

REPORT ON THE INTERNATIONAL CONFERENCE ON CITIES AND FEDERALISM: INTERNATIONAL PERSPECTIVES – 6 AND 7 MAY 2002, RIO DE JANEIRO, BRAZIL

The international conference was held concurrently with the 2nd Conference on Cooperative Federalism: Local Power, Governance and Citizenship, organized by the National Confederation of Municipalities (of Brazil), the Konrad Adenauer Stiftung and the Forum of Federations.

At the conference a *Background Paper on the Place and Role of Local Government in Federations*, prepared by Professor Nico Steytler (Community Law Centre, University of the Western Cape, South Africa), printed in Portuguese and English, was circulated to delegates.

The international conference was devoted to two key issues that confront local government in Brazil – the difficulties surrounding common competencies and the problem of vertical fiscal imbalance.

COMMON COMPETENCIES

On the first day of the conference the focus was on the difficulties associated with common competencies shared by local government and other spheres of government.

Professor Nico Steytler gave an overview of the theme of common competencies and intergovernmental relations, setting out how responsibilities are allocated between states and local governments. He noted that the problems that flowed from common (or concurrent) competencies were common to those federations where the powers of local government have been constitutionalized. Common competencies are often explicitly allocated to two spheres of government but implicit and even unintended overlaps also occur.

The problems created by common competencies are numerous and impact negatively on the effective and efficient functioning of federations. They include the following:

- Duplication of services;
- Inefficiency in the provision of joint services;
- Failure to provide services at all;
- Dumping responsibility for service delivery on local government;
- Lack of accountability by state and local governments to their respective electorates; and
- Domination of local government by states due to the latter's over-regulation and control.

Because concurrency is part and parcel of the fabric of most modern federations, it is not viable to recapture a dual model of federalism where all functions are neatly allocated and the spheres of government need not interact cooperatively. Countries have therefore addressed the problems of concurrency along a range of options. The first approach is to reduce the level of concurrency and establish greater division of powers between states and local government. Greater clarity is also sought on the exclusive powers of local government. Where concurrency of competencies is the intended result, the approach has been the effective management of the shared

authority in terms of the principles of cooperative government. A number of good governance principles have been developed to minimize the negative consequences of concurrency. The main thrust has been to define, within the areas of concurrent functions, the roles and responsibilities of local government with greater clarity and to engineer greater role differentiation. The principle of subsidiarity has often been applied: functions should be performed at the lowest possible level where those functions will be carried out. However, a number of practical measures must be devised to give concrete effect to this principle.

Glen Murray, the mayor of Winnipeg, Manitoba, Canada, spoke on the Charter City Movement in Canada the goal of which is the drafting of city charters that would reduce conflict, clarify responsibilities and promote accountability.

He commenced by sketching the financial difficulties that Canadian cities face because of their lack of revenue raising powers. As cities' taxing powers are usually limited to property tax, the revenue remains static because there is little growth in building. Since local government is a creature of provincial statutes, it faces increasingly the down loading of responsibilities by provinces without accompanying funds for their execution. The federal government has also withdrawn from housing and the building and maintenance of the highway system, leaving these functional areas to local government. Cities also face the challenges of globalization. They need to attract capital and a mobile work force. The health of the urban economies is also the health of the country. Cities have to compete against one another as if there are no national borders.

As a result of these events a Charter City Movement has been launched consisting of the seventeen largest municipalities in Canada. It forms part of the Federation of Canadian Municipalities, which represents almost all municipalities in the country. The aim of the movement is that cities write their own charter in which they define which powers they should have as well as their revenue raising capacity. These charters will be presented by the mayors to provincial governments at the same time, setting out a standardized position for cities.

The first basic claim of the charter is that permissive local government legislation should be enacted, enabling cities to do anything except that what is expressly excluded. This would include revenue-raising powers. In providing a blue print on municipal finances, it also seeks to establish a relationship between the tax base and expenditure. For example, tax on gasoline should be linked to road building and maintenance. Conversely, property tax should not be used for street maintenance and education; that should be financed from income tax.

In two provinces (British Columbia and Alberta) there is already charter-type legislation. In Manitoba a two-year legislative process is underway towards a charter that will build on the best practices in other provinces. There is also evidence of a healthy competition among province to adopt progressive local government legislation.

