

Local Government Finance and Intergovernmental Relations: Comparative Institutional Analysis

by

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1. Introduction

Local government taxation, central-local financial relations and other forms of decentralised public finance are seemingly quantitative questions, demanding a financial approach, requiring lots of number crunching and statistical analyses and utterly fit to be subjected to an economic analysis with a heavy doses of attention for normative public finance theory.

The comparative analysis conducted in this project, although not denying the importance of a financial-economic approach, has lead us to the conclusion that isolated financial figures on local government finance and taxation are hardly – if at all – to be interpreted without any insight in underlying institutional patterns and developments in various countries, i.e. various types or systems of intergovernmental relations. Many of the financial figures are lacking meaning outside the broader institutional context of the intergovernmental systems in which they have developed. The same is true for ongoing transformations and reforms in and of these relationships.

Central local finance and local government taxation are not merely technical and instrumental issues, however well public finance par excellence seems to lend itself for a public budgeting or accounting approach. Budgetary and financial relationships are part of a broader system of guidance, coordination, control, politics and power exercise which characterises any intergovernmental system, from the most complex, decentralised and federal systems to the – seemingly - most simple, unified, centralised unitary systems that we may find in the administrative world.

In this contribution, we aim at analysing and interpreting characteristics and possible developments in local government finance in a number of countries. These countries have been selected by the Dutch Ministry of Home Affairs (BZK) as potentially interesting as a source of inspiration or background information for developments in the Dutch system, known as the system of ‘home administration’. The project, conducted on instigation of members of Dutch parliament, is on ongoing and possible future developments in Dutch central-local relationships, most notably central-local finance and local taxation. The BZK project aims at assessing and evaluating past developments and future possibilities in terms of three scenarios. The Ministry would like to see these scenarios informed by possible international developments from a cross-national perspective.

We first set out to provide an international comparative institutional framework in the context of which characteristics and developments of local government taxation and intergovernmental financial relationships in various systems – prototypes – of intergovernmental relations may be interpreted. In chapter 2 we provide a brief – ‘headlines’ - comparative overview of the ‘Classical Models’ in Comparative Public Administration as far as the intergovernmental systems are concerned represented by the countries included in this study. In chapter 3 we will summarise some of the findings of the ‘nominal’ and descriptive inventory of developments in the various countries included in our field research. We will focus on characteristics and developments of local government finance in Denmark, Sweden, England, New Zealand, France and Germany. In chapter 4, on the basis of this country by country exploration, we will then try to formulate some comparative conclusions at the level of system characteristics – rather than the country specific level. We will relate the findings to our comparative framework and present developments as ongoing transformations and public sector reforms in Nordic Countries (Denmark, Sweden), Westminster Systems (England, New Zealand), a ‘Napoleonic’ (France) and a European federalist system (Germany). In chapter 5

we use our comparative institutional exploration to draw some final conclusions on the relationship between intergovernmental relations and local government finance.

2. Comparative Framework: Classical Models

From a Public Administration (PA) perspective, multi-layered governance and the existence of complex, interrelated and inter-organizational systems and policy networks are the rule of 'government in action' as public administration or governance is conveniently identified. This observation applies specifically to the complexities of intergovernmental – central-local – systems.

For a meaningful comparison of complex systems one needs a common or overarching – transcendent - problem definition. Next to a typology or categorisation of 'systems of home administration', a viewpoint is needed from which various and utterly diverse systems may be 'unified', i.e. compared from a common angle.

The Ministry of BZK in the context of this project is particularly interested in the issue of the characteristics of local government finance in relation to different scenarios in the development of intergovernmental relations ('*bestuurlijke verhoudingen*') in the Dutch system of 'home administration'. We therefore choose the concept of transformation and administrative change as the general frame of reference and starting point for our comparative observations. We will not choose a certain 'model' of reform – for example the in analytical circles still popular but for comparative understanding increasingly outdated New Public Management (NPM) model or 'paradigm' – as the yardstick ('the benchmark') for comparative analysis.¹ Rather, an institutional perspective suggests that in a context of transformation, change and institutional development, it is particularly the institutional capacity and perseverance to adapt to changing (economic, political, infrastructural, cultural) circumstances – i.e. the capacity for strategic action, resilience, institutional sustainability, survival and innovation of the system – which become focal points of attention in comparative analysis.² Later we will specify this in the context of (the transformation of) central-local financial relations and local government taxation.

As a general point of departure these approaches assume that administrative systems – like for example economic or political systems – seek some kind of stability and equilibrium in an ever changing environment. Stability is not a static, but a dynamic concept of balancing forces that are internal and external to any given system. Lane and Ersson³ maintain that the adaptive capacity to external circumstances in terms of threats and opportunities, and therefore the stability of a political-administrative system, depends on the capacity of a system as a whole to secure for its relevant component parts an acceptable balance in the trade-off between 'autonomy' on the one hand and codetermination or 'participation, access and influence' to relevant collective decision making arenas on the other hand. Where this trade-off is not in balance, instabilities may occur, which eventually might lead to a disruption, stagnation and breakdown of ongoing developmental processes.

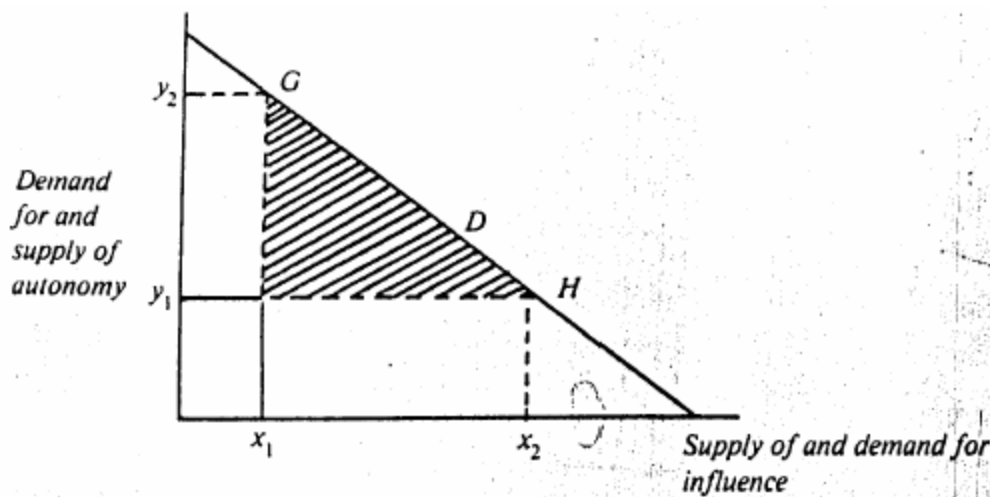
¹ Toonen, Th.A.J., (1996) Public Sector Reform in Western Europe: a Paradigm Shift or Public Administration as Usual?, in: Hesse, J.J. & Toonen, Th.A.J. (eds), *The European Yearbook of Comparative Government and Public Administration*, Volume 3. Baden-Baden: Nomos, 485-498.

² Toonen, Th.A.J. (2003) Administrative Reform Analytics, in: Peters, B.G. and Pierre, J. (eds), *Handbook of Public Administration*. London: Sage, 467-476; Toonen, Th.A.J. (2006- reprint 1993) Analyzing Institutional Change and Administrative Transformation: a Comparative View, in: Ottenyo, E. and Lind, N. (eds), *Comparative Public Administration: the Essential Readings*. Houghton-Mifflin.

³ Lane J.E. and Ersson, S.O. (1987) *Politics and Society in Western Europe*. London: Sage

In this perspective the well-known distinction in intergovernmental relations between autonomy (*'autonomie'*) and co-governance (*'medebewind'*) – which also underlies much of the Dutch (but also for example German, British or Nordic) debates on intergovernmental relations – is not presented as a zero-sum contradiction or management dilemma. Tensions among the two principles stem from the institutional trade off among two important values in organising governance: a balance between the organisational ability to act with a fair degree of independence and a minimum of transaction costs on the one hand (*autonomy*) and the need and potential to affect and cooperate with other interests and power holders involved in order to participate in decision-making arena's where decisions are taken which directly or indirectly affect one's interests. 'Agenda setting' is of equal importance – if sometimes not more important – to the problem solving capacity of systems of governance as the 'executive side' – the implementation and management - of governmental tasks is. Schematically the trade-off can be represented as in figure 1.

Figure 1: Political instability, autonomy and influence on national government



Adapted from: Lane and Ersson, 1987.
 Note: the shaded area represents the possibilities

Although Lane and Ersson apply the model to the influence of societal groups and regional interests on national government, it has to be noted that in the context of intergovernmental relations the same is true for the interests and influence of national (or 'higher') government on the actions and decisions of local (or regional) governments. These options are institutionally – as part of the institutional repertoire of action - even in the interest of decentralised, local government.

Within the larger system of intergovernmental relations there are many legitimate reasons – also from the viewpoint and value of decentralised governance – for central government to intervene in (inter-) local affairs, to resolve conflicts, or to be able to put common interests on the local agenda, just like the other way around. If the only institutional option which would prevail under such (legitimate) circumstances would be to take away local government authority with respect

to that task altogether and bring it under the ‘autonomy’ of national government, this would automatically imply the full centralisation of the tasks involved⁴.

The model suggests that there are various stable trade-offs between ‘autonomy’ and ‘influence’ or co-determination within a system, and that this is also to a large degree a subjectively felt, culturally and historically determined ‘trust’ factor. In terms of institutional position, the combination H (see figure above) with a relatively low degree of autonomy in combination with a fairly high degree of co-decision possibilities would to, say, a large Swedish community provide the same sense of self-determination as the position G (see figure above) for, say a regional government like Flanders or Catalunja in the Belgian, respectively Spanish context. Low degrees of confidence and trust in channels or platforms for joint decision-making in central-local relationships will induce a larger demand of autonomy, and the other way around.

The model points out three elements, which are important for our comparative analysis. First, it underscores the importance of national, historical and contextual information and characteristics in interpreting any given institutional arrangement, like a given central-local government financial system, from a comparative, cross-national perspective. Second, the model indicates that there are various institutional arrangements in the context of which the trade-off – often operationally experienced as a ‘conflict’, ‘dilemma’ or ‘paradox’ – can be resolved and that one ‘model’ or institutional arrangement is not necessarily and by definition ‘better’ than its institutional equivalent. Third, the model points out that we are dealing with a dynamic situation. The trade-off is also represented as a ‘production possibility line’ for autonomy and co-determination in any given system. When – due to internal or external circumstances – the amount of resources available to any given system of governance and therefore the overall problem solving capacity of the system, increases or decreases, for example under the impact of (international) economic growth or decline, this is bound to affect the (experienced) equilibrium positions. This will ‘destabilise’ the intergovernmental relationships.

The interesting part is that the latter does not only occur under conditions of decline and shrinking resources or institutional capacities. Also growth and expansion of problem-solving capacity of the system as a whole – in other words: a positive sum game with feasible ‘win-win’ solutions - will trigger potential conflict and debate on how to apply these newly regained resources in terms of either increasing ‘autonomy’, or the joint decision-making capacities or both. Even periods of institutional growth trigger periods of instability in intergovernmental relations. The question then becomes whether and to what degree the structure of the political and administrative system allows for constant correction and balancing in turbulent environments. Too much internal stability on the short run, in terms of lack of change, reform and adaptation, might on the long run even drastically destabilise and threaten the perseverance of the system.

In a complementary approach and in the context of a comparative analysis of central-local relationships in unitary systems, Page and Goldsmith⁵ identify three factors which are of crucial importance in assessing the institutional balance among national and local authorities:

1. Functions (*‘taken’*),
2. Discretion (*‘beleidsvrijheid’*) and
3. Access (*‘toegang’*) to relevant decision-making arena’s.

⁴ Cf. Raad voor het binnenlands bestuur (Rbb) (1988) *Medebewind: van autonome waarde!, Tweede advies over territoriale decentralisatie*, Den Haag: Rbb.

⁵ Page, E.C. and Goldsmith, M. (eds) (1987) *Central and Local Government Relations: A Comparative Analysis of Western European Unitary States*. London: Sage.

In our conclusions we will focus on these three elements as focal point of comparison and feedback to the questions and scenarios underlying this project. We will complement them where necessary on the basis of our country studies. As a starting point, however, we assume that these three variables and therefore the balance between 'autonomy and participation' are affected by various institutional factors which in turn influence the adaptive capacity for stable reform and institutional development.

Before we may turn to our country studies, however, we will have to formulate a conceptual framework for cross-national comparative analysis. We do this by taking recourse – like in the BZK scenario design – to the 'Classical Models' of intergovernmental systems, in this case with regard to the countries or systems represented by the countries in our study. Current insight in intergovernmental relations invites us that in doing so we need to think in terms of three interrelated worlds of action and reform: the Intergovernmental Constitution (IGC), Intergovernmental Relations (IGR), and Intergovernmental Management (IGM).⁶

Intergovernmental Constitution (IGC)

The - for comparative purposes – very common distinction between federal and unitary states is primarily a formal legal distinction. The mere juxtaposition of federal and unitary systems, however, breaks down in the face of the varieties of administrative systems that need to be addressed. Federalism is generally recognised as an abstract and multi-interpretable concept. Gradually analysts are experiencing that the situation with respect to the concept of 'unitarism' is not very different: 'Indeed, only God knows what the unitary principle is and he has been remarkably reluctant to let mere mortals into the secret'.⁷

It is analytically useful to make a distinction between federal and unitary *states* versus federal and unitary *systems of governance* and public administration. From an empirical viewpoint – the governance view - the actual relative subsystem autonomy within a unitary state might be as large or as small as within a federal structure. The federalisation process in Belgium, for example, for a long time went hand in hand with a strong process of centralisation in (regionalised) central-local relationships, in that the regional authorities did strongly cling to their newly acquired powers.

The other way around, unitary states from a sociological, political or administrative point of view may actually operate as federalised systems. This can be a 'sociological federalism', a concept Lijphart⁸ once needed to introduce in order to fit the Dutch case into his comparative analysis. Conversely, a governance and administratively oriented 'implementation' federalism within a unitary state structure is also possible. This characterises the administrative build up of many northern European States, in which local governments play an essential role in actually carrying out and 'administering' nationally agreed upon policies and therefore – formally or de facto -

⁶ Cf Wright, D. S. (1988) *Understanding intergovernmental relations*. Pacific Grove: Brooks/cole; Toonen, Th. A.J. (1990) *Internationalisering en het openbaar bestuur als institutioneel ensemble: naar een zelfbestuurskunde*. Den Haag: Vuga; Toonen, TH.A.J. and van der Meer, F. (2006) Area and Administration: a multi-level analysis of a multi-layered phenomenon, in: Michael Burgess & Hans Vollaard (eds), *State Territoriality and European Integration*. New York: Routledge, 71-100.

