above-mentioned *INDETEC* acts as a technical secretariat to the *Comisión*. The *Comisión* is generally considered an effective forum for promoting a better dialogue across government levels, as well as among the different states, and has on occasions facilitated the reaching of consensus on needed fiscal reforms.

## 5. Switzerland

The Swiss Confederation is characterized by high degrees of both fragmentation (it comprises 26 cantons and over 2700 municipalities in a country of under 7.5 million people) and sub-national autonomy. These features reflect the wide diversity in language, religion and level of per capita income across the cantons. The cantons are represented in the Council of States, to which the 20 largest cantons elect two representatives each, and the smaller six one each. The Council, which is modeled on the United States Senate, has full legislative powers and a veto power on all federal legislation. A peculiarity of the Swiss Confederation is its heavy reliance on direct democracy (referendums) to decide on fiscal policy issues.

Exclusive spending responsibilities of the federal government are specified in the Constitution. All other functions are split between the cantons and the municipalities, which account for

---

<sup>31</sup> See Pineda, Ramirez and Rasteletti (2015)

<sup>32</sup> Details can be found at <http://snf.gov.mx>

about 38 percent and 20 percent, respectively, of total general government spending. Each government level has substantial autonomy in carrying out its assigned responsibilities.

There is substantial overlap in the taxation powers of the different levels of government as regards personal and corporate income taxes. In contrast, the federal level controls most indirect taxes, and the cantons and localities the property taxes. In all, the cantons account for nearly 30 percent and the localities for about 19 percent of total tax revenues. There is significant tax competition among cantons in both the provision of tax exemptions and the setting of the rates of personal and corporate income taxes.

Fiscal equalization transfers have been historically relatively small and ineffective. They have been strengthened by a 2008 reform, but fiscal disparities among both cantons and municipalities remain significant.

There are no federally imposed limits on cantons' borrowing, although most subscribe to a principle of balancing their budgets over the medium term. In fact, some cantons have accumulated sizable debts. Aggregate sub-national debt is equivalent to around 22 percent of GDP.

Given the characteristics of the Swiss Confederation, it is not surprising that intergovernmental fiscal cooperation is not much developed. There is no institutionalized forum for coordination between the federal government and the cantons. The main channel of influence of the cantons on national policies is the Council of States (see above).

The main forum for multilateral cooperation among the cantons is a Presidents' Conference, supplemented by sectoral ministerial-level ones. Horizontal coordination is frequently enshrined in inter-cantonal agreements on specific issues or policies, which may include all the cantons or a subset of them.

## **6. The United States**

The US federation encompasses the federal government, 50 states and more than 87,000 local governments. Each state has its own Constitution. In cases of conflict between the national and state laws, the former prevail. The US has a bi-cameral national Congress, where legislation needs to be sanctioned by both Houses. Each state elects two representatives to the Senate.

The assignment of spending responsibilities broadly follows the subsidiarity principle, but many services are unbundled, leading to concurrent responsibilities in several broad spending areas. The states' share in total expenditures is just slightly lower than that of the federal government. However, the influence of the federal government on spending has been rising in the last several decades, especially through the imposition of (sometimes unfunded) spending mandates on lower government levels.

The three levels of government share the income tax base, while most indirect and property taxes are levied at the sub-national level. State taxes account for about 20 percent, and local

taxes for 15 percent, of total general government taxes. States and localities engage in significant tax competition, especially in corporate income and consumption taxes, as well as excises. There are, however, constitutional limitations on sub-national taxation powers: states cannot levy taxes on international trade and taxes deemed to impede interstate commerce.

There are no revenue sharing and equalization transfers. Intergovernmental transfers take the form of block or special-purpose transfers, reflecting allocative, as well as distributional, purposes.

There are no controls on sub-national borrowing imposed by higher-levels of government, but most states have adopted constitutional rules of balanced current budgets. The adoption of such rules is largely the result of a long history of no bailouts of states by the federal government. There is a formal bankruptcy procedure (chapter 9) for insolvent local governments.