The cities movement also crosses international borders. There are already linkages between cities in Canada, the US and Mexico; they face similar problems that came in the wake of the North American Free Trade Agreement (NAFTA) and the dropping of

tariffs. A global movement of cities could deal with important cross-border issues when national governments appear unable to do so.

C. Neil Giuliano, the mayor of Tempe, Arizona, United States, and representatives of the National League of Cities also noted that the trend in the US is for local government to receive less money from the federal government while they are under pressure to provide more services with fewer tax dollars. The challenges faced by city leaders are how to grow city economies, protect the environment and manage ethnic diversity. Because of these challenges, cities have been discovering that it is imperative to work together across local boundaries. Some cities have cooperated regionally to take better decision on water-use, transportation, and land-use. Regional councils are made up of all local governments, regional transportation associations, water-use management agencies and other local government entities in the region. A number of states have also created organizations that address homeland security preparedness on a regional basis.

In land-use planning a recent Supreme Court decision has strengthened local governments. Any delay caused by municipal planning requirements, resulting in the temporary non-use of land, does not require compensation of the landowner.

The National League of Cities (NCL) has tried to help cities to find ways to be more active in successful land-use planning. The NCL has identified three distinct roles for local governments. First, officials must determine the local context of land-use decisions - how do new developments fit in with existing patterns of settlement, transportation and environmental needs? Second, local leaders should apply their communities' vision and values to land use planning. Third, all available regulatory tools for long-range planning should be used.

A number of cities have promoted smart developments through various innovative policies and practices. For example, a city has offered a municipal planning course for citizens to foster better understanding and participation by them. Tax incentives have promoted developments that rejuvenated inner city areas. A set of development criteria ("smart growth matrix") has been developed in terms of which new developments can be assessed.

Violeta Ruiz Almendral from the **Department of Finance and Tax Law, University Carlos III de Madrid, Spain**, explained the use of covenants between the central government and municipalities to redefine municipal responsibilities. The three levels of government in Spain – central government, autonomous communities and municipalities - share a number of competencies. While the Spanish Constitution recognizes local autonomy, it does not grant municipalities specific competencies. The central government and the Autonomous Communities must define such competencies. The central government regulates the basic elements of local competencies and has done so in the Local Government Act of 1985 and the regulation of local finances in 1988. The Autonomous Communities regulate the competencies in further detail.

Both the central government and the Autonomous Communities are responsible for the financing of local entities. There is no special law for major cities; the only difference is that the large municipalities receive more responsibilities. The provinces

that date from Napoleonic times do not have material competencies; their function is to coordinate municipalities in their territory.

After the first round of decentralization, entrenching the creation of Autonomous Communities in the Spanish Constitution, the second round of decentralization resulted in the *Pacto Local*. The *Pacto Local* is an agreement between the central state and the Federation of Spanish Municipalities and Provinces (FEMP) for the development, clarification and amplification of the competencies of municipalities. The object of the agreement was to effect a second decentralization of competencies and, to avoid confusion of roles, clarify the distributed competencies. The process of negotiating and approving the *Pacto Local* took the best part of five years, commencing in 1993 when the FEMP voiced the necessity of such a *Pacto Local*.

The agreement is important as it serves as a significant model of cooperative federalism; it strives to clarify the distribution of competencies in a system where the major part of the competencies is shared. The agreement has been criticized because of its democratic deficit, an inevitable result of executive federalism. The answer to this criticism has been that the agreement strengthens democracy because it favours transparency. The Spanish Constitutional Court recognized the importance of the agreement; although it is not binding, it is nevertheless important from a policy point of view.

The agreement can work adequately depending whether there is cooperation or conflict between the parties. The financing of local government is a crucial element in making the *Pacto Local* effective. What is further needed is for each Autonomous Community to have its own pact with local authorities in its area.

A second *Pacto Local* is necessary and negotiations are continuing. Municipalities want to increase and redefine the following competencies: public transport, consumer affairs, sport, education, employment, youth, the environment, women, safety, health services, social services and tourism. The financial arrangement that must accompany the *Pacto* would again be crucial to make it work.

VERTICAL FISCAL IMBALANCE

On the second day of the conference the focus fell on the question of fiscal imbalance – the allocation of functions to local government without providing it with matching funding.

