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URBAN POLICY PLANNING STUDIO STUDIES
ON
LOCAL GOVERNMENT FINANCE
THROUGH
A COMPARATIVE APPROACH

"LOCAL GOVERNMENT FINANCE IN THE WORLD"

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In this volume, the papers prepared in partial fulfillment of requirements of UPL 512, Urban Policy Planning Studio I, due to Spring Term of 1995, are reevaluated and gathered in the form of a book, so as to provide comparative data about **Local Finance Mechanisms** and **Local Fiscal Structures** in several countries. The study has been carried out by Müge AKKAR, Ebru ALARSLAN, Asli ARAS, Ela BABALIK, Gül HAFIZOGULLARI, Ersan OCAK, Nalan SEVİM being instructed by Prof. Dr. Melih ERSOY, Emre TEKİNBAS (General Director of Bank of Provinces) and Res. Asst. Basak AYSAL.

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A.THE INSTITUTIONALIZATION & ORGANIZATION OF LOCAL GOVERNMENTS AND THEIR FISCAL STRUCTURE IN BRITAIN

A1. THE CONSTITUTIONAL STATUS OF LOCAL GOVERNMENT

Local government in Britain exists by virtue of ACTS of PARLIAMENT. The structures, functions, funding and many of the processes of local authorities are determined by law. COUNCIL can only undertake actions that are justified by law. If a local authority acts outside this framework, it may be held by the COURTS and obliged to stop its unlawful action (CHANDLER, 1991, p:1).

ACTS of PARLIAMENT lay down the broad framework for regulating local authority structures, functions and procedures; but many Acts permit a GOVERNMENT MINISTER to change detailed elements of the legislation by the use of statutory instruments (CHANDLER, 1991, p:1).

Therefore, Britain is a UNITARY STATE through the political representation in Parliament and the complex system of dispersal of the agencies of public administration. But, there is a SUBSTANTIAL RECOGNITION of HETEROGENEITY (KINGDOM, 1993, p:8,9).

A2. THE STRUCTURALIZATION OF BRITISH LOCAL GOVERNMENT IN A HISTORICAL PERSPECTIVE

A2.1 The Local Government Evolution In History

Local government in Britain existed before the middle of the 19th century, but it hid its identity. Before that local government is, and always has been derived from that of national government. The earliest local government was whatever local presence, the king was able to maintain and rely on to preserve his influence and protect his throne (FOSTER, JACKMAN, PERLMAN, 1980, p:9).

From the beginning of the middle ages, there developed a parallel system of local government in the chartered or incorporated towns based on royal charters granted to them. There was a form of system which were single-purpose boards responsible for such services as poor law administration, public health, highways and education. Within the town boundaries, the officials were usually elected, and had both judicial and administrative duties. These forms of government survived

in their essentials until the 1835 Municipal Corporation Act, which was the major change in terms of transformation of these duties to multi-purpose elected local authorities responsible for the provision of a range of public services.

The local government authorities in Britain have been changed in terms of name, responsibilities and functions. However, we can mainly identify 3 species of local authorities until the 19th century; parish, borough and county. In addition, there have existed ad hoc authorities which were founded for special purposes.

PARISH were first locally based state administration, which has not a statutory basis, having evolved from the old manorial system. Actually, parish did not tended to reflect the DEMOCRATIC IDEALS, but the ECONOMIC and SOCIAL ORDER of the local community with domination by a local elite, that are self-perpetuating representing landed interests ruling largely for its own end.

As for COUNTIES; they emerged with the growth of the parish and was settled by the central government. County has three responsibilities that can be summarized as finance; i.e. collecting taxes; military support, law and order with its own courts. County courts, which mainly dispense justice, are the assembly of citizens to select and appoint certain officials. In addition, they receive king's order and select a member to present them at the Parliament.

BOROUGH is between the levels of the parish and county. Before the 10th century, there was not an urban society, but there was villages, i.e. agrarian order. After the 10th century, towns began to emerge with the trading activities and offered safety through fortification. Certain towns evolved as FISCAL and JUDICIAL CENTERS, and sought independence from their parent counties and central government. In the 15th century, the peak in the movement towards autonomy through incorporation was reached. Boroughs were emerged as the centers of local administration. Some of them elevated to county status. The election of officials, efficiency in administration and financial probity are some features of boroughs.