The presidential nature of the federal government and related separation of powers have prevented the emergence of executive federalism (as in parliamentary-type federations, like Australia or Canada). The main formal channel of influence of the states on federal policies is through the Senate, in which the states have more direct and equal representation.

Inter-governmental cooperation is therefore largely horizontal, including associations of state governors and of state legislatures, and various local inter-governmental associations, with a primary advocacy function. States and local governments also enter into ad-hoc agreements on issues of mutual interest.

The National Association of State Governors (NGA) plays an important advocacy role for the states, not only by lobbying the Executive and the Congress on issues of particular relevance to the states, but also by representing the states' viewpoints on issues being taken up by the Supreme Court. The NGA is articulated into four permanent Commissions (on Economic Development, Education and Labor, Health and Social Issues, and Natural Resources) responsible for analyzing and promoting the achievement of states' common position on issues in their respective areas. Over the years, the association has promoted agreement by the states on set of common broad principles on federative relations and on tax reform. The NGA also, especially through its Center on Best Practices, promotes the dissemination of knowledge on issues of relevance to the states.<sup>33</sup>

## **II. Euro area members**

The adoption of the Fiscal Compact in 2012 by most EU members and its translation into high-level national legislation have shaped the evolution of intergovernmental fiscal cooperation in

---

<sup>33</sup> More details on the NGA can be found on its website ([www.nga.org](http://www.nga.org)) and in Carvalho (2015).



the EU in recent years. The key features of the new fiscal framework can be briefly summarized as follows.

The fiscal numerical rules included in the Stability and Growth Pact (SGP) have been strengthened. The medium-term structural fiscal deficit objectives (MTOs) must not exceed 0.5 percent of GDP. Nominal deficits higher than 3 percent of GDP still trigger the excessive deficit procedure (EDP). The gross public debt should not exceed 60 percent of GDP. Countries in violation of these limits must adhere to pre-specified correction paths. The framework is supported by enhanced surveillance by the EC, and by strengthened procedures for the application of sanctions for protracted violations of the rules.

The fact that all limits apply to the general government (GG), but the central government (CG) is responsible for ensuring their observance, has heightened the need for intergovernmental cooperation in EU countries. There is significant variation in the mechanisms these countries use to promote such cooperation, but there are also similarities, which are discussed in the selected cases presented below.<sup>34</sup>

## 1. Austria

The Austrian federation includes the federal government, nine states and over 2,100 local governments. The federal government has relatively large spending responsibilities, but in many areas it delegates their execution to the states, which account for about 16 percent of general government spending. However, since in many areas they act as agents of the center, their spending autonomy is limited. Local governments account for about 15 percent of total spending.

The federal government collects some 95 percent of total taxes. It shares them with the states and municipalities according to formulas defined in a federal law, which is revised every three years.

Since 1996, sub-national fiscal targets have been negotiated and enshrined in Domestic Stability Pacts covering five years, with mixed records of implementation. The compliance record, initially strong, weakened after 2002, partly reflecting lack of enforcement, and was marred by sub-national resort to various accounting stratagems, such as reclassification of public entities. Deviations from the Pact's targets were especially pronounced during the crisis years, leading to a downward revision of the targets in 2011.

The 2012 Stability Pact sets structural budget deficit limits for each level of government (0.35 percent of GDP for the federal government, and 0.08 percent of respective GDP for each of the states). Local governments' deficits should not exceed in aggregate 0.02 percent of GDP. The distribution of the latter total among individual localities is to be decided by a state-level coordination council.

---

<sup>34</sup> See Tournemire, 2014 for more detail.

