



International Roundtable

The Practice of Fiscal Federalism: Comparative Perspectives

Costa Do Sauipe, Bahia, Brazil , December 12-13, 2005

Hosted by the Government of Bahia, Brazil

Organized under the auspices of the Global Dialogue on Federalism

An initiative of the Forum of Federations and IACFS

Theme Coordinator: Anwar Shah, World Bank Institute

The program for the International Roundtable has been designed around the questions for further examination identified from each of the Country Roundtables. Over the course of two days at the International Roundtable, there will be three substantive sessions.

The program design is created according to the Forum of Federation's own learning method. Its intention is to be an interactive space devoted to discussion in which the dividing line between the speakers and those listening is deliberately removed. The time indications below are guidelines for the participants. It is in the authority of the Session Leader to decide when changes, adaptations, and breaks are appropriate to guarantee a smooth flow of the dialogue process. It will be the Session Leader's decision to determine the order of the questions presented and discussed. All of the presentations/statements should be made in an informal way and without any technical aids like Powerpoint, overhead projectors etc.

Goals of the Roundtable

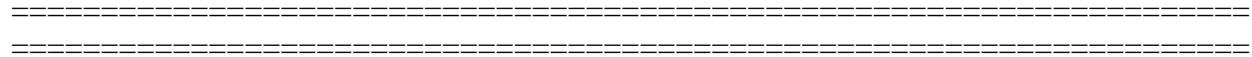
- To develop new insights of institutions of fiscal federalism and how they can enhance national efficiency and equity while responding to the challenges arising from a globalized ("flat") world.
- To learn from others' experiences as to how local solutions can be enriched by global experiences on fiscal federalism.
- To prompt ideas about how the comparative value of each chapter in the published volume might be enhanced.

Procedures

- The Session Leader makes a short presentation about the session topic and choice of questions (10 minutes).
- Country representative(s) present their question (context in which it was raised in the country roundtable and reason why it should be discussed with international experts, their expectations) (10 minutes).
- Roundtable dialogue participants develop the experience of their countries in relation to the issue raised and are invited to explore the topic any further if

advisable. It is at the Session Leader's discretion to involve any additional guests into the discussion (approximately 20 minutes).

- At the end, the Rapporteur has an opportunity to summarize and point out what s/he thinks are new insights and key comparative aspects discussed during the session (10 minutes).
- Break time will be incorporated into each session – again, at the Session Leader's discretion (20 minutes).



Monday, 12 December

9:00-10:00 Opening and welcome

Welcoming remarks by the host country: Fernando Rezende
Introduction of Global Dialogue program and procedures: Raoul Blindenbacher, Forum of Federations
Introduction of the Theme Roundtable: Anwar Shah, World Bank
Self-introduction by participants

**10:00- 1:30 Division of Fiscal Powers in Federal Systems
Session Leader: Ron Watts**

- *“Optimal vertical fiscal imbalance”* – Alan Morris, Australia, Questions 1¹
- *“Asymmetric fiscal federalism”* – Joaquim Sole-Vilanova, Spain, Question 2
- *“Excessive debt situations”* – Lars Feld, Germany, Question 2
- *“Weakening of states in the US federal system”* – Bill Fox, United States, Question 2
- *“Fiscal federalism and federalist state: is one possible without the other?”* – Galina Kurllyandskaya, Russia, Question 2

1:30 – 3:00 Lunch

**3:00 - 6:00 Intergovernmental Finance and Regional Disparities
Session Leader: Isawa Elaigwu (TBC)**

- *“Sharing the proceeds of natural resources”* – Akpan Ekpo, Nigeria, Question 1
- *“What is the relation between fiscal competition and fiscal equalisation?”* – Gebhard Kirchgässner, Switzerland, Question 1
- *“Regional disparities and federal antagonisms: What is the role of regional development policies in fiscal federalism?”* – Fernando Rezende, Brazil, Question 3

¹ See annex for a full list of questions.

Tuesday, 13 December

9:00-12:00 noon Accountable Governance and other Contemporary Issues

Session Leader: John Kincaid

- *“Ensuring the effective deliverance of local public goods and services by municipal and - Aboriginal governments”* – Robin Boadway, Canada, Question 2
- *“Transition from centralized planning to market”* – Govinda Rao, India, Question 1
- *“Necessary ingredients for secure an efficient system of delivery”* – Saiful Azhar Rosly, Malaysia, Question 2
- *“Enhancing accountability at all spheres of government”* – Bethuel Setai, South Africa, Question 1

12:00-1:00 p.m. Evaluation and Concluding Remarks

This is an open forum for participants to share insights and make additional remarks, complete evaluation of the Roundtable, and for Anwar Shah, Theme Coordinator, to make concluding remarks.