⁷ Bulpitt, J. (1989) Walking back to Happiness? Conservative party governments and elected local authorities in the 1980s, in: C. Crouch and D. Marquand (eds.), *The New Centralism, Britain out of step in Europe?* Oxford: Basil Blackwell; also Toonen, Th. A.J. (1990).

⁸ Lijphart, A. (1984) *Democracies; Patterns of majoritarian and consensus government in twenty-one countries*. New Haven: Yale University Press.

have a strong impact on national government policy formulation. The main *a priori* difference among unitary and federal states is that, due to the different legal frameworks, the relative autonomy of subsystems has a distinctive legal expression.⁹

For our purpose we may distinguish four classical types of ‘intergovernmental constitution’. Analytically these types might be – and in practice are being - studied and therefore interpreted in terms of different conceptual frameworks. We will indicate some of the relevant concepts, but for our purposes further elaboration is not required and would make our analysis more complicated than necessary. One has to be aware, however, that in comparative analyses not only the ‘objective characteristics’ of a system, but also the often hidden or silent conceptual framework which the ‘country-reporter’ is using, affects the interpretation of how a system of governance actually operates.

Federalism	versus			Unitarism
Dual Federalism	Cooperative Federalism	Consensus Unitarism		Westminster/ Jacobin Unitarism
Authority	---	Interdependency	---	Hierarchy

‘Federalism’

For the analyses of intergovernmental systems, a distinction is to be made between co-operative or horizontal federalism, and dual or vertical federalism. In the case of vertical federalism, the division of labour among the different governments rests upon assigning different policy areas to different governments. The division of labour is characterised by a more or less exclusive allocation of tasks and competencies in the area of legislation *and* administration within different policy areas to the different layers of government. The different governments in principle carry out their own rules, regulations and policies.

In contrast, a system of co-operative or horizontal federalism is characterised by a division of labour in terms of the functions of legislation, execution and financing. One level sets the rule and another level is responsible for implementation. By and large the distinction between horizontal and vertical federalism is the distinction between the basic set up German 'co-operative federalism' and the American 'dual federalism'.¹⁰ Both systems do amount to the development of complex intergovernmental relations, but the basic nature of these will differ from each other. The nature of interdependency and coordination in a system of dual – vertical - federalism is one of the coordination among different policy sectors, which are assigned to the prime responsibility of different governments. The nature of interdependency and need for coordination in a system of horizontal – cooperative – federalism is more administratively in that various governance functions – policymaking, execution, supervision –within the same policy fields have been assigned to various levels of government and need to be reassembled for effective action.

The legitimate and constitutionally recognised existence of different 'governments' with different territories is more easily acknowledged in a federal state, with its formally more clearly

⁹ Lane & Ersson, 1987.
¹⁰ Gunlicks, A.B. (1986) *Local Governments in the German Federal System*. Durham: Duke University Press.

distinguished subsystems, than in unitary states. This may contribute to more deliberate attention and sensitivity to arrangements for institutionalised co-operation and consensus building.

‘Unitarism’

Also, unitary states, even at a constitutional level, cannot be treated as an undifferentiated category. The archetypes of a unitary state are the Jacobin French and the British Westminster varieties of the unitary state. Discussions about different unitary states have often been couched in terms of a juxtaposition of the French 'centralised' and the British 'decentralised' unitary state, a distinction that in the 1980s came under serious scrutiny.¹¹

In a comparative analysis where the Netherlands is involved, we will have to further differentiate the concept of ‘a unitary state’. Contrary to much of the conventional wisdom, the Dutch system has not been designed from the perspective of parliamentary sovereignty and subsidiary notions of centralised governance and administration.¹² The Dutch 'decentralised unitary state' is a concept, which according to many political scientists, theoretically cannot exist - ‘decentralised centralisation’ - and is therefore discarded as self-contradictory. Yet from an historical perspective, this principle of a ‘decentralised unitary state’ reveals characteristics which reflect the constitution of what can more appropriately be called a 'consensus state'.¹³

The term ‘decentralised unitary state’ was not used in the 1840s and 1850s, The term decentralised unitary state is actually a misnomer when referring to the constitutional structure as designed by the founding father of the current Dutch constitutional design, Thorbecke in 1848. Thorbecke tried to apply an organic, non-centralised concept of the ‘unitary state’ to the task of intergovernmental design. The institutional set up of the Thorbeckian unitary state has facilitated the subsequent institutionalisation of the internationally famous system of *pillarisation* in the modern Dutch state of late 19th, early 20th century, later temporarily to become renowned as the ‘*polder model*’.¹⁴

The inclusive authority model of Westminster or Jacobin Unitarism will face predictable problems in administrative adaptation and modernisation processes. The clearly circumscribed division of labour and competencies ('ultra vires'-doctrine) among the different levels of the administrative hierarchy has the advantage of relative clarity and transparency. The administrative blueprint of the hierarchical, inclusive and supposedly complementary division of labour between different layers of government will, however, be constantly tested by the requirements of a changing administrative environment. Much external, i.e. centralised force will be necessary to change and reform the system. Intergovernmental reform will require ‘an act of Parliament’, which almost by definition implies that the only ‘real reform’ is ‘legislated reform’.

Legislated reform

Subsystem adaptation to externally changing circumstances requires previous reforms of the existing division of labour and authority. The British system of 'ultra vires', for example, requires an Act of Parliament to change the existing domain of local government autonomy. In contrast to the federal situation, the hierarchical nature of the reform process is prone to contribute to a

¹¹ Ibid.

¹² See: Toonen, 1990.

¹³ Hendriks, F and Toonen, Th.A.J. (eds.) (2001) *Polder Politics: The reinvention of consensus democracy in the Netherlands*: Aldershot: Ashgate.

¹⁴ Ibid.

rather one-sided, unbalanced and centrally dominated adaptation process. The classical example is the Thatcher reforms where ‘decentralisation’ no longer meant ‘local government’ but ‘the market’. Devolution to territorial entities (at the regional level) became an issue again once a (Blair) government was installed which, with all the continuities of its predecessors, had ambitions to improve government operation and to ‘rejoin’ an in the meantime -by (regionalized) agentification- disjointed government apparatus.

Institutional transformation

In contrast, in consensual systems, the reform of the intergovernmental constitution and other parts of the intergovernmental system will most likely be conducted in an organic manner, with (framework) legislation very often following pragmatic and step by step transformations of the system. In principle, in consensual systems – both ‘federal’ (Germany) and ‘unitary’ (the Netherlands, Sweden) - there is a lot of room for ‘reform-bargaining’ and for ‘institutional transformation without (legislated) reform’. The organic systems are supposed to change ‘from within’, which often explains the lack of a (centralised) reforming authority and the prevalence of deadlock – *Reformstau* - and stagnation if vested interests are unable to mutually agree on required strategic action.

Intergovernmental Relations (IGR)

Intergovernmental relations consist of the configuration of legal, financial, political, administrative and organisational relationships and linkages among the different elements and units, which are distinguished within a state – IGC - system. Most research suggests two important dimensions along which systems of intergovernmental relations might productively be analysed. Firstly, the question regarding the 'horizontal' or the 'vertical' nature of relations repeats itself at the level of the IGR. The second dimension concerns the degree of administrative and political interwovenness of the different levels, which generally characterises the intergovernmental system of a particular country.

Local self-governance	versus			Administrative deconcentration
Horizontal Administration	Interwoven Administration	Vertical Administration		Field Administration
Coördination	---	Exchange	---	Agency

Regarding the first dimension, the 'horizontal' or the 'vertical' nature of relations, the relationships between different levels of government may be characterised by the horizontal principle in which units of government at one level carry out the legal rules and norms, which have been set at another level. This principle applies to systems, which are characterised by regional and local self-administration, and includes countries such as Great Britain, the Scandinavian countries, the Netherlands, and Germany.

Field organisation

The so-called ‘Napoleonic states’¹⁵ – with France as the ‘ideal type case’ - are predominantly characterised by the principle of verticality. Some would like to speak of administrative

¹⁵ Page and Goldsmith, 1987; Wunder, B. (ed.), (1995) *Les influences du modèle Napoléonien sur l'organisation administrative des autres pays/ The influences of the Napoleonic model of government on the administrative organisation of other countries*, Brussels: IIAS.

deconcentration. The public authority, which sets the rule, also takes care of the implementation by means of field agencies in the region. The (former) prefectorial system of France is the most notable example in this respect, but the category also includes countries like Italy, Spain, Greece, Portugal, and still characterises developments in Belgium so far. In some systems, forms of vertical administration have led to a more uncoordinated 'picket fence model'¹⁶ in which national ministries have each, more or less independently, set up their own field agencies and thus functionalised service delivery. The issue of territorial integration is neglected at the expense of territorial fragmentation and a lack of co-ordination and policy integration.

The German system differs from the French system in consequently applying the principle of local self-administration in the relations among Bund and Länder and Länder and municipalities. This contrasts the French deconcentration of services into the hands of a (prefectorial) field administration, which executes assigned functions under the responsibility of the central government. The German *Regierungsbezirke* are also a form of territorial coordination, but rather of administrative regional/Länder services than of operational executive service delivery. Both systems, however, either by means of a prefectorial, or by means of a local government field organisation, try to secure a comparable degree of (territorial) integration of national services in the region. In terms of the IGR, in this case a unitary and a federal system do share a very common strategy as far as the organisation of IGR in administrative terms is concerned.

The territorial dimension of the French system has become more political – rather than bureaucratic - in nature in the course of the decentralisation, and reform processes of the 1980s and 1990s. The Departments were granted democratic legitimization by substituting the Prefect by a directly elected council as the major way to democratically control executive action at the local and supra-local level. Creating more flexibility in the French intergovernmental system has been an important reason behind this form of enhancing and politicising territoriality in the operation of public service delivery and control.

Interwovenness

The second dimension of the system of IGR distinguished here, concerns the degree of administrative and political interwovenness of the different levels, which generally characterises the intergovernmental system of a particular country. Some systems are characterised by statutory regulation and a high degree of separation of the different layers of government. One might speak of steering from a distance. The most notable historical example is the 'dual' British system where the principle of 'ultra vires', in joint combination with the emphasis on local autonomy within these fixed boundaries, has led to a system that '... can be called a Dual Polity, a structure of central local relations in which national and local politics, and national and local government, operated, by and large, in two separate compartments'.¹⁷

The political interwovenness of levels of government can take on different forms. The operation of the political party system may be relevant, or elaborate institutional and formalised arrangements for joint decision-making across various levels of government, like in Germany. The horizontality principle creates a fundamental interdependency relationship among various levels of government. The tradition of a 'non-executant role' of central government, characteristic for countries like Great Britain, Germany, Scandinavian countries and the Netherlands, is

¹⁶ Wright, V. (1979) *Regionalization Under the French Fifth Republic: The Triumph of the Functional Approach*, in: L.J. Sharpe (ed.) *Decentralist Trends in Western Democracies*. London/Beverly Hills: Sage Publications.

¹⁷ Bulpitt, 1989; Bulpitt, J. (1983) *Territory and power in the United Kingdom*. Manchester: Manchester University Press.

traditionally identified as one of the overriding factors in explaining the variety in the share of local government activity in the overall state activities.¹⁸ In these systems, local governments are strongly embedded in the overall state structure, often taking a larger share of governmental expenditures out of the overall budget than the national government does. The Anglo-Saxon system of local government and municipal self-administration creates at least a potential dependency of national upon local governments for the implementation of public services. The national 'Napoleonic' governments in Southern Europe dispose over their own deconcentrated field agencies to carry out their policies.

The degree of interwovenness is conventionally being addressed - and criticised - under the heading of 'centralisation'. Practitioners will never tire of stressing the need for 'complementarity', coordination and the reduction of duplication and overlap in central-local relations. The model of partnership versus the model of central and decentralised government relationships has equally stressed the desirability of disentangling intergovernmental relations on behalf of the 'lower' governments.

Interdependency

If anything, comparative intergovernmental experience and research over the past decade have at least contributed to a considerable modification of this conventional wisdom. It was precisely the relative lack of direct administrative and political interwovenness of the system in the British setting, which allowed the Thatcher government to implement its retrenchment policies of the mid 1980s at the local level of government, without directly being confronted with the administrative and political counter forces. These would undoubtedly have been mobilised if the institutional arrangements would allow for bureaucratic and party political access of local interest to the national decision making centres. Not until the introduction of the 'poll tax' did the national administration become directly involved in 'local' issues, and directly experienced the effects its decisions had at the local level of government. It meant the beginning end of the – particularly for local government in England – harsh period of Thatcher rule.

The osmosis of the French system provides the case in contrast. It is more centralist in set-up and nature, but over time, in effect has developed into a complex interplay of forces in which more than once, central government has not been able to pursue its stated policy preferences against the interests and will of the local authorities. The recurrent and systemic inability of one of the supposedly most centralised states, to reform the “according to many observers”, archaic, French municipal government system is almost legendary.

In sum: a non-executant role of central government and local self-administration are relevant factors for explaining the potential importance of local public economies in intergovernmental systems as a whole. In addition, a certain degree of interwovenness of levels of government, which connects national and local agencies even against their will, seems necessary to allow for institutional conditions under which local politics and administration may maintain or at times raise its importance to national politics.

Intergovernmental Management (IGM)

The intergovernmental management dimension, finally, refers to the array of problem solving activities, procedures, techniques and forms of steering, guidance and control, which persons

¹⁸ Page and Goldsmith, 1987; Rhodes, R.A.W. and Wright, V. (eds), (1987) *Tensions in the territorial politics of Western Europe*. London: Cass.

deploy, which operate at the interfaces of the different governmental agencies. They operate within the given intergovernmental constitutional and relational framework of the intergovernmental system.

Statutory Control	versus		Administrative Control
Administrative Reform Authority	Statutory Regulation	Joint Decisionmaking	Administrative Regulation
	---	Persuasion	---
			Bargaining

Different forms of IGM may effect different, and sometimes counterintuitive, results as far as the operation of the system is concerned. The Scandinavian countries and Britain, for example, differ from France, Italy and Spain in that they rely more heavily on IGM by general norms, statutes, regulations and criteria that must be observed by the authorities involved. In contrast to this management according to statutory regulation, the other countries tend to rely relatively more on administrative regulation by direct and more detailed guidance, in which many decisions of local authorities involve the intervention of central government officials in individual cases.

In the Northern countries the management, by statutory regulation, is often practised and advocated in the name of 'decentralisation'. The empirical observation of Page and Goldsmith¹⁹ is that the intergovernmental management practice underlying administrative regulation implies close links between centre and specific localities. Page and Goldsmith conclude that local government has much better opportunities to influence central policymaking in the investigated Southern states than in Britain and Scandinavia in the North: "In South Europe, not only is the voice of local government as a whole heard at the centre, but also that of the individual municipality".²⁰

Different styles of intergovernmental management and underlying administrative cultures may drastically change the way in which the same institutional and financial arrangements, at the level of IGC or IGR, might actually operate on a day-to-day basis. Supervision powers of one public authority over another might be used in one system as a mechanism for coordination, consultancy, support, mediation and problem solving, among levels of government. In other systems they might vehemently be exploited for trying to settle narrow-minded bureaucratic and political fights and conflicts, or to block or veto developments of adjacent units in the intergovernmental system. The same is true for central-local grant systems. It is often the combination of features at the constitutional, relational and managerial levels of intergovernmental systems, which determine the nature of the system.