At this time, there were also AD HOC AUTHORITIES, which were acting with statutory authority and providing public utilities on a commercial basis. After this system established, it led to a variety of technical and administrative improvements in the provision of local services.

By the end of the 18th century, the municipal corporations, the parishes and all the special-purpose authorities constituted local government (FOSTER, JACKMAN, PERLMAN, 1980, p:10).

The restrictive practices and physical environment of the old boroughs did not allow industrial development. The new areas outside the old boroughs where there were no obstacles to industrial development, did not have a local government enough to mitigate the social consequences of development. The old institutions were destroyed due to their inability to adopt to the changing conditions of the 19th century. The swarming of population to towns and cities, the growing filth and disease in those places, the terrible growth of pauperism and misery creating crime and disorder brought about its collapse. Especially, in the industrial centers, entrepreneurs, industrial leaders, lawyers and bankers were PRINCIPAL AGENTS of the CHANGE. They met their functional requirement in two ways; that is, by compensating for outmoded local government structures through the creation of AD HOC BODIES charged with the responsibility for providing particular services, and by a form of the existing municipal institutions and practices. Therefore, modern local government in Britain has its roots in the 19th century. During that century, many of the characteristics of British system of government at both national and local level were established.

In 1835, the **Municipal Corporation Act** was established in order to regulate new system in the local government. The Act, on the one hand, confined the role of the justice of the peace in the largest boroughs to judicial matters; but, on the other hand, it brought directly elected corporate boroughs in Britain. In other words, the system in which the elected borough councils were composed of elected councilors and non-elected alderman were appointed by the council, were established by this Act. The system, that had evolved under the justices, had welded the COUNTY and PARISH into a complex TIERED SYSTEM (FOSTER, JACKMAN, PERLMAN, 1980, p:10). However, the local representative was elected by the public in parish; while it was appointed by the central government in counties until the 1888 Local Government Act.

During the period after that Act, the old and special purpose authorities were often still the most effective and conspicuous organs of local government. The New Poor Law had set up special authorities, which was called as the Boards of

Guardians: The Public Health Act, in 1848, had created local boards of health; and the 1870 Education Act had created local school boards.

The **1888 Local Government Act** extended democratic principles to the counties. This Act established elected county councils and county borough councils. At the same time, some progress was made in reducing the number of special-purpose authorities by transferring functions to the counties. Some of the largest cities and towns become COUNTY BOROUGH (with a minimum population of 50000 people), which is the single-tier authorities with the power and duties of both counties and boroughs for their areas. County borough, that is the status of the largest of the urban area, is largely autonomous.

The next stage was the establishment of the TWO-TIERED SYSTEM, which was become realized by the **1894 Local Government Act** that was the rationalization of the second-tier authorities. That is, the local government formed with the COUNTIES and DISTRICTS. While the first-tier authorities were COUNTIES; large areas were divided into BOROUGHs, URBAN and RURAL DISTRICTS. Urban and rural district councils covered small local areas and provided a limited range of local services. At the same, local self-government was introduced for the PARISHES as a third-tier. The rural district councils were divided into parish councils. Each of these local authorities undertaking some of the local authority functions shared according to the importance of the unit. County councils would provide the major local services; while the lower-tier authorities would provide services of a more local character. In the cities and large urban areas, a single-tier system of local government was created with county borough councils providing all local services to their populations. Both innovations enabled more special-purpose authorities to be assimilated, while the geography of local government for the first time reflected the principle that the area of a local authority must fall entirely within the area of the next larger authority in the hierarchy above it.

**FIRST
TIER**

County Council
62

County
Borough
Council
61

London
County
Council
1

**SECOND
TIER**

Urban
District
Councils
535

Rural
District
Councils
472

Non-County
Borough
Councils
270

Metropolitan
Borough
Councils
28

City
of
London
1

**THIRD
TIER**

Parish
Councils

Parish
Meetings

TABLE 1: Elected local government in England and Wales, end of the 19th century. (WILSON, D., GAME, C., 1994, p:46).

While the basic structure of local government lasted until the 1960's, there were several adaptations to the pattern established at the end of the 19th century. A major driving force behind the structural adaptations which took place before the major reform of the boundaries was the inappropriateness of existing boundaries given the increasing urbanization of the early 20th century. Between 1889 and 1925, some 21 new county boroughs were created and over 100 county borough boundary changes were instituted.