Violeta Ruiz Almendral introduced the topic. The decentralization of fiscal powers may give rise to two types of fiscal imbalances: vertical as well as a horizontal. It is common in the literature on fiscal federalism to refer to “vertical fiscal imbalance” as the situation that arises when one level of government – usually the central or federal government – raises more revenue than what it actually needs for the exercise of its responsibilities, while at the other levels, the subnational governments raise less revenue than their expenditure. This creates an imbalance that must be solved to guarantee the required autonomy of the subnational governments; without funds they cannot exercise their authority.

Broadly speaking, vertical fiscal imbalance can be solved either through the transfers of funds from the central or federal government to the subnational governments or through the reassignment of taxation powers. There are advantages and disadvantages to both solutions. In practice a mix of both of them is used; most subnational governments accumulate revenue in the form of both transfers and the subnational government's own taxes. However, it must be taken into account that when subnational governments receive revenue almost exclusively in the form of transfers, an incentive to overspend is created. It may also create a lack of accountability that may not be in the best interests of citizens; taxpayers would have difficulty to relate taxes to expenditure, a necessary element in an accountable democratic state.

Horizontal fiscal imbalance arises as a consequence of the different levels of income of subnational governments. These differences may become greater when subnational governments are allowed to exercise taxation powers. Although decentralization will always result in such an imbalance, it is generally agreed that, for the sake of maintaining solidarity within the state, it is necessary to correct these imbalances. This is usually done in the form of transfers from the central state to subnational governments.

Vertical and horizontal fiscal imbalances affect all levels of government. However, it is often said that it is the local authorities that suffer most from these imbalances, as their powers to raise their own taxes are usually very restricted. In seeking the "magic formula" for the financing of subnational governments, the two imbalances, their causes and their consequences, must be taken into account.

Gustav Wabro, former secretary of state for Baden-Württemberg, Germany, spoke about municipal financing in Germany. According to the Baden-Württemberg constitution, local autonomy is guaranteed, a provision that is also found in the constitutions of the other *Länder*. The right to local self-government includes financial autonomy; municipalities must have the resources to fulfill their functions. The constitution of Baden-Württemberg provides that local government can collect its own taxes. Municipalities also receive transfers from the *Land*. These sources of revenue give municipalities a strong independent status.

Municipal finances are also provided for in the federal constitution, the Basic Law. Fifteen per cent of income tax goes to municipalities while a further 42,5% is allocated to the *Länder*. Municipalities have taxing powers over services, such as water and sanitation and may impose property taxes as well.

The German Constitutional Court has held that transfers to municipalities could not be a top-down determination; a fair system is required in which municipalities can participate in the process of allocation.

A new relationship between the municipalities and the European Union (EU) is emerging. In terms of the Maastricht Treaty, there is a common citizenship for all Europeans. At the same time people need to feel linked to their regions. The Council of Regions has thus been created. The Treaty also established the principle of subsidiarity; functions that can be performed at local level should be the responsibility of municipalities because they are the closest to the people.

Thabo Mokwena, chief executive officer of the South African Local Government Association, outlined the legislative provisions in South Africa that seek to counter unfunded mandates. Unfunded mandates are defined as the allocation of responsibilities to municipalities by the national and provincial governments without providing funds for their discharge.

Municipalities, as the third sphere of government, have constitutionally enshrined powers and functions. However, additional functions may be assigned to municipalities by national and provincial governments. In order to guard against the practice of shifting responsibilities without accompanying funding, the Municipal System Act of 2000 regulates the assignments of functions to municipalities by both the national and provincial governments. Where a provincial government, for example, intends to assign a function to all municipalities in its area jurisdiction, the provincial minister introducing the legislation effecting the assignment, must consult with the provincial minister responsible for local government, the provincial minister responsible for finance and organized local government in the province. The minister must also request an assessment of the financial implications from the Fiscal and Financial Commission, an advisory body dealing with intergovernmental transfers.

In the light of the consultations and assessment by the Commission, the provincial minister initiating the assignment must determine whether or not the assignment imposes a duty on the municipalities and, if so, whether it has financial implications. If there are financial implications, the provincial minister must take “appropriate steps to ensure sufficient funding and capacity building initiatives as may be needed” for the performance of the assigned function.