Framework for Comparative Analysis

The previous presentation may be summarised in the following analytical framework:

¹⁹ Page and Goldsmith, 1987.
²⁰ *ibid.*

Intergovernmental Systems (IGS)

A Framework for Multi-Level Analysis

IGC

Federalism	<i>versus</i>		Unitarism
<i>Dual Federalism</i>	<i>Cooperative Federalism</i>	<i>Consensus Unitarism</i>	<i>Westminster/ Jacobin Unitarism</i>
Authority	---	Interdependency	---
		Hierarchy	

IGR

Local self-governance	<i>versus</i>		Administrative deconcentration
<i>Horizontal Administration</i>	<i>Interwoven Administration</i>	<i>Vertical Administration</i>	<i>Field Administration</i>
Coördination	---	Exchange	---
		Agency	

IGM

Statutory Control	<i>versus</i>		Administrative Control
<i>Administrative Reform</i>	<i>Statutory Regulation</i>	<i>Joint Decisionmaking</i>	<i>Administrative Regulation</i>
Authority	---	Persuasion	---
		Bargaining	

The framework indicates that intergovernmental systems have to be studied at various levels of analysis and do require a multi-level analysis and interpretation. Included here are merely the formal aspects of intergovernmental relations from an institutional, administrative dimension, but other variables may be added. Next to the legal characteristics, for example, the IGS may be ‘constituted’ by cultural, historical legacies or infrastructural developments. The intergovernmental constitution is obviously also shaped by the relationship of state institutions to those of the civil society or the socio-economic system of a country. Relationships (IGR) may be more or less formal or informal and management practices may be founded on habits, conventions and organisational cultures, written as well as unwritten rules or mandates. This is all a matter of how deeply and in detail one would like to explore and investigate the subject. It is even possible that instead of a more or less legal framework one would conceptualise the political or cultural aspects of a country at any given level of analysis as the basis of comparison. The framework presented here, however, limits itself to several of the basic institutional framework characteristics of ‘classical models’ in comparative Public Administration with respect to IGS’s at various levels of analysis.

The most important feature of the above framework is that it requires a configurative analysis, assessing the characteristics of administrative system at various levels of analysis in combination. Too often, comparative analyses are conducted on the basis of information at one level alone, either the institutional level – federal versus unitary – or at the level of tools and instruments, i.e. the level of IGM – a large or a small share of local taxation as an instrument for funding public service delivery. Sometimes far reaching conclusions about the systems as a whole are based on isolated observations at one level or the other. ‘This is a unitary state, so...’. ‘This country uses a strict demarcation of authority, so...’. This country uses performance contracts, so...’.

The framework presented here, encourages research at various levels – leaving aside the (not futile) question of (un)availability of empirical data – within the IGS and stresses the importance of contextual analysis in terms of the configuration of institutional analysis at various levels with the system.

A federal system managed in an interactive and hands on way is bound to operate differently from a (constitutionally) similar system that operates on the principle of mutual exclusiveness and ‘steering from a distance’. The same type of central-local financial arrangements at the operational, managerial level of the system may play a different role, depending on institutional characteristics at the level of IGR or IGC. Organisational autonomy, obviously, has a different meaning within a constitutional context where the domain of this organisation is determined by players outside the unit, rather than by the initiative and innovative capacity of the (local) government unit itself. Public finance problems – like equalisation – in some countries have to be resolved by compensatory measures at the level of IGR (systems of revenue sharing) or IGM (categorical grants). In another system they might be resolved in the (uniform) ‘constitution’ (IGC) of the system. The same value – equity – is institutionally secured at different, not to say ‘incomparable’ levels within the design of the system as a whole.

Institutional configurations

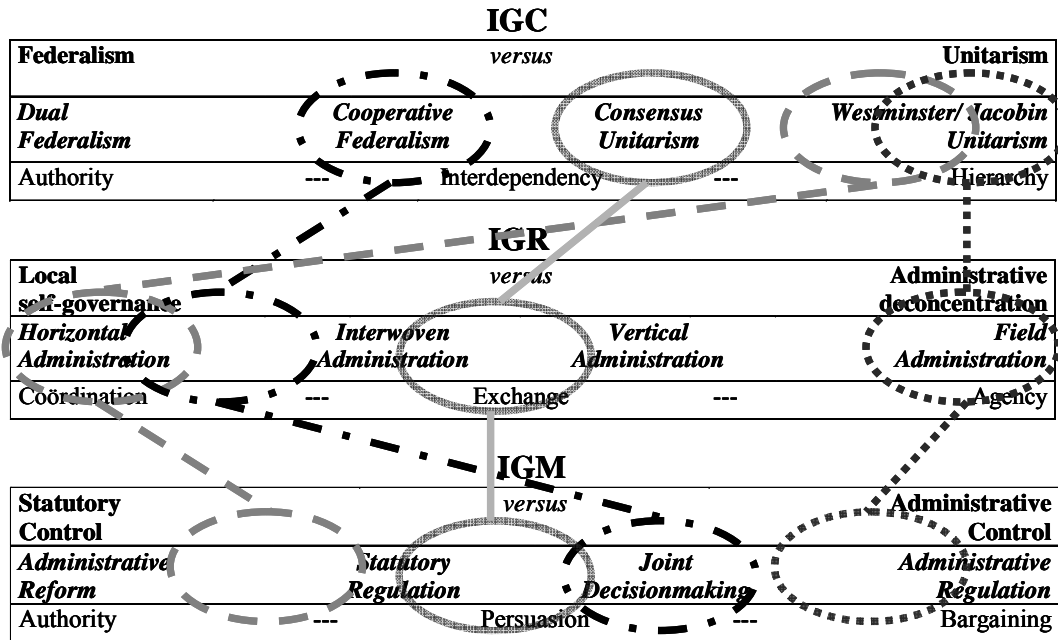
It is the configuration of characteristics at the various levels of analysis distinguished here, which make up the relevant comparative institutional profile of a given country. In our analysis we will take some of the ‘classical’ configurations which are being revealed in international comparative public administration as the prototypes, which may serve as a point of reference for interpreting ongoing developments and characteristics of individual countries. The following illustration basically summarises the analysis conducted in this chapter, for England (GB), Germany (Ger), France (Fr) and the Netherlands (NL). These ‘models’ serve as the yardstick and point of departure to compare and interpret developments in the various systems of intergovernmental relations that we will describe and investigate in the next chapter.

Each institutional profile in the illustration depicted here stands for a model: England (GB) for a Westminster type of unitary state, strongly centralised at the level of IGC, with a tradition of a clear separation of policymaking and execution at the level of IGR and a preference for generic ‘hands off’ IGM. Apart from England, the model in our project also encompasses New Zealand, whereas the Nordic countries – albeit different in political context - do share various characteristics and institutional traditions within this category.

Intergovernmental Systems (IGS)

A Framework for Multi-Level Analysis

GB: - - - - -
 FR:
- . - :Ger
— :NL



France (FR) stands here for the Napoleonic – if one likes: Southern European - system of IGR, characterised by strong central rule, a close – and often highly politicised – administrative interrelationship at the level of IGR, and a tradition of individualised, formal (*tutelle*) and fairly ‘hands on’ IGM system with direct involvement of higher ‘authority’ in local affairs.

Germany (Ger) represents the European form of (cooperative) federalism, which is characterised by a systematic, almost ‘constitutional’ separation of policymaking and execution across various levels of government, amounting to a high degree of administrative and political interwovenness across various planes of governance, which needs to be elaborated by a steady and ‘organic’ intergovernmental management process of cooperative joint decision-making, which - in the context of a *Rechtstaat* - is easily presented in a public law format despite its highly political nature.

The Netherlands (NL) presents the less formalised version of a cooperative state, in which the unitary legal structure provides national government with considerable leverage over regional and local government, but where a strong executive role of local governments contributes to strong interrelationships across various levels of governance. By lack of a strongly legalised tradition in formal ‘vertical’ cooperation and joint decision making, this structure evokes the creative use of administrative and bureaucratic tools and instruments to manage intergovernmental relations. Financial tools and arrangements are bound to make a strong part of the steering repertoire – in both directions.

3. Ongoing Developments: Country Reports

In this chapter, we will briefly describe some of the main characteristics and headline developments regarding the intergovernmental relations and local government finance systems in the various countries that have been selected for this study by the Ministry of Home Affairs: Denmark, England, France, Germany, New Zealand and Sweden.²¹

DENMARK

While Denmark shares the main characteristics of the Nordic political and societal model, it is at the same time clearly the southernmost outpost with higher population density and a welfare system influenced by continental liberalism.²² Denmark is a unitary state with a long-standing tradition of a decentralized public sector where the majority of welfare tasks are dealt with by local government, consisting of counties and municipalities. In general, counties are not hierarchical superior to municipalities. However, in some specified areas they have a supervising and controlling function. Denmark is in the midst of a fundamental reform of the public sector. Larger and more sustainable municipalities will be given the responsibility to handle most of the citizen-related tasks.

Strengthening local government

In 1970 an amalgamation reform took place, creating the basis for a transfer of tasks from the state to local government and a concurrent restructuring of the financial relations. Local authorities perform a broad set of functions. They are provided a general competence through law, yet most of the tasks performed are mandatory. The Constitution directs local authorities to take independent control of their own affairs subject to supervision by central government. While it does not provide protection against comprehensive legislative regulations of local authority matters, in practice local authorities have a considerable degree of autonomy.²³ To a greater extent than local governments in any other European country, Danish local authorities rely on local sources of income.²⁴ Tax levying has been extensively decentralized in Denmark and direct and indirect taxes constitute more than half of local government income. Other important sources of income are operations and investments, leading to around 80 % of local income being locally generated. Next to this, local government receives substantial general grants and some smaller special grants as well as state contributions in the form of refunds of certain types of expenditure, primarily within the social area. Three schemes for equalizing expenditure needs are set up: a national equalisation comprising all municipalities, an equalisation among municipalities in the Copenhagen Metropolitan Area, and a county equalisation scheme. With economic problems hitting Denmark earlier than other Nordic countries, local authorities were compelled to restrict their use of resources and central government control over the local budgetary system was increased. However, this led to

²¹ A more detailed and where possible statistical description and analysis will be provided in the background country studies, to be fully included in the final version of the research report.

²² Lidström, A. (2001) Denmark: Between Scandinavian Democracy and Neo-liberalism, in Loughlin, J. (ed.) *Subnational Democracy in the European Union. Challenges and Opportunities*, Oxford: Oxford University Press, 343-363.

²³ www.lk.dk

²⁴ Council of Europe (1997) *Local Finance in Europe, Local and Regional Authorities in Europe*, Strasbourg: Council of Europe.

Danish local authorities being less hit by the economic problems of the 1990's than its neighbours in Sweden and Finland.²⁵

The current reform aims at strengthening local government through a new process of mergers and task redistribution. The reform, which will come to force as of January 1st 2007, will lead to a decline of the number of counties (from 14 to 5) and municipalities (from 271 to 98). New and larger municipalities are formed through a decentralized process, with municipalities negotiating with their neighbouring municipalities on mergers. Only in two instances, the formation of new municipalities was decided by the state. Only 7 out of 98 municipalities will have less than 20.000 inhabitants and these municipalities, mostly smaller islands, have co-operation agreements with neighbouring municipalities. The mergers also lead to changes in the division of tasks between government levels, with the rationale being that municipalities will be able to take over a number of tasks that are currently handled by the counties. The municipalities will also lose some responsibilities to the state, primarily on the assessment and administration of taxes.

Local authority expenses amount to approximately 23% of the Danish GNP and as such, central government and local authorities co-operate closely on local authorities' budgets and tax rates.²⁶ However, the relationship between central and local government is described as mixture of control, negotiation and autonomy, with detailed involvement being avoided.²⁷ The National Association of Local Authorities and the Association of County Councils have an annual economic agreement with central government, and are involved in the policy-making process at national level at an early stage. Informal relationships lying beneath this formal structure have changed shape during recent years with a move from centralist corporatist arrangements to a more network-based pattern.²⁸

Alike in other countries under study, in recent years Danish local authorities enter in closer co-operation with each other. However, much alike the 1970 amalgamation severely reducing cooperation, the 2007 reform can be expected to again make cooperation less usual. Also of interest to our study is an increasing fragmentation of Danish local government. Since many organizational changes have been initiated by the local authorities themselves, the solutions selected vary locally. Partly in reaction to this, local authorities are compelled to provide detailed information about their services to their citizens.²⁹

ENGLAND

England is one of the four constituent parts of the United Kingdom, accounting for approximately 83 % of UK's total population. Local government in England comprises 9 regions -including the Greater London Authority (GLA)-, six metropolitan areas, metropolitan districts, unitary authorities, shire districts, shire councils, town councils, and parish councils. The size of the area covered and the size of the population served may vary considerably between authorities of similar types and with similar functions.

The powers of the regions are very limited and there are no elected regional governments except for London. In London, the upper tier consists of the GLA and its four functional

²⁵ Lidström, 2001.

²⁶ www.lk.dk

²⁷ Lidström, 2001.

²⁸ Ibid.

²⁹ *ibid.*

bodies. Most functions are delivered by the London boroughs and the City of London, lower tier authorities. In the six metropolitan areas most services are run by metropolitan districts, next to single purpose authorities. In most of the rest of England, called shire areas, there are two main tiers of local authorities: shire counties and shire districts. In some parts of the country, shire county and shire districts responsibilities are carried out by a unitary authority. Since most unitary authorities do not have responsibility for fire and rescue services, these counties also have a combined fire authority. In some parts of the country there is a further tier of elected parish and town councils that provide limited services. They vary widely in number of population, annual budgets, and role played. The number of parishes has increased recently and in the last few years some have been given new powers.

Local authorities work within the powers laid down under various Acts of Parliament. As such, local government has no general competencies, but may perform only what is permitted by parliament which defines the 'powers beyond which' ('ultra vires') it cannot go.³⁰ However, functions are far-reaching with some being mandatory and others discretionary.

About 62% of local authorities' gross income in 2003-2004 came from central government. The Aggregate External Finance consists of government grants (mainly a general grant, but also specific grants to reimburse payments as agents for the national government, and specific, conditional grants) and the National Non-Domestic Rates (a general grant distributing the national total of revenue from the taxation of business premises). The remaining income comes from local sources. Local authorities that are allowed to collect money directly through council tax are called 'billing authorities'. The council tax is a replacement for the community charge ('poll tax') and taxes domestic properties based on a system of valuation bands related to capital values and to the number of adults living in the property.