Also, the 1929 Local Government Act slowed down the process of creating and extending county boroughs and the minimum required population was raised from 50000 to 75000. The Act began to tackle the problem of the balance of urban and rural authorities, and particularly the number of very small authorities. The outcome of the boundary reviews which followed this Act was that between 1929 and 1938, urban districts were reduced by 159, rural districts by 169, and some

1300 boundaries were altered. But, many small authorities still survived. Structural reform across all authorities needed tacking in a much more concerned manner, but this did not happen until the post-war years.

Thereafter, the basic structure did not alter until the 1970's. With the ECONOMIC, SOCIAL and DEMOCRATIC changes; that is, changes in the patterns of industrial location, improvement in communication and conurbation developments which were densely populated around the big cities, especially London; leded the Royal Commission to establish London Government Act. Accordingly, administrative area of "Greater London" to be governed by a directly elected GREATER LONDON COUNCIL (GLC) were replaced the older London County Council created in 1888. And, Greater London Council were divided into 32 second-tier authorities to be known as London Boroughs. The Act was come into force in 1969.

The foundation of GLC was not enough for the reorganization of local governments, since small authorities were inefficient, they could not afford to finance the increased levels of municipal provision. Also, they could not afford to employ the qualified staff who were increasingly necessary to manage the welfare state at local level. While called a major reorganization and undoubtedly causing considerable administrative problem, the main innovation of the 1974 Act was the sweeping away of the county boroughs and the replacement of the old second-tier authorities by larger ones. The Act established Metropolitan Counties, Non-Metropolitan Counties as a first-tier authority. 6 metropolitan counties were formed by the Act. Outside the metropolitan counties, counties was divided into 47 non-metropolitan or shire counties. In country areas, the shire counties became the more important authorities. In cities, most powers were given to the METROPOLITAN DISTRICTS. Thus, now outside some authorities in Scotland, London and the Isle of Scilly, there are only counties and districts (FOSTER, JACKMAN, PERLMAN, 1985, p:13,14).

FIRST TIER	Metropolitan County Councils 6	Non-Metropolitan County Councils 47	Greater London 1
SECOND	Metropolitan District	Non-Metropolitan	London

TIER	Councils	District Councils	Councils 32 + City of London ¹
	36	333	
THIRD TIER	A few parish councils within metropolitan areas	About 11000 parishes (Communities in Wales) of which some 8000 have councils	

TABLE 2: Elected local government in England and Wales, 1974-1986.
(WILSON, D., GAME, C., 1994, p:52)

After the 1980's, Conservative Government implemented a reorganization which retained two-tiered system. 1985 Local Government Act abolished the top-tier authorities in the metropolitan areas and the Greater London Council; and then, distributed their functions between the AD HOC BODIES which were mostly formed with the appointed people. Firstly, for certain services such as arts, entertainment and waste disposal, responsibility was to be transferred to the lower tier authorities. In London, the control of these local services were transferred from county councils to borough or district council. Secondly, JOINT BOARDS were established in the metropolitan areas for police, fire and civil defense, and passenger transport. Accordingly, members of joint boards would be appointed by borough or district councils, with the number of appointed members dependent upon the population size of the appointing borough or district council. In London, a joint board was established for fire and civil defense, there being no police authority in London. Moreover, passenger transport had already been transferred to London Regional Transport, whose members appointed by the Secretary of State for Transport. And lastly, the Act established RESIDUARY BODIES and CO-ORDINATING COMMITTEES. The Residuary Bodies were responsible for winding up the affairs of each of the abolished authorities and to take temporary responsibility for activities not allocated elsewhere at the time of abolition. These responsibilities can be concluded as the disposal of surplus property, the management of debt and the winding up of the accounts. Residuary Bodies consisted members appointed by the Secretary of

State for the Environment. As for the Co-ordinating Committees, it was consisting of members appointed by borough or district councils, to plan for the takeover of functions by those councils and to consider whether joint arrangement should be introduced for the administration of any of the devolved services (MALLABAR, 1991, p:31,32).

A2.2 Local Government Today In Britain

Local government in Britain is today composed of the following system:

- London
- England apart from London

- 1) Metropolitan areas
- 2) Non-metropolitan areas

- Wales
- Scotland

A2.2.1 London

The capital is divided into 32 London boroughs plus the City of London and has no single multi-purpose local government structure covering the whole of the conurbation. The London boroughs are single-tier authorities in that they are each solely responsible for all the local government functions within their area.