1:00- 2:30 Lunch

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2:30 – approx. 6:30 p.m. Authors’ Meeting on Country Papers

This meeting is for country chapter authors only. Its purpose is for authors to both receive feedback on their draft chapters and to bring any questions they might have concerning the theme template and chapter-writing process. Please see country coordinator meeting agenda.

ANNEX

A GLOBAL DIALOGUE ON FEDERALISM The Practice of Fiscal Federalism: Comparative Perspectives

Questions submitted for International Roundtable

AUSTRALIA

Question 1

Is there an “optimal amount of vertical fiscal imbalance” that would allow a Federation to function most effectively? Is some centralising of tax power desirable to provide the Federal Government with the fiscal capacity to implement a national agenda? Is this consistent with the principle of subsidiarity?

How should this question be approached and what principles should apply to consideration of “desirable” fiscal imbalance? In addressing this question, are there tax bases that are best accessed by the Federal government? By State/Provincial/local governments?

Question 2

Can a comprehensive equalisation system which seeks to assess the fiscal needs of States/Provinces provide for equitable outcomes for individuals or communities irrespective of their location or circumstances? What is the concept of equity that is relevant to equalisation? Can equalisation provide equitably for the particular needs of disadvantaged groups of people or disadvantaged regions that are outliers in terms of national standards?

Is it appropriate to include the requirement of mutual obligation in the system of equalisation, particularly where per capita transfers reflect assessments of significant disadvantage for particular groups.

How would mutual obligation be reconciled with the principle work of subsidiarity and local policy choices for optimal outcomes? How do other countries balance the desire for equity with the desire for autonomy at the sub-national level?

Is it possible to have a system of equalization that achieves efficiency goals, and if so, does this necessarily mean a trade off with equity (however defined), and if so, what might this trade off be?

BRAZIL

Question 1: Federal autonomy and fiscal discipline: rules and institutions for intermediating conflicts

Question 2: Asymmetric conditions and symmetric norms: implications for efficiency and efficacy of public policies

Question 3: Regional disparities and federal antagonisms: the role of regional development policies in fiscal federalism

Question 4: Central and local governmental relations: the weakening position of the states/provinces in federal regimes.

CANADA

Question 1

What is the appropriate fiscal balance, both vertically between the federal and sub-national governments and horizontally among sub-national governments? In particular, what fiscal balance will best facilitate the autonomy and capacity of sub-national governments to provide important public services to their residents while at the same time ensuring that the federal government can pursue its legitimate national social and economic objectives using fiscal instruments?

Question 2

What fiscal arrangements, including taxation powers, transfers and governance measures, are suitable for ensuring that local public goods and services are delivered effectively and accountably by both municipal and Aboriginal governments?

GERMANY

The assignment of competencies enjoys constitutional precedence over the fiscal constitution in Germany. Thus, the recent decision by the newly formed grand coalition which aims at disentangling the responsibilities and decision-making powers of the federal level and the states (Länder) is a first important step and the precondition for a change of the fiscal constitution. That the latter needs to be changed appears to be consensus in Germany today. The dispute is about the degree of change. The participants of the roundtable reflected this general assessment in their statements and their discussions.

The country roundtable in the end of October was thus focussed on the possibilities to achieve a reform of fiscal federalism in Germany with the goal of higher responsibility and autonomy of both the states and the federation. The main questions emerging from that discussion in German fiscal federalism today are:

Question 1

Is it possible to change the assignment of revenue sources, for example by introducing a (restricted) autonomy of the states in setting income tax rates, given the strong differences in resources of the states? To what extent is Germany willing to accept regional asymmetries?

Question 2

As several states currently are in excessive debt situations and ask for bail-out by the federal community, the second question is how future excessive debt can be prevented. Is it possible to establish and to enforce restrictions on states' deficits and debt in the German constitutional and legal environment?

INDIA

Question 1

The reforms in policies and institutions required by a federation in the context of transition from centralized planning to market. These would involve focus on issues such as substitution of public enterprise profit with taxes, dealing with the regional inequalities with changed pattern of resource allocation, the implications arising from getting rid of controls on prices and outputs

and implicit transfers due to such controls and removal of impediments to internal trade to ensure a common market.

Question 2

The challenges to Indian fiscal federalism arising from globalization are equally important. This involves (i) the issues of providing efficient public services to ensure competitiveness in Indian economy; (ii) to compensate revenue loss arising from reductions in the customs duty which inter alia involves the introduction of Value Added Taxation, and (iii) difficulties of taxing mobile international capital and skilled labour.

MALAYSIA

Question 1

Discuss the principle on which grants and loans are given out by the Federal to the State governments.

Question 2

Achieving the targets of the Malaysian Plans will require an efficient system of delivery both at the Federal and State levels? What are the ingredients necessary to secure an efficient system of delivery?

NIGERIA

Question 1

How do other countries practicing fiscal federalism share the proceeds of natural resources between federating units? What experiences can we learn for Nigeria?