Recent moves towards decentralization after an area of centralization

From about the 1930's local government powers and functions have declined, with the post WW II welfare state meaning a greater centralization in policy-making and centralization being accelerated when Mrs. Thatcher came into power in 1979. Reforms led to transfer of functions to central government agencies, reducing the discretion of local authorities over service delivery - through limitations of the services that can be provided 'in house', privatisation and compulsory competitive tendering (later on replaced by best value tendering by the Labour government)-, and reduced autonomy over total spending.³¹ In 1997 the Congress of local and Regional Authorities of Europe (CLRAE), a body of the Council of Europe, denoted the UK as a country with serious deficiencies in the practice of local democracy. It identified problems as a considerable reduction of local authorities' power through the concentration of many local authorities into a single level and the dismantling of others, in conjunction with the creation of quasi non-governmental organizations, and limits imposed by central government on local-authority expenditure and diminishing revenue available for local authorities.³²

³⁰ Loughlin, J. (2001) The United Kingdom: From Hypercentralization to Devolution, in Loughlin, J. (ed.), *Subnational Democracy in the European Union. Challenges and Opportunities*, Oxford/ Oxford University Press, pp.37-60.

³¹ Ibid.

³² *ibid.*

With the Labour Government coming to power, a devolution program was set up. Central government established a Central Local Partnership Meeting with the Local Government Association (LGA), which represents the majority of local authorities in England and Wales, and the relations between the centre and local have considerably eased.³³ The Department for Communities and Local Government's (DCLG) started a government-wide debate with local government and key stakeholders on the future of local government, under the banner of 'local:vision'. The major topics dealt with are 'neighbourhoods and user empowerment', 'leadership', 'performance framework', 'Local Area Agreements', 'local government efficiency', 'towns and cities', and 'local government finance'.

The government's policy to devolve power has been put into practice with the announcement of key powers for the Greater London Authority (GLA). DCLG plans to publish a Local Government White Paper later this year that will include further options for devolution to local government in England. The idea is that it "will set out a clear vision for the future role and function of local government, providing opportunities to shift power from central government down to users, communities and local government so that services are regulated from the bottom up, not the top down. It also offers the opportunity to ensure greater freedom is combined with efficiency and equity".³⁴ The 'local:vision' debate also considers the findings of Sir Michael's Lyons Independent Inquiry into local government finance and the current and emerging role of local government in relation to service delivery. This inquiry considers the current and emerging strategic role of local government, implications for accountability, and changes to the funding system which can support improved local services. The debate so far has shown the importance of clarifying the role and function of local government in relation to key service areas.³⁵

FRANCE

The French state is traditionally centralised, which means that sub-national government is strongly influenced by the French central state. The new system that has developed in the past decade seems to be under strong influence of decentralisation, but at the same time the influence of the central state seems to be as strong as ever.

Decentralisation means transfer of powers, but it seems to be transfer of tasks, and like in Sweden, this is accompanied with the necessary funds. The influence of the central state is exemplified in the role played by the prefect (*préfet*). His institutional position had been changed during the reforms, but he still is the eye and ear of the central state on local level and, in effect, his position has been strengthened through decentralisation. Relative few powers are delegated to local and regional authorities, because the exercise of state powers at local level is a matter for ministry field departments and national public institutions. However, devolution policy and decentralization policy were pursued since the 1980s. As a result of the subsidiary principle the territorial units are supposed to 'take decisions in all matters that are within powers that can best be exercised at their level'. Part of the idea is that they can, on an experimental basis and for a limited purpose and time, deviate from the strict powers they have been awarded under the law. Sub-national authorities have the power to make local regulations, but this does not include the right of initiative and is therefore derivative, residual and subordinate. Territorial authorities may also exercise the right request to experiment. In this way they are enabled to adapt laws to their specific circumstances.

³³ *ibid.*

³⁴ www.communities.gov.uk/localvision

³⁵ *ibid.*

In spite of the devolutionary developments many functions have not been delegated to the lower tiers of the authorities. France is still an exception in this respect in Europe. The French central state has still retained substantial executive machinery at local level. The 2004 law delegates some power to the local authorities, but it is on an experimental basis. The field of local authority action is wide, vague and often the source of conflicts, so much so that any clear-cut segregation of these sectors seems out of the question. The municipalities have always played a key role in administering the collective socio-economic interest at local level, with a subordinate but always decisive role in the *département*, and only more recently in the *région*. There is a range of mandatory local public services: many are the responsibility of the municipalities and of the departments and only partly of the regions.

The French system of decentralisation is still characterized by a continuous loop of cooperation and co-decision between the various levels of government and frequent interference by the State in local prerogatives.³⁶ The cooperation between the various local government levels is extensive and varied. One of the most important forms of cooperation is in the EPCIS's, '*Etablissements Publics de Cooperation Intercommunale*', in which *régions*, *départements* and councils cooperate. This inter-local level even levies taxes. There are various forms of cooperation: inter-communal; inter-regional and mixed. Tasks can be transferred to a variety of formal organisational structures. Municipalities contract – or outsource – service delivery to adjacent departments.

Access to the French central government is through channels linking the local and regional governments with representatives in Parliament. An additional channel is the prefect. The cooperation between the state and sub-national authorities is laid down in a '*contract de plan*', in which a plan is described as well as its principle objectives. It is not really possible to say whether this contract is one between equal partners or whether the state is dominant in this sphere. On the one side the local governments can only perform tasks in decentralised fields when they receive funds, which could be a bargaining point for them, on the other hand the central state, could provide funds which are adequate in its view, but with which local government may not agree and still have the task added to their field of policy. There is a continuous loop of cooperation and co-decision between the French levels of government.

Contracts and finances

The local financial system is inextricably bound to the central system, which is another sign that real decentralisation connected with independent powers is non-existent in France. The complexity of the system is enormous.

Since the 1980s the transfers of competences from the state to the local authorities has played an important role. The French regime of local finances is characterized by strong fiscal guaranties and financial support to the benefit of co-operating local authorities. Finances are mainly distributed through the cooperating administrative sub-national units and not directly to the local authorities. While the State does not finance activities outside its own remit, it requires local authorities to help fund some central government projects, especially in the context of the *contrats de plan* Etat-régions.

³⁶ Allegri, G. (2004) *Strengthening regional and local democracy in the European Union/ vol. 1/ "France"*, CoR-Studies, E-1/2004, Brussels, 273-354.

The Constitutional Council ensures that the share of own resources in the overall resources of each category of local authority does not decrease; shares of national tax yields are now regarded as own resources. The revenue from local taxes by non-central government in 2004 accounted for 48.5% of resources. These authorities commit more than 70% of public investment expenditure. It has to be mentioned that the main beneficiaries of the transfers were the departments.

The general principle of devolution has always been that a strong financial and economic guarantee is given to the territorial authorities, which meant that French regionalism has been characterized by largely economic functionalism. Devolution therefore meant that transfer of powers also meant transfer of funds to be able to execute these additional powers. As a consequence of this development the sub-national authorities have received a legal provision for the equal distribution so as to make sure equality between the territorial authorities is guaranteed.

Local finances generally make a distinction between operating income and investment income. The first includes the transfer from the State to the authorities of a percentage of tax revenue via global operating endowment, a form of non-ties state subsidy equally distributed among the various local levels. Local budget funding is almost equal to half of the national budget. The state grants are made up of transfers of indirect taxes by the state to the sub-national authorities. Part of these financial transfers is a compensation for the transfers of competences that are not accompanied by increased local taxes. Additional funds are given by the state as annual subsidies for investments for either *communes* or groups of *départements*. As a consequence of decisions made on the national level, the state has to contribute to the local budgets, especially to the budgets of the cooperating local authorities, in order for them not to overstretch their budgets. The system means that compensatory funds are transferred or exemption of taxes is given. In 2005 the total sum of the state grants was 25% of the total resources of the local collectives for the four local taxes.

GERMANY (Bavaria & North Rhine-Westphalia)

Germany has a complicated government structure. The *Bund* and the *Länder* are the main legislative levels in the country, where the land can only make legislation if the *Bund* has not done so in the policy field where the *Land* aims to make laws. However the line between who does what is not a clear line and this can cause uncertainty. In spite of this, the *Länder* counterbalance the power of the Federal level, since they are better equipped to deal with local issues on the basis of subsidiarity. The *Bundestag* marks the boundaries as far as the legislative power of the *Land* is concerned. The *Bundesrat* is the main level of regional cooperation between the *Länder*, however the role of the Financial Planning Council, a form of cooperation between the *Länder* and the *Bund* is also important in this respect. Both are a forum for consultation concerning policies and the necessary connected funds.

The complex structure of Germany is mirrored in differences as to local government structures between *Länder*, with each *Land* having its own '*Gemeindeordnung*' and specific differentiation among municipalities (e.g. *Kreis* versus *Kreisfreie Gemeinde*). In general, the *Gemeinde* play an important role in execution of *Land* and *Bund* law. Given the powerful position of the *Länder*, municipalities in Germany have little room to use their autonomy.

Bavaria has a relative strong economy; North Rhine-Westphalia a relative weak economy. Both *Länder* operate according to the subsidiary principle; though the *Land* usually thinks they are the right level to execute the law. Currently, Germany is undertaking a reform to

restructure the power balance. Goals of this reform are to modernize the structure of the Federal Republic of Germany, in order to ease the decision-making process of the *Bund* and the *Länder*, making accountability more clear and enhancing efficiency. With the new Federalism Reform, the *Länder* will continue to get more powerful; and certainly we can expect this will also influence (power) relations between the *Bund*, the *Länder*, and local authorities.

Finances & equalisation

Equalisation is based on solidarity and Germany has this in three ways: first between the “old” and the “new” *Länder* and second within the *Länder* between the various levels of government and within the levels of government between the various kinds of government based on territorial criteria. The system is very complex, since it contains redistribution between the federal state and the *Länder* and between the *Länder* themselves. Since 1990 equalisation has been an ongoing massive re-distribution from West to East Germany.

Germany has a very comprehensive and detailed legal framework for budget processes at different levels of government. Taxes are levied at different levels, and redistribution mechanisms are set at work. In different *Länder* there are different mechanisms set up. While the municipalities in Bavaria and North Rhine-Westphalia have a similar tax structure, the contributions that the municipalities of North Rhine-Westphalia receive are not as specified as they are in Bavaria. In general, municipalities in North Rhine-Westphalia have more freedom to spend the money as they see fit; however, they also face a tighter budget.

The benefit of the spreading of finances lies in the guarantee for an equal standard of living. The relations between the municipalities and the *Länder* are the same in organisation and finances, except for the fact that the finances are externally audited by the RPA's (*Rechtsprüfungsamt*). Germany's legal tradition is reflected in the way oversight is organized (the courts).

Recent developments

The most recent developments in financial policy concern Germany's effort to comply with the Stability and Growth Pact of the EU. Since the German economy is stabilising for the first time in many years, reforms are enacted to reduce the budget deficit. These reforms comprise a wide array of measures, such as cutbacks and raised taxes. Municipalities are affected by these measures, as the example of the ‘Hartz IV’ in North Rhine-Westphalia has shown.

Similar to the other countries in this research project, Germany aims at more efficient and effective government and 2006 will see a reform in the structure of the power balance. Accountability is one of the focal points of the Reform of Federalism. Here also NPM makes itself felt, and German local governments have developed into champions of NPM reform in the midst of an otherwise still strongly law oriented and highly political system of cooperative intergovernmental relations.

NEW ZEALAND

Local government in New Zealand consists of regional council and territorial authorities, including city councils and district councils. The government system is highly centralized, with major coordinating and functional responsibilities set at central level in the public service

departments and the crown entities. This is illustrated in local government contributing 3.5% only of the gross national product. However, few functions are mandatory. This leads to a system which we can describe as ‘autonomy on the crumbs’ (*‘autonomie op de kruimels’*): “The tension between local variation and national uniformity has driven many of the public policy decisions regarding not only the development of public institutions but also the allocation of functional responsibilities. The result was a system of local government that granted councils a high level of autonomy, while the services that mattered – health, education, policing, housing, welfare – came under the control of the central government”.³⁷ Making bylaws seems to give councils a wide scope of legislative power, but this power is limited to certain areas of policy. Here again there are limits set by central government.

Within the centralized system of government, local government does not derive from any constitutional entitlement and this has resulted in a system whereby many perceive local government as a necessity more than anything else. The review that resulted in the Local Government Act 2002 looked, almost for the first time, at the principles and powers of local government, but it did not attempt any consideration of its constitutional role. The Act clearly acknowledges that local authorities have an undeniable local ‘governmental’ role (as opposed to only administering local functions on behalf of central government), but they do not provide constitutional protection of this role, which leaves local government vulnerable to any potential future change in its role.³⁸

While scarce finances provided by central government are said to be a limiting factor for the development of local activities, councils raise major part of their revenue by their own funds (mainly taxes and charges). The Local Government (Rating) Act 2002 provides councils with powers to set, assess and collect rates to fund local government activities. It updates and simplifies previous rating powers to meet the needs of modern local authorities. Also, New Zealand’s local authorities have considerable autonomy. Overall, it is intended that local authorities are accountable, above all, to their electors.

For the inter-local groupings by which tasks are performed in cooperation, contracts are made. Here also the question can be raised in how far this is a free process, since transfer of powers must first be reported to central government level. It may be so that the plan must be approved, which makes for strong central government influence, and therefore limits freedom of local government, but once the approval is received, local governments could then be free to negotiate on an equal footing resulting in a contract to perform the task.

(NPM-)reforms

Local government was reformed in 1987, 2002 and 2006, where the two latest reforms were influenced by NPM. This resulted amongst other things in the power for local government to form Council Organisations (CO), Council controlled organisations (CCO), Council-controlled trading organisations (CCTO) and Local Authority Trading Enterprises (LATE), which all are meant to perform tasks allotted to local government. These organisations are based on the model of State-Owned Enterprises (SOE) and reflect NPM ideas on governmental execution of tasks.

³⁷ Scott, C., Reid, M., Yeabsley, J., and Zöllner, E. (2004) *Positioning New Zealand Local Government, Local Futures*, Wellington: School of Government, University of Wellington.

³⁸ Matthews; Hewison & Sheppard (2005) Local Government and New Zealand’s constitutional inquiry, in *Public Sector* Vol. 28, (2). www.ipanz.org.nz

Where-as New Zealand is the NPM-state par excellence, this does not mean that local government is entirely free to pursue commercial activities and reorganise their tasks at will. In spite of the fact that New Zealand does not have a formal Constitution, the many laws provide a strict frame within which local authorities must operate.