The City of London has a special status governed by ancient charters and has had privilege of being excluded from the local government reforms that have been imposed on the rest of the country.

A2.2.2 England Apart From London

A2.2.2.1 Metropolitan Areas

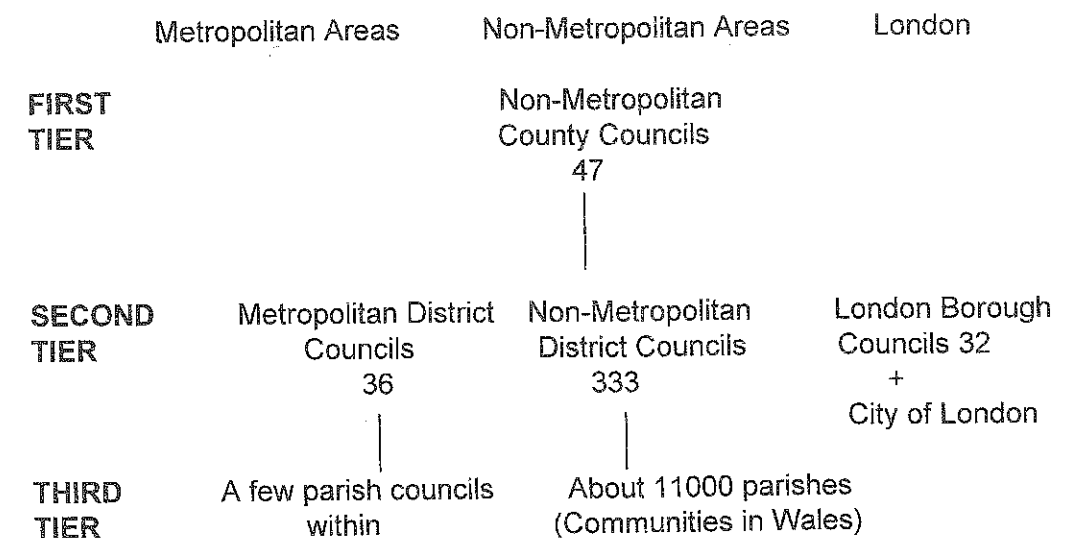
Metropolitan areas cover 6 conurbation (comprising Tyne and Wear, Merseyside, Greater Manchester, West Yorkshire, South Yorkshire and the West Midlands), which are divided into districts. Metropolitan districts, like the London boroughs, are single-tier authorities administering the majority of local government services in their territories.

When the metropolitan areas came into being in 1974, they were each administered for some functions, principally POLICE, FIRE, TRANSPORT, HIGHWAYS and STRATEGIC PLANNING, by a metropolitan county council. But, these bodies, along with the Greater London County Council (GLC), were abolished in 1986. Their powers were transferred to the metropolitan districts, apart from POLICE, FIRE SERVICES and TRANSPORT. These functions are still administered on a metropolitan county wide basis by a separate JOINT BOARD for each function composed of representatives from the metropolitan districts within the former county area. There are also a few parish councils in the metropolitan areas, although, like all parish councils, they do not undertake any major services.

A2.2.2.2 Non-Metropolitan Areas

The remaining parts of England are divided into 39 counties and 296 districts. There are also some 10000 parish councils in these areas.

This is a two-tier system of local government but it must be emphasized that, although the counties are larger in size and have more powers than the districts, the districts are not subordinate to the county and remain separate authorities governed by their own elected councils.



metropolitan areas

of which some
8000 have councils

TABLE 3: The organization of elected local government in England and Wales, 1993. (WILSON, D., GAME, C., 1994, p:62).

A2.2.3 Wales

A two-tier structure of counties and districts was established. The structure of local government is nearly the same with that of London and England apart from London. However, there are no metropolitan areas in Wales. Also, community councils provide the Welsh equivalent of the English parish councils.

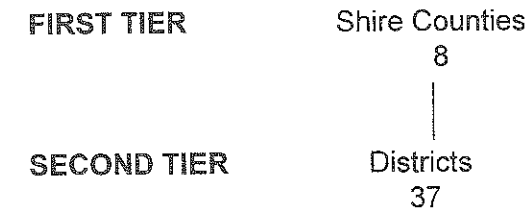


TABLE 4: The organization of elected local government in Wales (KINGDOM, 1991, p:81).