Question 2

How does the assignment of expenditure and revenue powers between federating units affect fiscal co-ordination with the economy?

RUSSIA

Question 1

Revenue autonomy of the states and the balance between taxing powers and expenditure responsibilities: can fiscal federalism survive without some degree of revenue autonomy?

Question 2

Fiscal federalism and federalist state: is one possible without the other?

SOUTH AFRICA

Question 1

How to achieve optimal alignment between, the electoral system, monitoring and evaluation, and the Intergovernmental Fiscal Relations systems in order to enhance accountability at all spheres of government. For example the theory of fiscal decentralisation argues for the devolution of powers and functions to the sphere of government that is closest to

the people in order to increase accountability. However, this outcome can in reality be undermined depending on the social context and the nature of the electoral system within a country. We would like to explore other country experiences in this regard, and understand the lessons learned and what other mechanisms of accountability have been used by other countries to achieve maximum benefit from fiscal decentralisation.

Question 2

What is best practice experience with respect to utilising budget reforms, and the allocation of powers and functions (to achieve fiscal decentralisation) to address vertical and horizontal imbalance? South Africa's system is characterised by vertical and horizontal imbalance. Over the years various reforms have been made to the budget process as well as to the allocation of powers and functions to address this. What has been the experience of other countries, particularly those with IGFR systems still in their developmental stage, and what is emerging as best practice?

SPAIN

Question 1: Equalization and incentives

With the Constitution of 1978 Spain moves from being a unitary country to a decentralized or quasi-federal country. Spanish regions have about 35% of all expenditure. Regions have power to tax personal income, and other taxes and share VAT and Excise taxes. There is an equalizing grant that equalizes tax capacity and needs but keeps a "unitary" criteria or target of equalization: for an equal tax effort all regions get more or less de same revenue (own taxes plus equalizing grant) but the poor regions get more, apart from the project grants for development purposes that the poor regions receive. Rich regions complain on that because the *ordinality principle* is not fulfilled and in consequence there are no incentives for the poor regions and for the rich regions on extending the tax base. The question is:

How can a country move from having an *unitary* criteria of equalization into having a *federal* criteria of equalization were equalization do not mean identical but "reduced differences" in order to combine equity and efficiency?

Question 2: Asymmetric fiscal federalism

In Spain two systems of regional finance cohabit: the common regime and the special regime. Two regions (Basque Country and Navarre) enjoy the special regime (and in some aspects the Canary Islands also). Catalonia, another leading region of the process of federalism, is looking for some kind of asymmetry in the financial model. The question is:

Where are the *limits* of asymmetry in fiscal terms (i.e. in terms of different fiscal powers and different equalizing mechanisms in regional finances), in order to maintain loyal fiscal competition, to avoid balkanization, and reach an homogeneous criteria of solidarity within the country?

SWITZERLAND

Question 1

What is the relation between fiscal competition and fiscal equalisation? Under which conditions is a fiscal equalisation system necessary for fiscal competition to survive, and under which conditions will the fiscal equalisation system destroy fiscal competition?

Question 2

How can a system of fiscal federalism be constructed to cope with the bail-out problematic? Which rules are necessary in order to prevent moral hazard from financially less responsible member states and/or local communities in a federal state?

USA

Question/Issue 1: “The U.S. lacks an effective apparatus for intergovernmental fiscal policy coordination”

Discussion: The U.S. Roundtable participants concluded that the major fiscal federalism issue in the U.S. is the lack of a formal or informal process for effective coordination of intergovernmental fiscal policy. As a result, federal initiatives may often be in conflict with state policies and/or state policies may be in conflict with local government policies. Moreover, the lack of fiscal policy coordination reduces the effectiveness of fiscal policy initiatives of all governments in the U.S. system of federalism. The participants agreed that there is a great need for a formal collaborative process or mechanism for the coordination of intergovernmental fiscal policies. Priority concerns for coordination include tax and revenue policy, and intergovernmental cost sharing programs such as health care, education, and infrastructure, among others.

Question/Issue 2: “There has been a weakening of the states in the in the U.S. federal system”

Discussion: The U.S. Fiscal Federalism Roundtable concluded that the second most important fiscal federalism issue involved a weakening of the states role and authority in the U.S. system of federalism. More specifically, while the U.S. constitution “reserves for the states” authority and responsibilities not specifically given to the federal government, the states are concerned that there has been a steady erosion of state authority in the U.S. system of federalism. The preemption of state authority and the increasing dominance of the federal government in the U.S. system of governance have resulted from aggressive federal government initiatives to increase its’ principal role in setting tax and revenue policy, and defining intergovernmental program responsibility. The expanding role of the federal government in the U.S. system of fiscal federalism has also been aided and abetted by U.S. Supreme Court decisions, often based on the commerce clause of the U.S. constitution.