Overall, it is believed that after 15 years of reform local government is in a stronger position to think and act strategically. Significant changes include (among others) greater autonomy, increased capacity and scope, greater accountability, new governance, management power, new tools, fragmentation. However, local government reform has not seriously addressed the question of functions and responsibilities. While strengthening and modernizing the structures and process of local government, functional change continues to be incremental, and the freedom to think and plan strategically remains constrained by organizational boundaries and overlapping jurisdictions.³⁹

SWEDEN

The paradox of local self-government

Local self-government is seen as a basic principle of the Swedish government system, and as such local authorities rank first in the political and administrative system. According to the principle of local self-government, local authorities have extensive powers, functions and budgets. Emphasis is placed on local authorities being independent bodies, their power to levy local taxes, the capacity to adapt services to local needs, and the ability of local inhabitants to monitor and influence decision-making. However, while Sweden has respect for local administration, in the sense that local administration is said to be very independent from the central government in policies and finances, Loughlin and Martin weaken this statement by saying that: “the central-local relations present something of a paradox”.⁴⁰ “On the one hand, these constitutional guarantees give the local authorities a high degree of political and financial autonomy. On the other hand, the principles of equity and uniformity of service provision across the country mean that standards are set by the central government and in this sense the system is highly centralized. (...) There is thus a potential tension between the local authorities’ aspiration to political and fiscal autonomy and the necessity of the central government to supervise overall national fiscal policy”.⁴¹ They indeed appear to be right when a closer look is taken at the way Sweden arranges the position of local government. Local and central government co-operate continuously, but local government has to operate within limits set by central government and is closely monitored by the County Administrator who is appointed by central government.

Division of responsibilities

The division of responsibility between the state, the county councils and the municipalities is both a question of principle and a practical matter. It varies over time as a result of the development of society. Local government is provided general powers. It is further mainly based on special legislation, which is also influenced by EU- decisions. The key concept for the Swedish model of administration is decentralization: both responsibility for services and

³⁹ Scott et.al., 2004.

⁴⁰ Loughlin J. and Martin, S. (2004) *Local income tax in Sweden: reform and continuity*. Paper prepared for the Balance of Funding Review. Centre for Local and Regional Government Research, School of European Studies. Cardiff University.

⁴¹ *ibid.*

decision-making should be placed as close as possible to the people affected by decisions. The division of tasks between municipal and county councils is further based on the principle that tasks requiring a larger population base should be handled by the county councils. However, next to the development and implementation of local policies, local authorities are also assigned the implementation of a number of national policies, specifically in the field of welfare policies.

Local government can co-operate in many ways and this makes for a myriad of inter-local cooperative arrangements to which activities are transferred: limited companies, voluntary organisations and foundations. Between municipalities and councils contracts can be set up to perform tasks and these seem to be contracts on equal footing, since they concern partners on the same level. Public-private cooperation is increasing in Sweden. Tasks can be transferred from the central to the local government level, but have to be accompanied by financial measures. The Committee on Public Sector Responsibilities, in 2004, was appointed to come with proposals for a reform or restructuring of local government as far as tasks etc. are concerned.

Financing

The “local government financing principle”, implies a neutralisation of financial effects for local government of state decisions on action that is directly targeted at local authority activities. The main source of revenue for local authorities is direct local income tax, constituting approximately two-thirds of their total income. The local authorities have a constitutional right to levy tax, but the state decides what they can tax; and while local governments set their own tax rates, state government has used instruments as freezing local income taxes at existing levels, or penalizing local authorities that increase through reductions in state grants. Since the beginning of 2000, there have been no restrictions on tax levels.

An important part of municipal revenues come from central government grants (14 % in 2004). The specific grants in monetary terms are decreasing, as some of the former specific grants are being transferred to the general government grant. The local government equalization system, managed by the state, has been changed in 2005. It can be divided into five separate parts: income equalisation, cost equalisation, a structural grant, a transitional grant and an adjustment grant/charge. The general state grant and some earmarked grants were abolished and instead a corresponding sum is used to equalize differences in tax base per inhabitant.

4. Comparative Observations

The Nordic Model

The cases of Sweden and Denmark represented in this study reflect a model where local government has a strong position, but within an IGC-framework that reflects a dominant role of central government and an high ambition in terms of state involvement in society and the other way around. The system as a whole is characterised by a strong participatory dimension from civil society at all levels of governance and the role of the state in public life is generally (still) taken for granted. This has resulted in fairly high ‘aspiration levels’ regarding equity principles within public finance and among local governments.

Bounded local autonomy

Sweden is country with much respect for local government and administration, in the sense that local administration is said to be very independent from the central government in policies and finances. When a closer look is taken at the way Sweden arranges the position of local government, Loughlin and Martin appear to be right in weakening this statement by saying that “the central-local relations present something of a paradox”.⁴² Local and central government co-operate continuously, but local government has to operate within limits set by central government and is closely monitored by the County Administrator who is appointed by central government. Although the Swedish Constitution awards a special place to local government and gives it its formal basis, it does not specify the division of responsibilities between the state and local government, which is a matter of principle and a practical matter. The principle of ‘open households’ prevails. Yet, much of the division of labour is mainly based on special legislation, which, in the more recent past, is also influenced by EU-decisions. The Constitution sets out the right of local authorities to levy tax, but the state decide what they can tax.

Denmark is a unitary state with a long-standing tradition of a decentralised public sector where the majority of welfare tasks are dealt with by local government, consisting of counties and municipalities. Local authorities perform a broad set of functions. They are provided a general competence through law, yet most of the tasks performed are mandatory. The Constitution directs local authorities to take independent control of own affairs subject to supervision by central government. While it does not provide protection against comprehensive legislative regulations of local authority matters, in practice local authorities have a considerable degree of autonomy.

To a greater extent than local governments in any other European country, Danish local authorities rely on local sources of income. Other important sources of income are operations and investments, leading to around 80 % of local income being locally generated. Next to this, local government receives substantial general grants and some smaller special grants as well as state contributions in the form of refunds of certain types of expenditure, primarily within the social area. Also in Sweden, local taxation is an important source of local government finance. The main source of revenue for local authorities is direct local income tax,

⁴² Loughlin and Martin, 2004.

constituting approximately two-thirds of their total income.⁴³ Since the 1990s the tax base consists of earned income, including wage income, pensions and payments from health insurance and unemployment insurance. Before, it included corporate profits, household income derived from capital and real estate.

Institutionalised horizontality

The observed ‘paradox of local autonomy’ more or less resolves if one takes the level of intergovernmental relations (IGR) into account. The Nordic Model as represented here is a typical illustration of the balancing act in the *trade-off* between ‘autonomy’ and ‘co-decision’ that a modern local government face if they aspire a strong position in society as well as within the intergovernmental system. A strong role of local taxation brings along a strong state involvement in decisions on how the money has to be spend, be it that these interventions are rather institutionalised and do seem to work within a statutory framework giving rights of ‘access’ to both sides of the central local relationship.

The Constitution does not specify the division of responsibilities between the state, the municipality and the county council. The division of responsibility between the state, the county councils and the municipalities is both a question of principle and a practical matter. It varies over time as a result of the development of society. The key concept for the Swedish model of administration is decentralisation of executive power. The strong position of local government in the Nordic model is derived from the fact that they are crucially involved in the carrying out – implementation - of important public services. The contrast in our study is of course France where the municipal level hardly carries out public services and the national state itself maintains a large executive operation at the local level of governance. In terms of our framework: the application of the ‘horizontal principle’, i.e. co-governance (*‘medebewind’*), gives local government its undisputedly strong position in IGR, which by its very nature brings along a strong relationship with central government policy-making.

This relationship is elaborated in a rather well established, rather ‘business-like’ and institutionalised framework of intergovernmental relations and conventions. In Sweden, the *quid pro quo* principle applies to the relationships among the levels of government. Tasks can be transferred from the central to the local government level, but have to be accompanied by financial measures. The associations of local government have recently been merged and a formal platform for the interaction of central and local government has recently been streamlined and re-institutionalised. In 2003, the Swedish Association of Local Authorities (*‘Svenska kommunförbundet’*) and the Federation of County Councils (*‘Landstingsförbundet’*) decided on a merger, which would create a new association of Swedish municipalities, county councils and regions. There are various platforms to organise the encounter of *the* local government with *the* central government, be it of a structural nature or in the context of an innovation initiative (Free cities movement).

In Denmark this feature is reflected by the fact that local authority expenses amount to approximately 23% of the Danish GNP and as such, central government and local authorities co-operate closely on local authorities' budgets and tax rates. The relationship between central and local government is described as mixture of control, negotiation and autonomy, with detailed involvement being avoided. The National Association of Local Authorities and the

⁴³ In 2003 local authority revenue amounted to SEK 608 billion. Source: Ministry of Finance, (2005) *Local Government in Sweden. Organisation, Activities and Finance*, Stockholm: Regeringskansliet. Finansdepartementet.

Association of County Councils have an annual economic agreement with central government, and are involved in the policy-making process at national level at an early stage. Informal relationships lying beneath this formal structure have changed shape during recent years with a move from centralist corporatist arrangements to a more network-based pattern.⁴⁴

Equity by reform

The institutional structure clearly affects the arrangements for financing local government in the Nordic system. Equity is an important value within the rather egalitarian culture associated with the Nordic model. Despite collaborative structures and supervision institutions in the institutional domain between central and local government, the style of intergovernmental management is clearly entrenched by the idea that coordination among levels of government is not a matter of individualised, hands-on and administrative control. An important tool for 'intergovernmental management' in the Nordic countries is 'reform' of the basic structure – most notably the scale and structure – of local government. The strong position of local governments in the system as a whole assures that this reform is rather consultative and hardly one-sided process. New and larger municipalities in Denmark are currently formed through a decentralized process, with municipalities negotiating with their neighboring municipalities on mergers. Only in two instances, the formation of new municipalities was decided by the state.

In thinking about local-government finance, one should not overlook that more than in any other system of IGR reform of the scale of local government – at least in Sweden and Denmark (Norway provides a special case, given special (oil) resource) - has been an important feature, which may help to 'manage' issue of (financial) equity within the system. In 1966 in Sweden a large scale reform of local authorities was realized, which at the time implied an unheard of scale enlargement and 'homogenisation' of the basic local government units. In Denmark in 1970 an amalgamation reform took place, creating the basis for a transfer of tasks from the state to local government and a concurrent restructuring of the financial relations. As a more densely populated country the dynamics of scale might be more intensely felt in Denmark, than in Sweden. Also with economic problems hitting Denmark earlier than other Nordic countries, local authorities were compelled to restrict their use of resources and central government control over the local budgetary system was increased. In any case a new local government reform is in the making. The current reform aims at strengthening local government through a new process of mergers and task redistribution. The reform, which will come to force as of January 1st 2007, will lead to a decline of the number of counties (from 14 to 5) and municipalities (from 271 to 98). Only 7 out of 98 municipalities will have less than 20.000 inhabitants and these municipalities, mostly smaller islands, have co-operation agreements with neighbouring municipalities.

If local government as a whole is characterised by a rather uniform and rather large scale basic structure it is more easy to leave potentially equity disturbing tools like local taxation in the hands of these units, particularly if the system provides you – national government – with 'access' to local government decision making on the nature of these taxes and the way they have to be allocated in functional performance. In this context, it should be noted, that in Denmark in the ongoing local reform process municipalities will gain many tasks, but also loose some responsibilities to the state, primarily on the assessment and administration of taxes.

⁴⁴ Lindström, 2001.

Efforts at equalisation – in a comparative perspective - then have to be understood in terms of the correction of a fundamental homogenous if not uniform system, rather than the redistribution of resources within a highly diversified system like - in our study - is for example represented by the case of Germany. Central grants in Sweden are attached to extra demand on local governments, due to for example new tasks to be decentralised. The local government equalization system in Sweden distributes *growth* between municipalities and country councils in order to provide equal access to welfare for all citizens. The system, which is managed by the state, redistributes revenues of all local authorities in order to enable them “to offer their inhabitants ‘the same standard at the same price’, despite varying structural prerequisites in terms of tax base, age structure and geography”.⁴⁵ In 1996 an equalization system was introduced, containing both revenue equalization and cost equalization. In 2005 the system was revised. The general state grant and some earmarked grants were abolished and instead a corresponding sum is used to equalize differences in tax base per inhabitant.

The Westminster Model

As members of the former Commonwealth, New Zealand and England share many institutional characteristics. New Zealand confirmed the Statute of Westminster in 1947. The British entry to the EU in the 1970’s and the necessary lessening of historical ties by the early 1980s had triggered a fundamental reform and reorganisation process among the members of this former global economic alliance, which by the end of the 1980s would gradually become identified as the NPM movement, with England, New Zealand and Australia in the course of the 1990s to become the main global champions, and New Zealand as the - to many - attractive star.

The Westminster tradition is heavily rooted in the Common Law tradition. Within the Westminster tradition, the United Kingdom and New Zealand do not have a written constitution spelling out the position of local government. Apart from legislation, aspects of the constitution are found in judgments of the courts, and broad constitutional principles and conventions. Constitutional conventions are rules that have become established by frequent use and custom. Conventions are an important part of the relationships between and within the legislature and the executive. Although some conventions have been put into statutes, most of them are not enforceable laws. Their continued existence depends on people respecting and obeying them.

The Westminster system of democracy, gives extensive power to Parliament, i.e. central government. The fact that in the case of New Zealand central government does not have a restraining upper house means that the central government, under the prevailing unitary non-federal system, is more powerful than other governments in the Westminster system. Local authorities work within the powers laid down under various Acts of Parliament. As such, local government has no general competencies, but may perform only what is permitted by parliament (‘*ultra vires*’). In New Zealand, a number of years ago a power of general competence has been discussed, but has never been enacted. However, the system as such allows that local government functions may be far-reaching. At times in England this indeed has been the case with some being mandatory and others discretionary. Yet, in England since about the 1930’s local government powers and functions have declined, with the post WW II

⁴⁵ Swedish Institute (2005) *Local Government in Sweden*, Stockholm: Swedish Institute.

welfare state meaning a greater centralization in policy-making and centralization being accelerated when Mrs. Thatcher came into power in the UK in 1979.

Modernising central rule

Where-as New Zealand is the NPM-state par excellence, advocating organizational autonomy and public entrepreneurship, in the Westminster context this does not mean that local government is suddenly entirely free to pursue commercial activities and reorganise their tasks at will. In spite of the fact that New Zealand – like the UK - does not have a formal Constitution, many laws provide a strict frame within which local authorities must operate. Local government has been reformed in 1987, 2002 and 2006, where the two latest reforms were influenced by NPM. This resulted amongst other things in the power for local government to form organisations and enterprises, based on the model of State-Owned Enterprises (SOE). These organisations perform tasks allotted to local government and reflect NPM ideas on governmental execution of tasks. Making bylaws seems to give councils a wide scope of legislative power, but this power is limited to certain areas of policy. Here again there are limits set by central government.