Limits are also envisaged for the total public debt, with their distribution among government levels to be guided by their respective shares in the stock of debt. The Pact also includes a rule limiting the growth of expenditures to that of potential national GDP. Various escape clauses and a debt-brake-type correction mechanism are envisaged in this latest Pact. An independent Advisory Fiscal Council was created in 2013 to monitor compliance of all levels of government with the requirements of the Fiscal Compact.

The initial results of the 2012 Pact have been encouraging, with sub-national deficits declining to below the targets. However, little progress has been made to date on broader intergovernmental fiscal reforms (including increasing sub-national own revenue responsibilities and eliminating expenditure overlaps) that would help harden the sub-national budget constraint and ensure continued compliance with the EU objectives in the future.

Austria represents a good example of executive federalism, in which intergovernmental fiscal cooperation is largely driven by the federal government, given its dominant role. The states are represented in the Senate, but the role of the latter is a limited one.

Periodic Conferences between the federal and the state Executives, covering areas of common responsibility, represent the main forum for vertical cooperation. The periodic revisions to revenue sharing arrangements are negotiated within this forum. There is also a consultation mechanism involving the association of local governments for issues of relevance to the latter.

The main fora for horizontal cooperation are: a Conference of State Governors, supported by a permanent Secretariat; and two Associations of local governments (municipalities and towns), which are consulted by the federal government and the states on matters of local interest.

## **2. Belgium**

The Belgian federation comprises the federal government, 6 federated entities (3 regions and 3 communities), 10 provinces, and nearly 600 localities. It has undergone successive waves of reform which have substantially strengthened the autonomy of the federated entities, at the expense of the federal government. In contrast, the role of the provinces is declining.

As a result, federal spending responsibilities have been reduced over the last couple of decades, although still accounting for more than 62 percent of consolidated general government spending. The share of the federated entities has increased to nearly 25 percent, and that of local governments has fluctuated narrowly around 13 percent of the total.

Sub-national autonomy has been strengthened also on the revenue side, as some intergovernmental transfers have been replaced by increased regional surcharges on federal taxes. Nevertheless, the federal government still collects around 90 percent of total taxes, which are shared with the lower levels of government. There is a formula-based national equalization mechanism. The main parameters in the formula are regional personal income tax collections and unemployment levels.

Until 2013, the internal stability pact framework involved an annual determination of budgetary targets for the federal and the regional governments, based on the recommendations of a multi-partisan High Finance Council (HFC). The latter typically recommended a distribution of fiscal adjustment efforts between the two levels of government in line with their respective expenditure shares. Ex-post, however, the CG ended up contributing more.

In 2013, an intergovernmental Cooperation Agreement between the federal and federated governments adopted the EU-required principle of a balanced structural budget for the general government. The distribution of the target among the participating governments was decided by the *Comité de Concertation* mentioned below, to be effective through 2018, on the advice of the High Council of Finance, which is also responsible for the monitoring of compliance with the Agreement. However, this agreement does not seem to have been fully implemented so far.

Intergovernmental cooperation takes place through different institutional channels:

- In the Senate, whose members are appointed by the federated entities, but which has limited legislative powers;
- At the Executive level, through a “*Comité de Concertation*” comprising the federal and federated entities’ Heads of Government, and through 16 sectoral inter-ministerial committees; and
- Through a variety of formal and informal coordination fora between each federated entity and its own provinces and municipalities.

### 3. Germany

The German federation includes the federal government, 16 states and over 11,500 local governments, which are regulated by state legislations. It provides a clear example of cooperative federalism: a strong role of the federal government, as evidenced by extensive concurrent spending responsibilities, and authority to issue framing legislation in many areas assigned to the states; at the same time, the states collectively have veto power on federal legislation affecting them through the Upper Chamber of Parliament (*Bundesrat*), whose members are appointed by them.<sup>35</sup>

The states have no autonomy in setting the base and rates of taxes but share the revenue of the major national taxes. At the same time, they can block in the *Bundesrat* changes in shared taxes proposed by the federal government. The shared revenues are distributed partly on origin and partly on equalization criteria. Intergovernmental transfers are mainly horizontal, involving redistribution of shared revenues among states on the basis of indicators of respective needs.