Mokwena criticized the approach that the Fiscal and Finance Commission has adopted in assessing the financial implications of assignments. Its costing is for a short period of 2 to 3 years while the long terms financial impact is not considered. SALGA, as the statutory body representing organized local government in country, is seeking to play a more active role in examining the costing of imposed mandates. Already two pieces of national legislation – the Disaster Management Bill and the Immigration Bill – have been identified as not complying with the Systems Act and they have been referred back to the respective departments for amendments.

The system is still very new in South Africa and only time can tell how it will work in the future. While the legal framework is in place, the greatest challenge facing local government is to change the mindset of national and provincial officials. What is clear is that certain functions should not be shifted to municipalities and SALGA will oppose such attempts. The problem of unfunded mandates is a key issue in the debate around the viability of local authorities. With the forthcoming UN conference on Sustainable Development in Johannesburg, local government is saying that if sustainable government is going to happen, it will happen through local government. Rendering municipalities unviable through unfunded mandates, would, in turn, scupper this larger project as well.

John Ross, the president of the Australian Local Government Association, noted that the fundamental tension at the heart of a federal system, including in Australia, is the clear delineation of roles and responsibilities between the different spheres and the most appropriate allocation of resources. For an effective federal system of

government, he argued, every sphere of government, including local government, must have political and financial autonomy.

Over the past thirty years an evolution of governance has been underway that included the transfer of responsibilities and cost shifting from the federal government and state / territory governments to local government, blurring the roles and responsibilities of all three spheres of government.

In the past local government's role and responsibilities have been strictly prescribed by state legislation. This has changed to a more flexible arrangement stating only the general principle of local government competencies. State legislative instruments now provide local authorities with the authority to "do all that is necessary for good government in the interest of the community." Municipalities have thus a wide mandate to provide a range of services to their communities. They are also service providers on an agency basis for federal and state governments.

Intergovernmental fiscal relations are characterized by significant differences between the relative revenue raising and expenditure responsibilities of the three spheres of government. While the federal government raises 79% of all taxes, it was responsible for only 59% of the total government expenditure. States raised 19% of all taxes but were responsible for 37% of the total expenditure, while local government was responsible for raising revenue for 70% of its expenditure.

Increasingly local authorities are faced with unfunded mandates that arise in the following situations:

- Local government must now provide services that were previously provided by the other spheres of government. For example, the provision of aged and children's services was the responsibility of the federal and state governments; municipalities are now expected to provide these services regardless of whether or not it is financially possible.
- Services are formally referred to or assigned to local government through legislative and other instruments. For example, most state health legislation requires that municipalities conduct regular inspections of premises where food is prepared and handled to ensure compliance with health standards. This duty imposes a direct cost on municipalities. There are also more than 200 pieces of federal legislation which imposes planning requirements on local authorities. In meeting these requirements, municipalities incur a range of costs that are met out of their own source revenue.
- New and innovative services that are being provided to meet emerging community needs have no history of funding with the result that the responsibility for such funding is yet to be determined. For example, municipalities have recognized that they must provide their citizens with access to information technology by providing computers in public libraries for general community use.

Financing the emerging gap between local government's own revenue and expenditure is problematic; the choices facing municipalities are:

- Cutting back on the provision of unfunded mandates imposed by the other spheres of government;

- Increasing taxation, although some states have capped local government's powers to raise taxes; or
- Increasing user charges for public goods, facilities and services.

Recognizing this dilemma, the federal government has announced that a Parliamentary Inquiry will be established to examine the roles and responsibilities of local government and its financial relationship with the state and territory governments.

M. K. Stalin, the mayor of Chennai in Tamil Nadu, India, spoke about municipal governance in India. The government of India favoured decentralization and enacted in 1992 the 73rd and 74th Amendments to the Constitution guaranteeing local self-government through the pandachayat system. The 74th Amendment deals with urban municipalities. To date 96 municipal corporations, 1494 municipalities and 2092 town panchayats have been established. Generally, municipal administration is concerned with urban infrastructure like water supply, sanitation, environmental hygiene, disposal of solid waste, sewage and drainage facilities, slum development, education and transport.