A2.2.4 Scotland

The local government in Scotland involves regional councils, district councils and islands councils. The general purpose of a community council in Scotland is to ascertain, co-ordinate and express to the local authorities for its area, and to take such action in the interests of that community as appears to it to be expedient and practicable. In other words, community councils in Scotland are commenting on local plans, clearing up their area, dealing with traffic problems, organizing carol services and other social events, organizing the bus routes and becoming involved in the many other neighborhood activities so typical of residents' group and parish politics'.

FIRST TIER

Regions
9

Islands
3

SECOND TIER

Districts
53

TABLE 5: The organization of elected local government in Scotland (KINGDOM, 1991, p:81).

A3. LOCAL GOVERNMENT FUNCTIONS

A3.1 The Historical Context

The responsibilities of local government have been given by the principles of PARLIAMENTARY SOVEREIGNTY and ULTRA VIRES, meaning that local authorities can only undertake those functions for which they have statutory approval. Acts of Parliament determines 2 types of powers to local governments for provisions of services: Mandatory and permissive duties. MANDATORY SERVICES are the functions which must be provided by the local authority. But, the provision of the PERMISSIVE SERVICES depend on the preference of the local authority. In addition, if an authority wishes to take on some new function, it must promote a private bill in Parliament.

Local government has its origins in the growing industrialism and urbanism of 19th century. Because of the industrialism, the provision of many social services was motivated. In addition, an infrastructure of roads, street lighting, water supply, sewerage and law and order was needed to support the local economies. At first, these services were administered AD HOC BODIES, but the municipalities reached a high point as multi-purpose authorities by taking over the responsibilities of ad hoc bodies with the legislation in 1888 and 1894. The Acts of 1888 and 1894 did not bring all local services under the control of the new local authorities. Some ad hoc bodies remained. The most significant of these were concerned with education and Poor Law relief.

By the first decade of the 20th century, the intention was to municipalise basic utilities (gas, electricity and water supply, street lighting, public transport) so that local working people (through council membership) could gain a greater say in the life of the community.

The Education Act of 1902 brought education under local authority control in England and abolished the school boards. Education became the largest and most important service provided by local government and has remained so ever since Thatcher's government. Approximately half of the total current expenditure on goods and services provided by local authorities goes on education. In addition to schools for children of compulsory school age, local authorities provide nurseries, colleges of further education, polytechnics and a general adult education and youth services (HAMPTON, 1987, p:59).

In addition to education, the first legislation about the town planning was introduced in 1909 and planning has become a responsibility of local government.

Also, in 1929, local government took over the responsibilities of the Poor Law Boards of Guardians, inheriting the extensive range of rudimentary social services which had been developed since 1834. The responsibilities of the Poor Law Boards of Guardians were distributed among the appropriate committees of the county councils and county boroughs.

Housing is another local authority service that grew rapidly from the beginning of the present century, particularly after the First World War. Housing represents most of the capital assets of local government.

After the Second World War, the idea that state should intervene to the free market in order to regulate the economy in the general interest of all, had been popular. During the 1950's, until the 1980's, the Labor Government nationalized a number of basic industries, established the national health service, extended the welfare state and pursued policies of economic intervention. Dependently, local government assumed a key role as the producer of a comprehensive range of social services and were charged with carrying out many of the social reforms which central government viewed as being necessary.

Accordingly, the real estate of local government increased in these years, especially housing stocks. The proportion of the housing stock owned by local

authorities in England was 13% in 1947. This had risen to 25% of 1961 and 30% by 1976 (HAMPTON, 1987, p:59).

Also, personal social services developed from the late 1940's. The Children Act 1948 introduced local authority departments responsible for the welfare of children. These departments have become a major force in local government and are among the main spending departments after education.

Beside, the Education Act of 1944 created the post-war system of education as a national service which was to be locally administered. The powers of the Minister of Education were limited as the Minister did not employ teachers or build schools or control the curriculum. These were responsibilities of the local education authorities (LEA's).

In addition to these involvements in the responsibilities of local governments during this period, the present powers of local authorities in respect of town planning derive from the Town and Country Planning Act 1968. These provide for local authorities to prepare both structure (that is, strategic plans) and local plans for the implementation of the strategy in smaller areas or for specific purposes.