---

<sup>35</sup> See Feld and Von Hagen (2007) for a discussion of the advantages and disadvantages of the German model of cooperative federalism.

Until 2009 the states were not subject to statutory borrowing limits. Some faced financial distress and had to be bailed out by the federal government. A constitutional amendment adopted in 2009 stipulates that the states will have to run balanced structural budgets as from 2020. However, their lack of revenue autonomy raises concerns about the feasibility of this target for some of the states.

The extent of cross-constraints among the different levels of government requires extensive intergovernmental cooperation to minimize potential conflicts and maximize the chances of mutually beneficial outcomes. Such cooperation takes place in many fora at the Executive level, aiming to prevent conflicts in the *Bundesrat*. Examples of these fora are:

- The Stability Council, created with the Constitutional amendment of 2009, which includes the federal and state Ministers of Finance. This Council monitors developments in the states' finances; it is empowered to issue warnings to states considered at risk of fiscal crisis and to negotiate adjustment programs with them, but it has no formal enforcement powers. The Council is supported by an independent Advisory Board of technical specialists; and
- A Working Party on tax revenue forecasting, which is responsible for the forecast and distribution of shared revenues.

There are also various associations of local governments, which are consulted by the federal government and the *länder* on issues of relevance to them.

#### 4. Italy

Italy is a unitary state but has features similar to those of a federation. In particular, its 20 regional governments (5 with special statutes) are popularly elected and are responsible for important spending areas (especially health and infrastructures). They also have significant own revenue sources (mainly a tax on the value added of enterprises). However, in contrast to most federations, the regions do not have a "hierarchical" oversight of the lower government levels (110 provinces and 8,100 municipalities).

Decentralization deepened during the 1990s and 2000s, but a constitutional reform aimed at greatly expanding sub-national spending responsibilities was never implemented, and there has been some re-centralization during the recent crisis years. This includes a gradual phasing out of the provinces and the planned transformation of the Senate into a body with competence limited to legislation on inter-governmental matters.

There have been frequent changes in various features of the intergovernmental fiscal system (assignment of spending responsibilities, regional and local taxes, and the design of equalization transfers) in recent decades.

Italy has a long history of "Internal Stability Pacts" that included limits on sub-national deficits and spending growth, but their record of implementation has been mixed. To strengthen their

effectiveness, sanctions were introduced in 2003, and accounting and transparency requirements were tightened.

A constitutional amendment passed in 2012 requires, in line with EU mandates, balanced structural budget at all levels of government by 2016. However, it envisages scope for the regions to compensate temporary disequilibria among the municipalities in their respective territories. This provision is expected to strengthen the coordinating role of the regions vis-à-vis their municipalities.

Italy has a number of intergovernmental cooperation fora:

- Some vertical Executive-level ones:
  - A State-Regions-Provinces Conference;
  - A State-Municipalities Conference;
  - A Unified Conference in which all four levels of government are represented, chaired by the Prime Minister. Within this broader forum, a Standing Conference has been in place since 2013 for the coordination of the public finances, charged with reviewing the national and sub-national budgets for compliance with the above-mentioned fiscal rules, and with promoting dialogue on other aspects of inter-governmental fiscal relations;
- Parliamentary Committees on inter-governmental fiscal reform;
- Horizontal cooperation fora within each level of government, with primary advocacy functions; and
- A special mechanism is in place for consultation with the subnational units regarding EU legislation.

## 7. Spain

Spain is a quasi-federal unitary State comprising 17 regional governments (*Comunidades Autónomas*, CAs) with elected governments and substantial spending autonomy. Two of the CAs (the *País Vasco* and *Navarra*) have a special regime (*régimen foral*) with even higher spending and revenue autonomy, an asymmetry which is generating tensions and centrifugal pressures in the other CAs. Spain also comprises 50 provinces and over 8,100 municipalities, which are overseen by both the CG and the CAs.