The NPM reforms have been modernising, not really changing the institutional characteristics associated with the ‘Classical’ Westminster model as described in our conceptual framework. This observation applies to both England and New Zealand, taking into account that both countries in the course of the more than 20 years of ‘NPM reform initiatives’ and subsequent ‘Next Steps’ each have gone through differential political dynamics and have been subjected to different consequences of global economic dynamics and developments in their respective regions (Europe and South-East Asia). England, since the early 1980s has gone through successive waves of reform. In the early stages these weighted heavily on local government, with a strong ideological preference of the Thatcher government to see the market - rather than local government - as the main vehicle for decentralisation.

The Thatcher era has often been labelled as ‘centralising’, but more accurate it would be to stress the ‘relocative’ nature of the reforms in the 1980s. Thatcher government transferred, rather than ‘centralised’ former local government tasks from one to another institutional domain. Central government basically stuck to its ‘non-executive’ – i.e. policymaking – role and under the Thatcher regime tried to involve business and for example Urban Development Corporations and other Quango’s (Quasi Autonomous Non Governmental Organisations) in the production and delivery of services, formerly under the jurisdiction of local government councils. In the later stages of the reform, when privatisation strategies were exhausted, or became less popular, executive tasks formerly belonging to the domain of local government were transferred to independent agencies that operated in the region at an ‘arm’s length’ of central government. Under Major’s Next Steps programme, this ‘agentification’ – i.e. what would be called either ‘administrative deconcentration’ or ‘functional decentralisation’ in continental European systems – became the main institutional expression of the principle of a non-executive national civil service system. This functional decentralisation contributed much to the complexity of institutional structures and a need for coordination at the regional – i.e. supra-local level of governance. This in turn, largely triggered the agenda for ‘rejoining government initiatives’ under the later Blair regime.

In New Zealand also, since the 1980s, local government reform has swept over the local authorities. The first reform was in 1987 and the second reform in 1996. The most recent one

was June 2006, but this reform was not as fundamental as the two previous ones. While the first reform was aimed at transparency, accountability and separation of functions, the 1996 Amendment introduced significant reforms to the way local governments do business.⁴⁶ After 15 years of reform local government is now considered to be in a stronger position to think and act strategically. Significant changes include (among others) greater autonomy, increased capacity and scope, greater accountability, new governance, management power, new tools, and reduced fragmentation. Local government reform has, however, not seriously addressed the question of functions and responsibilities. While strengthening and modernizing the structures and process of local government, functional change continues to be incremental, and the freedom to think and plan strategically remains constrained by organizational boundaries and overlapping jurisdictions⁴⁷, as well as strong constraints from central government.

Dual Structures

It should be noted, that local government in the Westminster tradition is hardly seen as an independent entity and value in itself, but to a large extent is perceived as a utilitarian arrangement and vehicle for the civil society to engage in collective or public affairs at the local and regional level. The New Zealand Local Government Act 2002⁴⁸ states that the purpose of local government is (a) to enable democratic local decision-making and action by, and on behalf of, communities; and, (b) to promote the social, economic, environmental, and cultural well being of communities, in the present and for the future. Overall, it is intended that local authorities are accountable, above all, to their electors. Within the centralized system of government, local government does not derive from any constitutional entitlement and this has resulted in a system whereby many perceive local government as a necessity more than anything else. Local government as such is seen as a separate arena for political action, largely independent and separated from the national arena. Hence the term ‘dual polity’: local politics as a separate arena next to the national political system.

Local government as a form of local self governance is not the integrated, uniform municipal (executive) government organization known from the Nordic countries or the European continent (Germany, Netherlands). Mayors, for example, are – with the recent exception of the modernized version in the Mayor of London – traditionally largely ceremonial figures fulfilling an ‘honorable’ – not a professional – job. The emphasis in the governance of local government (by laymen, if not ‘amateur politicians’) is on (functional) policy committees, often fragmented and overlapping in nature and even apart from that not very fit to ‘manage’ large executive organizations.

The point of departure for the reform movement in New Zealand is less well documented. In the English case the long term dominance of the Labour party at the local level, apart from a highly idealized – if not ‘ideologised’ – local government autonomy principle in the postwar period, had contributed to an extended, state owned local enterprise sector for executive and public service production functions. These are hard to manage from a complex conglomerate of committees and disjointed decision-making centers, largely established for collective demand articulation. Although proponents of local government autonomy at the time had a

⁴⁶ It introduced new financial and borrowing provisions for local government. Source: Pallot, J. (1998) *Local Government Reform in New Zealand: Options for public management as governance*. Canterbury: University of Canterbury, New Zealand. www.ipuma.net

⁴⁷ Scott et al., 2004.

⁴⁸ Article 10 Local Government Act; www.legislation.govt.nz

hard time giving in, by all accounts and in retrospect, Mrs. Thatcher at her arrival to power was confronted with an utterly outmoded system of local government, that at the time also in functional terms (tasks to be performed) could not withstand the comparison with, for example, Swedish municipalities or French Départments.

We have already explained in our framework elaboration, how the structure of the English ‘decentralized unitary state’ allowed the Thatcher government to engage in a strong and deeply cutting local government reform process largely against (Labour dominated) resistance at the local level itself. Reforms led to transfer of functions to central government (executive) agencies and to public private organizations or market-oriented (‘market-tested’) arrangements, reducing the scope and discretion of local authorities over service delivery. With the Labour Government coming to power in, in the course of the 1990’s a devolution program was set up. Central government established a Central Local Partnership Meeting with the Local Government Association (LGA), which represents the majority of local authorities in England and Wales, and the relations between the centre and local have considerably eased.

Internal autonomy

Within the Westminster there are few formal interrelationships for the day to day management of individualized central local relationships. The main vehicle for homogenization and intergovernmental management – next to the reform and scale enlargement which has been carried out in England in the 1970s as well – is the law. The principal formal interface between local and central government is the Department of Internal Affairs. This ‘hands off approach’ easily created an illusion of freedom and lack of central interference in local affairs. The vehicles for central government ‘access’ to local government agenda’s are, however, more indirect and embedded in the overall ‘constitutional structure’ and the (dual) nature of intergovernmental systems. On the basis of their political agenda, some governments have been willing to exercise these institutional prerogatives *vis à vis* local government more than others. The eventual outcome of this process in England is still difficult to assess.

In New Zealand the government system is probably even more centralized than in England, with major coordinating and functional responsibilities set at central level in the public service departments and the crown entities. This is illustrated in local government contributing 3.5% only of the gross national product. Few functions are mandatory. The actual development is, that “(t)he tension between local variation and national uniformity has driven many of the public policy decisions regarding not only the development of public institutions but also the allocation of functional responsibilities. The result was a system of local government that granted councils a high level of autonomy, while the services that mattered – health, education, policing, housing, welfare – came under the control of the central government”.⁴⁹ Within this framework, New Zealand local authorities have considerable autonomy. This leads to a system which we described as ‘autonomy on the crumbs’.

Local government autonomy in the Westminster model is largely administratively and internal in nature. It is a functional organisational arrangement, rather than an institutional value and concept for external societal innovation and problem solving. The scope of this organisational autonomy is externally determined and not vested in the ‘right of initiative’ – legal autonomy – of local government itself. The ‘debureaucratization’ of local government implied by NPM reforms, fits the utilitarian Westminster tradition of aiming at a minimum of external and

⁴⁹ Scott et al., 2004.

individualised and hands on administrative interrelationships among levels of government. Where they need to exist, they have been redefined as contractual relationships, strictly specifying the object of 'discretion' and the conditions of use, but leaving the agent 'free' to carry out the job as he sees fit.

Central local financial relationships fit this centralized, utility and function oriented institutional pattern. In England about 62% of local authorities' gross income in 2003-2004 came from central government. In New Zealand this dependency on national grants has been substituted by a dependency on – functional and performance oriented – external sources of financial income. A minor part of local government revenues is derived from subsidies or grants from central government. Some 12% of the total revenue of all councils comes typically in the form of subsidies or grants from central government. New Zealand's local government receives no general purpose funding from central government.⁵⁰ Central government assistance is limited to direct programme grants (e.g. land transport programmes) and payments replacing property tax where land is owned by central government. Councils raise their own funds by way of rates, development contributions, fees and charges, petrol taxes and investments. Many councils require users of some council services to pay for the use of these services: user charges. Certain common forms of revenue raising are not permitted, for instance income tax or consumption tax.

The Napoleonic Model

The French state is traditionally considered to be very centralised, which meant that sub-national government is strongly influenced by the French central state. There has been considerable reform in the French IGS, almost continuously since the early 1980s. The new system that has developed in the past decade seems to be under strong influence of decentralisation policies, but the influence of the central state remains as strong as ever.

To many, decentralisation means transfer of powers. In the case of France it means the transfer of tasks, and like in Sweden, this is accompanied with the relocation of necessary funds. The influence of the central state is exemplified in the role played by the prefect, who is the eye and ear of the central state on local level and whose position has been changed and probably strengthened through the decentralisation process.

France is a unitary (semi-) presidential republic. In contrast to the Westminster model of the unitary state, the 'Jacobin' nature of the French unitary state is exemplified by the strong, if not predominant position of the French presidency within the overall governmental system. The French administrative system has strong local governments in parallel with central government branch – or field - offices at local level, which reflect a mix of powers between local and central government. In 2003 the revision of the Constitution provided a safeguard for local self-government. One of the most important factors was the principle of financial autonomy. This revision has to be understood as the next mile-stone in a very gradualist – but stable, long term and sustained – public sector reform process focussing on a restructuring of the intergovernmental system ever since the early 1980s.

⁵⁰ McKinlay P. and Local Government Centre, Auckland University of Technology (2006). *Local Government Finances - What's happening in New Zealand*. South Australian Local Government Financial Management Group Conference Adelaide April 2006. www.mdl.co.nz

Reducing complexity, increasing flexibility

The French state has to keep up a reputation in terms of being among one of the most centralised intergovernmental systems in the world. At the same time, it may serve as the archetype example that centralisation of tasks and decision-making is not necessarily the same as concentrating effective decision-making power at the apex of an integrated and streamlined governmental machinery.

In France, administrative centralisation has met the countervailing powers of individualised and decentralised functional political interests, networks and relationships. More than centralisation – which only provides part of the picture of the nature of the French IGS – is ‘organised complexity’ probably the keyword in gaining access to the operation of what conveniently – but to the regret of some French administrative scholars and political scientists – has been labelled the ‘Napoleonic Model’, which could perhaps represent some other administrative feature of governance systems in Southern Europe. Organised (social) complexity means: multiplicity, diversity and interdependency.

France is renowned for the fact that – for a long time – it had more local government units than the rest of the EU together. If that is not the case anymore, it is because many new member states – many of them ‘Napoleonic’ in character themselves – have entered the alliance, not because France has succeeded in recurrent attempts to reform a – to many observers – archaic, small scale local government structure. France is still divided into 22 regions (*‘régions’*) which are subdivided into 96 departments (*‘départements’*). The *‘départements’* are subdivided into 329 *arrondissements*, which are subdivided into 3,879 *cantons* and these are subdivided into 36,571 municipalities (*‘communes’*). Additionally there are 10 *dependent areas*. Co-operations between *régions*, *départements* and *communes* exists. There are stricter and looser forms of co-operation. As of January 2006, there are 2,558 inter-communal structures in which 32,826 *communes* are involved, which is 89.7% of all the French municipalities and serves a population of approximately 52.2 million.

Municipalities are headed by a mayor who is elected by the local council (*‘conseil municipal’*) from among their number⁵¹. The election of a mayor in many cases is the only relevant action to be taken. The mayor prepares and executes the council decisions and is the head of the municipal administration and representative of the state when implementing laws. In communes with a municipal police force the mayor is also responsible for public order.

The *‘département’* is a form of deconcentrated and decentralised public administration. In the course of the decentralisation process, the two functions that used to be combined in one organisation have been split. Whereas in the early 1980s the *‘départements’* were still an integrated unit of central government in the region, headed by the prefects, the deconcentrated administration – the collection of national ministry’s field offices - is now headed by a prefect. Operational executive tasks have been put under the responsibility of an elected council, thus transforming former deconcentrated executive services into decentralisation, not by transferring them to a ‘lower government’ but by devolution: replacing national bureaucratic rule by a democratically accountable council. The decentralized authority within the department rests with the *conseil général*, with an elected president who is responsible for the preparation and execution of the decisions of the *conseil général*. Devolution policy has

⁵¹ In municipalities with less than 3,500 inhabitants councils are elected by a majority vote. In those with more than 3,500 inhabitants, a hybrid system applies; half of the seats are filled by a majority vote, whilst the other half is filled under proportional representation with a bonus for the list with the most votes.

meant that ultimately there are less departments of the state itself at regional level and in the *départements*. From the perspective of a longstanding Dutch debate, however, it is interesting to note that the French have thus been adding one more ‘layer of government’ to the system at the very same time when also the regions were installed as an additional, democratically elected unit of governance.

The *région* is both a form of territorial decentralized administration as well as a unity of deconcentrated administration. Regional Councils Members are elected. The president of the regional council (elected by the council members from among their number) has executive power in the *région* and is head of the regional administration. At the same time regional prefects hold the post of departmental prefect of the *département* representing the capital of the region⁵².

The multiplicity and variety of governmental units within the IGS is complemented by a high degree of interconnectedness of the various levels of governance within the system. The Legislative Branch consists of Parliament. The relationships run top down and bottom up all at the same time. Subsidiarity plays an important role in the French state structure. As a result the territorial units are supposed to take decisions in all matters that are within powers that can best be exercised at their level.⁵³ Sub-national authorities have the power to make local regulations, but it never includes the right of initiative. Most local and regional authority functions derive from special legislation which lays down the relevant rules. Local authority is therefore derivative, residual and subordinate. The 2004 law delegates some power to the local authorities, but it is on an experimental basis.⁵⁴ In spite of all the devolutionary developments many functions have not been delegated to the lower tiers of the authorities. Ministerial powers have been delegated to the prefect of the *départements* and the *régions*, which means that the power of the prefect over local government is strengthened. The French system of decentralisation is still characterized by a continuous loop of cooperation and co-decision between the various levels of government and frequent interference by the State in local prerogatives.⁵⁵

One should not overlook, however, that many (political) interrelationships run the other way as well, giving local government bottom up access and influence at the ‘higher’ levels of authority. Very often the – powerful – prefect is representing the interests of (the local governments in) his department at the national ministerial level. Both at regional and departmental level, the task of the prefect, the representative of the State, is sometimes rendered more complicated because he finds himself forced to ask for funding for State-run projects.⁵⁶ The region is also the layer of government that may be involved in national planning and may accelerate its execution either by being involved in the preparation/approval phase or through the contracts de plan. The *cumul des mandats* – the accumulation of public mandates in the hands of one person – has ever since the 1980s gradually been restricted over the years as part of the intergovernmental reform process, but as a phenomenon still exists. Many politicians combine functions at local, regional, national or even European levels. The bicameral Parliament comprises the National Assembly, which

⁵² www.cor.europa.eu/document/documents/france_pdf.

⁵³ French Constitution, article 72.