However, some of the responsibilities provided by local authorities had been transferred to central government agencies. For example, the Ministry of Transport became the highway authority, and some of the construction responsibilities of local government on roads were transferred to this ministry. Also, the Ministry of Agriculture became responsible of a number of services between 1937 and 1944. Beside, in the post-war years, local authorities lost their hospitals to the National Health Service (NHS) and their gas and electricity undertakings to nationalized boards. The Local Government Act 1972 transferred the remaining local authority health responsibilities to the NHS and their water and sewage responsibilities to new regional authorities.

In the mid-1970's, producing a fiscal crisis in which the capitalist economy become unable to sustain the state services it required. When the Thatcher government came to power in 1979, it embarked upon a process of painful functional depletion as a large range of services were plucked, or partially plucked, from the local government breast. There was a general desire to reduce the role of local government and change it to one of 'coordinating' or 'enabling' the provision of services.

After the 1980's, the main changes in the local authority functions were made on education, housing, planning and personal social services.

Central government's education policies changed towards centralization. The policies of central government on education has concerned with how schools can better serve the goal of generating a more profitable and competitive economy. In order to become realized this centralization policy, the Education Acts of 1980, 1981, 1986 and 1988 aimed to weaken the LEA's control over the running of local schools. With the Education Act of 1988, it was established a National Curriculum along with specified attainment targets, programs of study, and formal assessment arrangements. Also, two new quangos, the National Curriculum Council and the National Schools Examination and Assessment Council, were established to advise the Secretary of State. Thus, the Secretary of State for education has become the central power to make regulations for appraisal of teachers. And, all sorts of duties have been laid on LEA's with respect to the way that aspect of the curriculum was undertaken. In addition, the central government ceased the funds on education provided by LEA's; and a system of education support grants was introduced. Therefore, schools became self-governing within the context of resources allocated by central government. Moreover, the Act of 1988 provided that the colleges would be completely independent of local authorities and would be financed by contributions from the central government and from the private sector.

As for the housing, the Conservative government saw the council houses as a treasure of finance for the state, and also as a strong instrument to animate private sector. With the Local Government Planning and Land Act of 1980, the Secretary of State for Environment became the central power on the control of development decisions. This institution had the power to appoint Urban Development Corporations which were modeled on the new town development corporations and were seen as an effective way of dealing with inner city dereliction. Urban development corporations would assume responsibility for planning, housing and build control.

Beside, 1982 Social Security and Housing Benefit Act shifted control from local authority administration to the central government social security administration. In other words, the role of local housing authorities has taken by a major quango: the Housing Corporation. More public money has channeled through this body, to

fund the activities of housing associations. The corporation has become a significant provider of publicly-funded housing and carry out a very substantial amount of improvement and rehabilitation work.

Also, the government has taken a number of other measures to support and strengthen the private housing market by the Building Societies Acts. Building Societies Act of 1984 has strengthened building societies and the government made special arrangements to facilitate the funding of council house sales. Societies have taken over from local authorities the role of major mortgage suppliers for older properties. With the Building Societies Act of 1986, larger societies were enabled to build, own and provide house for rent. A major building society has been involved in taking over, improving and managing a large estate on behalf of a local authority.

With the pressure of central government on the local authorities to sell the council houses, more than a million of council houses were sold by 1987. In addition, local authorities were obliged to sell unused land for private development.

The Local Government Planning and Land Act of 1980 changed the powers of local authorities on town planning. The Act redistributed certain planning responsibilities (consideration of planning applications relating to mineral workings, cement works and for developments that straddled the boundaries of National Parks) from county councils to the districts. Also, county councils lost the right to direct district councils to refuse a planning application on the grounds.

Beside, the central government has forced the local authorities to tender the provision of local services. New Right apologists argued that there was no local government service which could not be put out to tender, even the collection of taxes. The Local Government Act of 1988 forced the local authorities to tender especially some local services which are refuse collection, street cleaning, catering, cleaning buildings, ground maintenance and vehicle maintenance.

In addition, the transportation duty of local government has been transferred to the private companies with the Transport Act of 1985.

As for the personal social services of local authorities after the 1980's, the central government has decreased the financial supports to the local governments, and had willingness to control local expenditures.