The country has undergone a strong decentralization process in recent decades, more pronounced on the spending than the revenue side. The CAs have exclusive or shared competencies in major spending areas, but, with the exception of those under the *régimen foral*, more limited revenue autonomy since the most important taxes are collected by the CG and then shared with the CAs. The own sources of revenues are cyclically volatile, contributing to pro-cyclical fiscal policies by the CAs. The shared revenues are partly redistributed according to equalization criteria, complementing equalization transfers from the CG to the poorer regions. The extent of the redistribution is contested by the richer regions, fueling separatist tendencies.

During the last decade, multi-annual fiscal targets for the different levels of government were by successive Budgetary Stability Acts in 2001 and 2008. Annual targets ex-ante consistent with the requirements of the Acts were defined by the CG, reflecting negotiations with the CAs in a Council on Fiscal and Financial Policies, which included the respective Ministers of Finance. Compliance with the Acts was weakened by significant resort of the CAs to PPPs and accounting stratagems, and was practically abandoned during the global financial crisis.

In the wake of the Euro crisis, Spain has raised fiscal stability to a constitutional principle. Since 2012, negotiations on sub-national targets have been carried out within the framework of a new Organic Law on Budgetary Stability, which mandates convergence of the public debt of central, regional and local levels of government to 44 percent, 13 percent, and 3 percent of GDP, respectively; limits structural deficits of the general government to no more than 0.4 percent of GDP, and expenditure growth for all governments to that of potential output; and strengthens enforcement mechanisms, as well as transparency and accounting requirements, including on PPPs. Another change has involved the creation of an *Autoridad Independiente de Responsabilidad Fiscal*, charged with monitoring fiscal developments at all levels of government and assessing their compliance with the revised fiscal responsibility framework.

There are a number of fora for intergovernmental fiscal cooperation in Spain. At the Executive level, the most influential is the Conference of the Presidents, chaired by the Prime Minister and comprising the Presidents of the CAs. There are also a number of sectorial inter-ministerial conferences, including the Fiscal and Financial Policy Council, responsible for coordination in economic, financial and fiscal matters. The CG also is active in the negotiation of bilateral

agreements with individual CAs. The provinces and municipalities are represented at the central government level by the Federation of Spanish Municipalities and Provinces.

At the legislative level, the main forum is the Senate with 58 members appointed by the CAs. It has fewer powers than the elected House of Representatives.

The main fora for horizontal cooperation are the Conference of Governments of the CAs, and the Federation of Provinces and Municipalities. Both help identify the scope for common positions of their respective members in negotiations with the CG, and act as fora for exchange of views on common issues and challenges.

## Bibliography

Ahmad, E. and G. Brosio (eds.), 2006: *Handbook of Fiscal Federalism* (Edgar Elgar, Cheltenham).

Ahmad, E. and G. Brosio (eds.), 2015: *Handbook of Multilevel Finance* (Edgar Elgar, Cheltenham).

Ahmad, E., M. Bordignon and G. Brosio (eds.), forthcoming: *Multi-level Finance and the Euro Crisis — Causes and Effects* (Edgar Elgar, Cheltenham).

Bahl, R. W.; J.F., Linn and D.L. Wetzel (eds.), 2013: *Financing Metropolitan Governments in Developing Countries* (Lincoln Institute of Land Policy, Washington, DC)

Bakvis. H. and Brown, D., 2010: “Policy Coordination in Federal Systems: Comparing Intergovernmental Processes and Outcomes In Canada and the United States”, *Publius: the Journal of Federalism*, vol. 40, no.3

Bird, R., 2010: “Subnational Taxation in Developing Countries: a Review of the Literature”, *World Bank Policy Research Working Paper*, No. 5450, World Bank, Washington, DC.