⁵⁴ These powers are: awarding of state grants to enterprises and housing grants by groupings of municipalities with a local housing programme. CDLR, (2006), *Steering Committee on Local and Regional Democracy, draft comparative study of local authority and powers*, May 2006, (12), Council of Europe..

⁵⁵ Allegri, 2004: 299.

⁵⁶ Embassy of France in the US, 2005.

is elected through direct universal suffrage and the Senate, which is elected through a system of indirect suffrage by a body of 150,000 persons.⁵⁷ Local government is represented in Parliament through the members of the Senate. These are elected for a term of nine years by electoral colleges corresponding to the *départements* and composed of deputies and general and municipal councillors. Bills focusing on the organization of territorial authorities must first be examined by the Senate and then by the National Assembly. Since the Senate is the representation of the sub-national authorities, this means that they have considerable influence on this process.

Debureaucratization and professionalisation of relationships

Croizier and Thoenig⁵⁸, in the middle of the 1970's have referred to this system of complex interrelated layers of government as an immobile 'honeycomb-structure', rigid, with little flexibility and power to innovate and adapt to new problems and opportunities. It is no exaggeration to put forward that the decentralisation and devolution process ever since its early stages in the 1980s have been a more or less deliberate effort to dismantle the interwovenness of the system. This in order to create more innovative and problem solving capacity, most notably at the local and regional levels of governance which – socially and economically - have become increasingly important with the move towards what had become known in the meantime as the knowledge-based economy. Original efforts – in the very early 1980s – at local government reform had failed once more – partly as a consequence of the political overrepresentation of small municipalities and rural areas at the national level. Governments responsible for implemented local government amalgamation very often consisted for the large part out of mayors of small municipalities and in the early 1980s more than 90% of the Senate members, at the same time occupied the position of mayor or local, departmental, or regional council.

Ever since, in a slow but steady process of continuous territorial and intergovernmental reform many plans have been issued and to a larger or lesser degree been implemented, basically oriented at reducing the immobility and complex interdependency of the various layers within the intergovernmental system, starting out with the steady reduction of the amount and kind of public mandates which can be accumulated in one person, and making the various 'layers of government' not less numerous, but more visible and transparent by putting them under democratic rather than bureaucratic rule. Gradually, functional powers and responsibilities have been pushed 'downward'. Much was driven by an underlying (regional) economic reform agenda, once it was concluded that strategic macro-economic policy no longer required the 'central planning' deemed necessary in the 1950s and 1960s, but regional and more specifically urban economic initiative and dynamics. Early on in the process, by 1982 local authorities were granted the power to take initiative in the fields of economic development and support to firms. All regulatory town-planning became part of the responsibility of the municipalities or groups thereof.⁵⁹ In 2004 additional power was given towards the initiatives local government can take in locally directed policies. This power mainly concerns acting as electronic communications network or service operators, thus illustrating how the reform and decentralisation process follows a larger economic policy agenda.

⁵⁷ French Constitution, article 24.

⁵⁸ Croizier, M. and Thoenig, J.C. (1976) The Regulation of Complex Organised Systems. in: *Administrative science quarterly*, 21(4).

⁵⁹ CDLR, 2006.

The ‘flexibilisation’ of relationships has been a key concern, again, with small steps to be taken, given the complexity of interests involved – not only at national levels. Although the right to exercise local initiative (autonomy) is still limited and restricted to carefully selected and designated policy domains, territorial authorities may also exercise the right request to experiment. In this way they are enabled to adapt laws to their specific circumstances.⁶⁰ Part of the idea is also that they can, on an experimental basis and for a limited purpose and time, deviate from the strict powers they have been awarded under the law.⁶¹ As a consequence of the devolution policy, development of contractual policies between the state and local or regional authorities in order to implement various sectoral policies and finance investments, was instated. Within the sphere of cooperation between the French central state and the sub-national authorities - the *régions*, *départements* and the *communes* - so-called *contracts de plan* can be drawn up, in which they can, under article 11 of the 1982 law⁶², agree to execute a plan and meet its principle objectives. In this scheme the regions play a vital role.

Contractualisation

Relationships among units and levels of government are still heavily politicised and geared toward individual units and cases, rather than the local or regional government as an institution. Still, the management of relationships among units and levels at the same time seems to have become more ‘contractual’ in nature, with formal agreements replacing informal, political arrangements. The cooperation between the state and sub-national authorities is laid down in a *contract de plan*, in which a plan is described as well as its principle objectives. It is not really possible to say whether this contract is one between equal partners or whether the state is dominant in this sphere. On the one side the local governments can only perform tasks in decentralised fields when they receive funds, which could be a bargaining point for them, on the other hand the central state, could provide funds which are adequate in its view, but with which local government may not agree and still have the task added to their field of policy. This illustrates the continuous loop of cooperation and co-decision between the French levels of government.

The cooperation between the various local government levels is extensive and varied; one of the most important forms of cooperation being in the EPCIS’s (*Etablissements Publics de Cooperation Intercommunale*), in which *régions*, *départements* and councils cooperate.

The local financial system is inextricably bound to the central system, which is another sign that real decentralisation connected with independent powers is non-existent in France. The revision of the Constitution of 2003 was intended to make things less complicated. But this exercise was not entirely successful. The complexity of the system is great. A large part of the local government budget consists out of local taxes, but this is partly a function of the still limited scope of ‘autonomous’ local government action. Three quarter of local public expenditure are committed by the municipalities and groupings of municipalities with their own tax resources⁶³. The state grants are made up of transfers of indirect taxes by the state to the sub-national authorities.⁶⁴ Parts of these financial transfers are a compensation for the transfers of competences that are not accompanied by increased local taxes. A large share of

⁶⁰ Allegri, 2004.

⁶¹ French Constitution, article 72.

⁶² Law 82-653 of July 29, 1982.

⁶³ CDLR, 2006.

⁶⁴ These state grants have a direct link to the four local taxes: habitation, property (built and non-built) and professional tax.

local taxation seems synonymous for a relatively small package of functions or services provided. The more executive tasks are ‘pushed down’ to local government, the more likely that the share of external funding will (have to) increase.

Resources of the territorial units will come from taxes levied on the basis of statutes. Transfer of powers from the central to the territorial units will be accompanied by resources equivalent to the exercise of those powers. The same goes for newly created powers. The principle is that equality between territorial units will be promoted by special mechanisms.⁶⁵ The general principle of devolution has always been that a strong financial and economic guarantee is given to the territorial authorities, which meant that French regionalism has always been characterized by largely economic functionalism. Devolution meant that transfer of powers also implied transfer of funds to be able to execute these additional powers.⁶⁶ As a consequence of this development the sub-national authorities have received a legal provision for the equal distribution so as to make sure equality between the territorial authorities is guaranteed. This process of equal distribution has in fact been launched in the 1980s and became law in 1995.⁶⁷

The Constitutional Council ensures that the share of own resources in the overall resources of each category of local authority does not decrease; shares of national tax yields are now regarded as own resources. But at the same time, while the State does not finance activities outside its own remit, it requires local authorities to help fund some central government projects, especially in the context of the *contracts de plan* Etat-régions. For example, local authorities who were very keen to develop their road networks have paid 50% of the cost of some main roads. Also, central government will not easily give up in an economic scenario of scale enlargement at the local level. Finances are mainly distributed through the cooperating administrative sub-national units and not directly to the local authorities.

Financial constraints have led the State increasingly to seek top-up funding in order to carry out its own projects. But this has contributed to rises in local taxation and these forms of cross financing lead to confusion about responsibilities. As part of the reforms, supervision powers have been revised and strengthened. State supervision of local authorities takes the form of subsequent review of legality by the administrative courts, to which the prefect of a department may refer cases for the purpose.⁶⁸

The Cooperative State Model

Where Sweden and New Zealand have relatively simple IGR structures with fewer layers, Germany has a complicated government structure that in several ways resembles France, once one is able to look beyond the distinctive public law features of the unitary versus a federal state structure. Germany has aspects of a “unitary federal state”. The *Länder* have to be understood as full fledged political systems in themselves. Their relationship to local government is basically the same as within a unitary state: each *Land* has its own local government act. The administrative organization of local government rests with the *Länder*. The legal framework for local government of distinct *Länder* differs.

⁶⁵ Cf. Constitution, article 72-2.

⁶⁶ Ibid.

⁶⁷ Allegri, 2004.

⁶⁸ CDLR, 2006.

The Federal Republic of Germany acquired its current form after the reunion of Germany. The unification of West Germany and East Germany took place 3 October 1990. The Constitution of May 1949, known as Basic Law, became the Constitution of the united Germany. The German federation has 13 states (*Länder*) and 3 “free” states (or city states: these are Bremen, Hamburg and Berlin).⁶⁹ These 16 states are fairly powerful in comparison to the national (federal) level of government (the *Bund*).

The *Bund* and the *Länder* are the main legislative levels. The task of legislating is split between the Parliaments (*Landtage*) of the 16 states and the German Federal Parliament (*Bundestag*). However, the line denoting who does what is – almost by definition - not a clear line and causes much uncertainty and room for political deliberation. Federal and regional powers sometimes overlap in areas such as justice, social welfare, civil law, criminal law, labour law and economic law. The *Länder* have their own legislative powers with regard to culture, education, universities, broadcasting/television, local authority matters and the police.⁷⁰

The *Länder* counterbalance the power of the Federal level in that they are better equipped to deal with local issues on the basis of subsidiarity and that they have acquired the right to be consulted by the federal government on matters where they are holding executive powers and responsibilities, which covers nearly every domain of governmental intervention in society. The *Bundesrat* has the ‘first say’ in all legislative affairs (the *Bundesrat* co-signs all laws). It has significant influence on all topics. The *Bundesrat* has the right of initiative and is made up out of state presidents. Each state has a number of votes relative of its number of constituents. There are 69 votes in total; Bavaria – the state covering the largest area – and North Rhine-Westphalia – the state with the largest population, both have six.⁷¹

Stable adaptive capacity

The post-war Constitution originally allocated most tasks almost exclusively to the regional (*Länder*) level, leaving only limited scope for federal legislative action. In the decades to follow the constitutional deal step by step has been re-bargained. The legislative power in nearly all policy domains – with the notable exception of the regional identity related areas as cultural affairs, media and (higher) education – have more or less voluntarily been transferred to the federal level. This was done in exchange for executive powers in those fields and the right to be formally consulted – i.e. the right of access to the policymaking arena – in federal (and sometimes even EU) legislative processes.

This form of co-governance is basically the foundation of the strong powerbase the *Länder* have in the German Federation and derived from that of German local government. The Classical form of German federalism is being identified as ‘Coöperative Federalism’. The reason behind this label is the institutionally created need for (federal) policymakers and (regional) policy-executors to cooperate with and also among each other across various levels of governance. However, the structure of the relationship among *Bund* and *Länder* is largely

⁶⁹ CIA Factbook 2006

⁷⁰ Corrado, M. (2004). Strengthening regional and local democracy in the EU, vol. 1, CoR Studies/E-1/2004.Germany, pp. 355-430. www.cor.eu

⁷¹ Statistisches Bundesamt, 2006

(http://217.79.215.163/Site/Inhalt/EN/1_20Aktuelles/1.6_20Stimmverteilung/index.templateId=renderUnterseiteKomplett.html); Statistische Ämter des Bundes und der Länder, 2006 (http://www.statistik-portal.de/Statistik-Portal/de_jb24_jahrtab57.asp).

repeated in the relationship between *Länder* and *Gemeinde* (municipal government). The first sets the rule and by-laws – often in the context of a Federal framework law – the latter take care of the executive tasks. Municipalities thus have their own autonomy, but also act as agents of the *Land* (and sometimes even of the *Bund*) when executing law either from the *Land* or from the *Bund* - the *Land* usually executes law from the *Bund*, but may decentralise the execution to the municipalities.⁷²

Because of the systemic nature of this co-governance structure some observers prefer to speak about the ‘*Cooperative State*’, rather than ‘*Cooperative Federalism*’. The whole system, at all levels is imbued with the need for interaction and consensual decision making. The *Bundestag* marks the boundaries as far as the legislative power of the *Land* is concerned. The *Bundesrat* is the main level of regional cooperation with and between the *Länder*. Beyond this apex a complex and diversified system of local and regional governance has emerged, that in degree of differentiation and variety does not differ substantially from the French case.

Municipalities have general powers to deal with matters of local interest under their own autonomy, within the legal framework of the *Land*.⁷³ Given the legal-federal tradition, the institutional differentiation, has probably received an even more formal expression than in France. Germany has multiple formal types of municipalities.⁷⁴ ‘*Kreisangehörige Gemeinden*’: municipalities belonging to an administrative district (circle); ‘*Kreisfreie Gemeinden*’: municipalities not belonging to a circle; ‘*Kreisangehörige Städte*’: large municipalities belonging to a circle; ‘*Kreisfreie Städte*’: large municipalities / towns which perform the functions of a circle, and which thus do not belong to a circle; ‘*Grösse Kreisstädte*’: district capitals (only in Baden-Württemberg, Bavaria and Saxen). Bavaria e.g. has 7 districts. Due to their magnitude these cities perform some of the functions of the districts.

From a bottom up perspective, the municipalities create the basis of an intricate consensual system of cooperation and joint decision-making, which extends itself across various levels of governance. Three main associations exist at local level: the German Association of Towns (‘*Deutscher Städtetag*’), which represents the major cities; the German Association of Towns and Municipalities (‘*Deutscher Städte und Gemeindebund*’), which brings together small towns and the municipalities which, from an administrative point of view, are part of a district; and finally the Association of German Districts (‘*Deutscher Landkreistag*’), which represents the districts. These associations, at their different levels, seek to defend the principle of local self-government. The *Bundesrat* is the most important regional level of cooperation between *Länder*.

The Cooperative State – for a long time – has managed to develop routines, procedures and even a culture of cooperation and solidarity through negotiation. Germany has a very comprehensive and detailed legal framework for budget processes at different levels of government. The Basic Law or Constitution, defines the roles of the key actors in budget processes. It is supplemented by a body of laws and regulations.⁷⁵ For many years, the German system operated as a gradualist, but stable system for economic and public sector adaptation to ever changing national and international circumstances. Solidarity was the

⁷² Prakke, L., and Kortman, C.A.J.M. (2004) *Het staatrecht van de landen van de Europese Unie*, Deventer: Kluwer.

⁷³ Ibid.

⁷⁴ Strengthening regional and local democracy in the COR, 2004.

⁷⁵ OECD (2004) *Journal on Budgeting*, 4(3).

political concept, but behind the screen this stood for a continuous elaboration of institutional compromises and strategic package deals of give and take, trading off different interest and compensating for temporary loss. In this gradualist and continuous process of consensus building and joint decision making, financial institutions and financial arrangements – naturally – played a crucial role.