The city of Chennai (formerly Madras) has over 11 million inhabitants and 4 million voters. Revenue generation is achieved through taxes, fees, penalties and fines and transfers from the state government. Taxes consist of property tax, general tax, elementary education tax, professional tax, company tax, timber tax, advertisement tax, tax on carriages and animals, surcharge on stamp duty and entertainment tax. Fees are charged either seasonally, monthly or annually and include those for trade fairs, festivals, tourist vehicles, fish sellers, parking and advertisement. Penalties are collected for those who default on the taxes or fees.

Over the past few years the municipality has achieved considerable success with its three-pronged strategy:

- Providing primary education and primary health to the poor (reporting a 30% increase in recipients).
- Dealing with solid waste disposal, by using garbage as fuel for power generation, resulting in the reduction of garbage heaps and greater cleanliness.
- Creating a world-class infrastructure by building roads and fly-overs that have eased traffic congestion. This was done with the municipalities' own revenue.

Mayor Stalin made the following suggestions to increase revenue generation:

- In order to fund roads, part of the motor vehicle tax levied by the states, should be passed on to the municipalities.
- Public-private partnership should be encouraged.
- Tollgate tax may be collected at one point of entry into the municipal area.
- Certain facilities may be offered for private participation on a "build-operate-transfer" system, whereby the burden of capital expenditure is reduced.

The conference was closed by **Paulo Roberto Ziulkoski**, president of the National Confederation of Municipalities and **David Mac Donald** from the Forum of Federations.

CONCLUDING COMMENTS

The conference highlighted two important issues relating to international comparisons. First, while there was a remarkable congruence of experiences on the topics of common competencies and vertical fiscal imbalance, these matters were often expressed in different terms. The mismatch between responsibilities of local government and the sufficiency of funds for their execution is referred to in Brazil as “vertical fiscal imbalance”, while in Canada the term is “downloading”. In South Africa it is called “unfunded mandates” and in Australia “cost shifting”. The use of different terms alert us to the danger that we could easily talk past one another even when discussing the very same problems. Understanding the commonality of problems can be facilitated by the proper appreciation of the place and role of local government in each country under discussion, the very purpose of the background paper.

Second, international comparisons between the status and role of local government in different countries are increasingly being used in the reform movement of local government. In the Charter City Movement in Canada, the superior position of local government in comparable jurisdictions has been used to advocate change in the status of cities that country.

On the focus areas of the conference, three key questions emerged:

- How should the appropriate functions and powers of local government be determined;
- How should the exercise of common competencies be managed; and
- How are local government functions to be financed?

Determining the functions and powers of local government

In the past local government was simply the recipient of functions that other levels of government bestowed on municipalities. A fundamental shift is taken place where local government participates in the process of defining their functions. Moreover, being closest to the people, local government can be informed by residents about what services they should provide. In Spain, organized local government was the negotiating party with the national government in concluding the *Pacto Local* that defined municipal powers. In Canada, the objective of the Charter City Movement is to ensure that city officials and residents define what functions and powers will be the most appropriate for their city. In South Africa, residents approached councilors with their security concerns, which eventually led to the establishment of municipal police forces. These three cases illustrate the trend that local communities are increasingly taking their destiny in their own hands and do so through organized local government.

Flowing from this general principle of local self-government is the further realization that when granting powers to local government, a one-size-fits-all approach is inappropriate. The necessary distinctions should be drawn between types of municipalities and the powers that are accorded to them; their capacity to assume the required responsibilities is most often a function of their size and tax base.

Common competencies

Whatever functions are given to local authorities, they are seldom exercised in isolation from those of other levels of government. Functions cannot be neatly allocated between levels in watertight compartment and common competencies are inevitable. For the effective exercise of common competencies a high level of cooperation between the levels of government is clearly necessary. Because of the problems inherent in common competencies, the trend is to seek greater clarity of responsibilities with local government an active partner in such determinations.

Financing local government responsibilities

Having participated in the definition of their responsibilities, it will be of little comfort to local government to find that there are inadequate funds to discharge those responsibilities. If duties are dumped on local authorities without accompanying funds, they have had, in effect, no say in the matter. At the heart of the question lies local autonomy. A local authority must be able to decide whether or not to take on a new function or to take sole responsibility for a particular task. The major consideration would be its capacity to finance that responsibility. Unless there is a clear link between the performance of a function and adequate funding for that responsibility, local government may not be able to perform its primary function of serving its citizens.

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1 July 2002