Blochliger, H. and C. Vammalle, 2012: “The political economy of fiscal decentralization”, in OECD/Korea Institute of Public Finance (KIPF), *Institutional and Financial Relations across Levels of Government* (OECD, Paris).

Boadway R. and A. Shah (eds.), 2007: *Intergovernmental Fiscal Transfers* (World Bank, Washington, DC).

Bonet, J., A. Munoz and C. Pineda Mannheim (eds.), 2014: *El Potencial Oculto: factores determinantes y oportunidades del impuesto a la propiedad inmobiliaria en América Latina* (IDB, Washington, DC).

Carvalho, C.M.S., 2015: “Instrumentos de advocacy federativa no Brasil: o dilema dos estados na questão fiscal”. Doctoral thesis, São Paulo: EAESP/FGV.

Council of Australian Governments (COAG), 2013: Briefing paper no. 106, prepared by L. Blayden, available on COAG’s website [www.coag.gov.au](http://www.coag.gov.au)

de Mello, L., 2010: “Europe”, in J. Martinez-Vasquez and P. Smoke (Eds.), *The State of Local Government Finance: Are we ready to face the demand?, Second Global Report on Decentralisation and Local Democracy* (United Cities and Local Governments, Barcelona)



de Mello, L. and S. Lago-Penas, 2013: Local Government Cooperation for Joint Provision: The Experiences of Brazil and Spain with Intermunicipal Consortia”, in S. Lago-Peñas and J. Martinez-Vazquez (Eds.), *The Challenge of Local Government Size* (Edgar Elgar, Cheltenham)

Feld, L. P. and Von Hagen, J., 2007: “Federal Republic of Germany “, in Shah, op. cit.

Fretes Cibils, V. and T. Ter-Minassian (eds.), 2015: “*Decentralizing Revenue in Latin America: Why and How*” (IDB, Washington, DC).

IMF, 2014: “Fiscal Transparency Code”, available at <http://blog-pfm.imf.org/files/ft-code.pdf>.

Khair, A., 2011: Avaliação do impacto de mudanças nas alíquotas do ICMS nas transações interestaduais, IDB Discussion Paper, no. 212

Koutsogeorgopoulou, V. and Tuske, A., 2015: “Federal-State Relations in Australia”, OECD Economics Department Working Paper 1198

OECD (2015a), *Water Resources Governance in Brazil* (OECD, Paris).

OECD (2015b), *The Metropolitan Century* (OECD, Paris).

Pineda, E., Ramirez, A., and Rasteletti, A., 2015: “Subnational Revenues in Mexico: The Long Road to Reform”, in Fretes and Ter-Minassian, op.cit.

Shah, A. (ed.), 2007: *The Practice of Fiscal Federalism: Comparative Perspectives*, Forum of Federations and IACFS (Mc Gill University Press, Montreal).

Ter-Minassian, T. and A. Fedelino, 2010: “Impact of the global crisis on sub-national government finances”, in IEB’s *World Report on Fiscal Federalism*, 2009, Barcelona, December 2009, reprinted in a revised and updated version in the proceedings of the Bank of Italy conference: “Fiscal Policy: Lessons from the Crisis”, March 2010.

Ter-Minassian, T., 2012: “Reform Priorities for Subnational Revenues in Brazil”, *IDB Policy Brief*, No. IDB-BP-157. IDB, Washington, DC.

Tournemire, G., 2014: “Coordination Arrangements across Government Sub-sectors in EU Member States”, EC European Economy Economic Paper 517, Brussels

Vammalle, C., D. Allain-Dupre and D. Gaillard, 2012: “A sub-central perspective on fiscal policy in a tight fiscal environment”, in OECD/Korea Institute of Public Finance (KIPF), *Institutional and Financial Relations across Levels of Government* (OECD, Paris).

Watts, R.L., 2008: "*Comparing Federal Systems*", Institute of Intergovernmental Relations, Queens University, Kingston, Ontario.