The Financial Planning Council, a co-operation between the *Länder* and the *Bund* became an important institutional platform within this process, as a forum for consultation concerning policies and the negotiation about necessary funding. The quest for equalisation plays a key role in this process and is based on solidarity among the *Länder* and regions. Given the overall structure of the Cooperative State, Germany had to deal with this solidarity in three separate, but interrelated ways: first within the *Länder* between the various levels of government, second within the levels of government between the various kinds of government based on territorial criteria and third among the different *Länder*. The cooperative system is predictably very complex, since it contains redistribution between the federal state and the *Länder* and between and within the *Länder* themselves. Due to a lack of legally-binding opportunities to influence the budgetary policy of the *Länder*, the necessary co-ordination of budgetary and financial planning between the levels of government must be done in the Financial Planning Council. To this end a national stability pact serves as an instrument to co-ordinate at the domestic level the expenditure of the Federation and the *Länder*. The Financial Planning Council meets twice yearly and decisions are adopted in mutual agreement.

Stability turned rigid

For a considerable period of time the cooperative system ‘managed’ to do quite well. Long term economic prosperity provided a congenial context for a bargaining culture. The revenue of joint taxes is divided between the Federal Government and the *Länder*. They include income taxes, corporation and turnover taxes. Municipal taxes are in whole or in part attributed to the municipalities. These are entitled to revenues from special taxes such as taxes on property and local consumer taxes and taxes on luxury goods. They also get a proportion of the revenues from specific taxes such as income taxes and a proportion of revenues from turnover taxes. A proportion of total revenues from joint taxes accruing to the *Länder* and part of the revenues from taxes levied by the *Länder* themselves are also for the municipalities.⁷⁶ The goal of the Financial Spreading (*Finanzausgleich*) in the states is to level the benefits and the costs of the municipalities. In most cases this is based on the expenditures, income and the tax base.

At the end of each fiscal year, the Federation and the *Länder* must submit an account of all revenue and expenditures. This is done for each political subdivision, as no mutual accountability exists. There is one annual report by the Federation, 16 by the *Länder* and roughly 13,000 by the municipalities. These data are condensed by the Federal Statistical Office, and recycled into the processes at the Financial Planning Council.⁷⁷ Based on the macro-economic benchmark data and the tax revenue estimates, a budget prognosis for the coming budgetary year is made for the Federation, the *Länder* and the municipalities.

Since 1990 equalisation between *Länder* and between the *Länder* and the Federal State has been an ongoing massive re-distribution from West to East Germany through a complex

⁷⁶ Corrado, 2004.

⁷⁷ Lübke, A. (2005) Fiscal Discipline between Levels of Government in Germany, in: *OECD Journal on Budgeting*, 5(2).

system of government activities and the social security system. The estimates of the amounts of these transfers range up to as much as € 100 billion annually since 1990. The transfer between 1992 and 2002 is estimated to be approximately € 90 billion per year. The amount has declined from € 110 billion a year in 1995 to €72 billion in 2002. This 'Länderfinanzausgleich'-system (equalisation system between the states) shows a pattern of transfers from West to East Germany, mostly financed by the federal states in the southern part of the country⁷⁸. More important perhaps than the financial figures and data, is the observation that – by and large – this used to be a mutual process of give and take in a context of economic growth and developments, until the Cooperative State quite suddenly was confronted with a single direction redistribution game to be played with four new participants, which had little to offer in terms of compensation and mutuality and which had not been 'socialised' in a negotiation culture of institutional cooperation, 'solidarity' and consensus building.

The modernization and integration of the eastern German economy continues to be a costly and long-term process, with annual transfers from west to east amounting to roughly € 70 billion. Germany's aging population, combined with high unemployment, has pushed social security payments to a level exceeding contributions from workers. Structural rigidities in the labour market - including strict regulations on laying-off workers and the setting of wages on a national basis - have made unemployment a chronic problem. The fall in government revenues and the rise in expenditures have raised the deficit above the EU's 3% debt limit. Germany is the fifth largest economy in the world and has become one of the slowest growing economies in the euro zone. Growth in 2001-03 fell short of 1%, rising to 1.7% in 2004 before falling back to 0.9% in 2005.

Rejuvenating joint decision-making and modernising cooperation

Our analysis suggests that next to the financial and economic dimension, there is an important intergovernmental and institutional dimension – an institutional deficit – to the considerable slowdown of the steady Post War machinery of gradualist adaptation and modernisation of the German economic, social and governmental system to the imperatives of the international economic environment. The clear and probably underestimated differentiation between the "old" and the "new" *Länder*, caused a gradually developed, elaborated and trusted opportunity structure for autonomy and participation within the German federalist system to change rather abruptly. Some, by now, speak about a 'reform deficit' in Germany.

The 'constitutional' nature of this deficit implies that it will not be an easy task to overcome these difficulties. They originate, at least partly, in the extremely complex and interdependent way in which the (legitimate) financial equalisation issue among various 'autonomous' actors and stakeholders had to be renegotiated within a participatory system of joint decision-making and without an overarching power or agreement to provide the lead. Quite abruptly the intergovernmental game was not embedded anymore in a 'culture of trust and confidence' of feasible mutuality and joint benefit. It did not help that this occurred in a context of overall economic decline, but an intricate and gradually developed system of trust and solidarity making among many (semi-)autonomous governmental units – however well embedded in cooperative infrastructure and environment - is bound to collapse and cause stagnation in the face of sudden and unanticipated common challenges.

⁷⁸ Frinck, J.R. and Goebel, J. (2005) *Regional Income Stratification in unified Germany using a Gini Decomposition Approach*. Discussion Papers 540. German Institute on Economic Research.

By now, similar to the other countries in this research project, Germany has also embarked at a public sector reform trajectory aimed at more efficient and effective government. The year 2006 holds a promise to show a reform in the structure of the power balance among the various intergovernmental parties involved. Accountability is one of the focal points of the Reform of Federalism. Since the German economy is stabilising for the first time in many years, reforms are enacted to reduce the budget deficit.⁷⁹ Goals of this reform are to modernize the structure of the Federal Republic of Germany, in order to ease the decision-making process of the *Bund* and the *Länder*. It is also aimed at making accountability more clear and at enhancing the efficiency in achieving the governmental goals. Federal arrangements need to become more efficient, which is attained by greater devolution of powers, tasks and financial responsibilities of the Federal government and the *Länder*.

If these reforms are enacted, they will have a great impact on the power balance between the *Bund* and the *Länder*.⁸⁰ Current law requires the consent of the *Länder* in half of all new legislation. This ‘*Zustimmungsgesetz*’ is reduced to a third of the cases. With the new Federalism Reform, the *Länder* will continue to get more powerful. Since the reform is in progress, the current extent of it is yet unknown, but we may expect the municipalities to be reduced in autonomy and to start acting even more as an agent of both the *Bund* and the *Land*. For some time already, NPM makes itself felt. Germany is clearly not an NPM state and a relative newcomer to this part of the reform game. German local government, however, has developed into NPM champions. It remains to be seen to what extent this concept will inspire local governments in Germany to actually exercise the general competence they generally have within the intergovernmental system of the Cooperative State. It would not be the first time in recent German history that ‘autonomous’ municipal initiative triggered bottom up innovation within the participatory system of joint decision-making of the Cooperative State.

⁷⁹ www.bundesregierung.de

⁸⁰ www.kreise.de/landkreistag/auswahl-presse.htm

5. Conclusions

Our comparative institutional exploration enables us to draw a number of conclusions as to the relationship between intergovernmental relations and local government finance. While finances are often treated as an isolated discipline, an instrument for funding tasks, our analysis shows that it is necessary to understand financial relationships' connection to the larger institutional context and framework of intergovernmental relations in order to perceive possible patterns or scenarios. Central-local financial arrangements are only partly tools or instruments for the defrayment of functional tasks performed by local governments. They are part of an intricate balancing system that uses a variety of tools and institutional arrangements to accommodate tensions of unity, coherence and integration with the need for selectivity, variety, initiative and innovation.

Our analysis does not suggest a uniform trend in local government finance where some kinds of finance or taxes are globally being replaced by some other form of funding. There has been and still is a long term local government reform process going on, which is part of a larger public sector transformation in the Western world - a process of adaptation to changing global economic conditions and circumstances. This process is conducted at different speeds and with different 'reform styles' in different countries, but it is clear that local government reforms and, as part of that, developments in local government finance are basically serving as an economic agenda. In many countries this is linked to a minimum of aspiration levels in terms of equalisation. The Nordic Countries have over recent years clearly been more ambitious in this respect than for example the UK and New Zealand. For most of the countries one gets the impression that the system is geared towards funding a basic – bare – local government infrastructure to sustain and that this base line funding is being topped up by functional task performance on the one hand and more or less fortunate regional-economic circumstances on the other.

Even in the most egalitarian Nordic systems with high levels of aspiration in terms of equalisation, it needs to be observed that the citizen - not the local community, leave alone local government - is the target of this equalisation policy. Shining through our findings is that in addition to equalisation regarding the income of and services for the citizen, there is a second form of equalisation connected to the economic nature of the overall reform agenda. Creating a level playing field – more out of necessity than out of ambition - for local and international business is becoming a unifying factor in the type of taxes and governmental income that may be used to fund various local government activities at the local level. In addition, it seems that the emerging monetary discipline under (European) stability packs forces governments to take some measures in balancing the budget towards local government that perhaps would not have been taken without this external constraint.

A global development of individualisation in taxation policies, creating a level playing field for national and international business and increasing monetary discipline 'flattens' the financial playing ground for municipalities and other forms of local government. Strongly differentiating taxes – like income tax or corporate profit taxes – clearly become less suitable as instruments for financing local government activity, given the differential and cyclical nature of these resources at the local level. Not so much a concern for local government, but rather a concern for (varying degrees of) equity among citizens and business corporations seems to be driving institutional developments here.

Countries with the highest ambition on the front of equalisation policy without wanting to take recourse to strong centralisation measures, have been taken measures which would be considered rather draconic – to the extent of being completely infeasible (most notably in France and Germany) – in the context of other systems. The Nordic case suggests that it is still possible to leave many of the dynamic, cyclical and macro-economically relevant resources and corresponding taxes - like income tax – in the hands of local governments, at the condition that other very homogenizing measures are to be taken elsewhere in the institutional system: most notably at the level of the constitution of the (scale of) local government units themselves.

Everywhere one sees a tendency towards local government scale enlargement as an effort to accrue the economies of scale. Mostly this is done by inter-local cooperation, which seems to be thriving everywhere. But the degree of scale enlargement of local government in the Nordic systems can hardly be explained by an economic cost scenario only. It is hard to assess on the basis of our information, but the way the Nordic countries ‘tinker’ with their local government institution – and also the difference in speed among the less populated Sweden and the (relatively) more urbanised Denmark - suggest that an economic cost scenario in the Nordic case is at least married to a distributional and transaction costs scenario.

From a distributional perspective, territorial scale enlargement allows for creating a level playing field for local autonomy and local government in terms of the potential resource base. Many of these can then be left in the hands of local governments and their incumbents and citizens to decide, leaving central government in the role of the regulating ‘master of the market’. One should not overlook the extent to which national governments in both Sweden and Denmark have acquired substantial powers and tools to intervene and ‘correct’ allocative decisions within the local government system from a national point of view, be it less than elsewhere on an individualised and more on an institutional and regulatory manner. The fact that central government is not overburdened with all kinds of direct ties and individualised relationships to local government makes its position and its potential to act targeted and selectively stronger rather than weaker. The fact that a large share of local government finance is being derived from local taxation does not say much about the external autonomy and freedom with which these resources may be spend, as next to the Nordic case, the cases of France and New Zealand very well illustrate.

This confirms the hypothesis that a transaction cost agenda or scenario underlies some of the patterns we perceive. The case of Germany illustrates what happens in a system with less attention to create a ‘level playing field’ among local governments as the starting point for IGR, and also makes equalisation the subject of individualised encounters and transactions. Within many parts of the Cooperative State par excellence, the aspiration levels towards equalisation – under the heading of solidarity – are perhaps no less than in the Nordic states. Given the diversity of local government and the disparity of the resource base among them, an utterly complex system of fiscal equalisation has to be permanently negotiated and renegotiated, almost on an individualised basis. One may develop routines, cultures and standard procedures with which the tremendous transaction costs of such a system may be reduced or contained - a system which by the way many participants may welcome as a value of checks and balance, integration and gradual adaptation forgoing hypes and administrative fashion cycles. But the development of Germany over the last decade shows that this system has a hard time coping with sudden changes, new system wide challenges and structural economic decline, almost at the expense of procedural breakdown. For the case of Germany – like in many other countries - it is good to realise, that large parts of the economic dynamics

are generated outside the governmental sector, so that institutional stagnation only indirectly affects the economic well-being of the population and its neighbours.

This is not a plea for drastic local government scale enlargement. One needs constantly to keep in mind the differential demographics, territorial conditions and historical background of the various countries involved. Besides, scale enlargement pushes the (equalisation) problem behind the borders of local government and might make some issues less visible, but these issues do not necessarily disappear. The transaction cost scenario – which is implied by the constant battle among the trade off between ‘autonomy’ and ‘co-determination’ in an ongoing process of (more or less) steady adaptation to changing external circumstances – is illuminating some other features from our comparative overview.

France provides a case very close to the German one, be it that the institutional point of departure is quite different. A blocking highly participatory system of intergovernmental relations, at the verge of deadlock, is gradually being pushed over – by and from a centre that as such does not exist in Germany - into the direction of a system where organisational autonomy and responsibility step by step pave the way for a more flexible, contractual and dynamic operation. An interesting feature is that as gradually more tasks are being pushed down the administrative hierarchy, funding follows. This implicates that – other things being equal - the amount central government funding relative to ‘local taxation’ increases.

Rather than a sign of centralisation, in the Napoleonic context, this has to be read as a sign of increasing local government involvement in conducting the affairs of the state. It is unlikely that the basic structure of the French local government system is soon to change. Given the strong connectedness of the French municipal structure to local civil society and its citizens – there is little of a gap between municipalities and their citizens, contrary to the French state and its citizens - this is perhaps even a wise ‘decision’. But this means that an increased local autonomy scenario needs to take into account the increasing need for cooperative and collaborative structures and processes for interaction across multiple levels of governance.

The institutional alternative is provided by the Westminster case, most notably New Zealand. Large part of the local government reforms have been aimed at the reduction of transaction costs, but then at the horizontal level, among the traditional multitude of differential local government policy committees, that used to make up Westminster local government structures. The reforms of local government in New Zealand have largely amounted to the abolition of this commission system and resulted in an integrated municipal type of governance as used to be more common only for the Nordic and continental European systems. Modern principles of internal organisation and management have wisely been applied, creating an organisation quite willing and probably capable to take the responsibility for its actions and autonomously accounting for its deeds. But if central government is not willing to utilize this institutional facility and ‘push down’ functional tasks to be carried out by this modern local government organisation, the sign of a large ‘own income’ is largely a sign of the marginal meaning of local governance in society and its overall governance system.