A3.2 The Species Of Local Government Functions

The obvious feature of British local government is still the very wide range of services and functions for which it has been responsible; although the functions of local governments have been restricted by the central government especially after the 1980's. While some of the functions of local authorities involved a regulatory role, most have involved direct service provision. Many central government departments have had little responsibility for the direct provision of services, and have performed an essentially supervisory, promotional, or regulatory role.

The most of the public services have been supplied by the local government in Britain. The functions of the local government is shown in the Table 6. But, it should be noted that:

- a) There is no particular local authority in Britain which is wholly responsible for a function. For instance, although county councils have powers over the provision of education, central government can determine how they administer many aspects of this function, such as the subjects to be included in the national curriculum.
- b) More than one authority may have powers over a particular function in an area. In non-metropolitan areas of England, recreational facilities can be provided by the county, the district and the parish.

	NON-METROPOLITAN AREAS		METROPOLITAN AREAS		LONDON
	Counties	Districts	Districts	Joint Boards	Boroughs
♦Education, careers service	✱		✱		✱
♦Housing		✱	✱		✱
♦Social services	✱		✱		✱
♦Police	✱			✱	

♦Fire service, civil defense	*			*	
♦Traffic and transportation	*			*	
♦Highways	*		*		*
♦Water					
♦Libraries	*		*		*
♦Museums and art galleries	*	*	*		*
♦Strategic planning	*		*		*
♦Local planning, development control		*	*		*
♦Economic development	*	*	*		*
♦Recreation, parks, pools, sports centers		*	*		*
♦Refuse collection, street cleansing			*		*
♦Refuse disposal	*		*		*
♦Consumer protection	*		*		*
♦Cemeteries and ceremonial		*	*		*
♦Licensing		*	*		*
♦Council tax and rate collection		*	*		*

TABLE 6: Main functions of principal local authorities in England and Wales in 1993. (WILSON, D., GAME, C., 1994, p:64,65.)

A4. LOCAL GOVERNMENT FINANCE IN BRITAIN

For the analysis of the fiscal structures and fiscal tools of Britain, it is necessary to overview the central economical policies of the country through a historical context. The fiscal tools of the local governments and the extend to which these tools are being used effectively depends largely on the intergovernmental relations. These relations are the outcomes of central economical policies.

A4.1 Intergovernmental Fiscal Relations Through Central Economic Policies

The modern fiscal system of Britain has been passed through several periods where many different public expenditure policies were held.

In the nineteenth century, the key to public expenditure was the notion of a *balanced budget*. The governments would raise in tax, only to finance the needed expenditure, not more. Therefore, public expenditure was viewed to be necessary but evil. This view was also applied local expenditures: Most elections would result in the election of the candidates termed *economizers*, whose principal aim was to protect the rate (the local tax of property which will be mentioned in part 4.2.2.2.d) payers.

In the early twentieth century however, a movement away from economizing was realized with the municipal socialism of the Labor Party. *Social justice* was the key-word of the period. To fulfill this political aim, tax funded local services were the valid fiscal system. Interventions took place in social life with legislation for pensions and national insurance.

Two world wars had a profound effect on attitudes towards public expenditure. The state intervened in social life on an unprecedented scale so that the liberal idea of the minimal state could never be completely reasserted. Expenditure rose during both wars, never to return to the pre-war levels (KINGDOM, 1991, p:173).

As for the post-war decades, the concept of the balanced budget was replaced by the idea of a *budget deficit* aimed at stimulating the economy in times of slump. High spending on social services was acceptable to both parties, either Labor or Liberal.

The mentioned economical policies where social necessities were given the priority without fiscal discretion, lasted until the oil crises of the 1970's. The period of economical discretion starting from early 1970's up to today, is very important in determining the existing fiscal local structures. That is why, in this study, the specific period of 1970-1990 will be examined in details. The mentioned periods of 1970's to 1990's are characterized in four basic phases:

The first phase of early 1970's, which can be named as the phase of **consultation**, reflects **considerable local discretion, central direction and intervention**. But the actions of fiscal discretion are more the exceptions rather than being the rule.

The second phase of corporatism at late 1970's shows accelerating economical decline; inflation-partly through oil price rises- and public expenditure cuts. The intergovernmental relations are based on influencing the local governments through incorporation; the central government's trying to secure municipalities' voluntary expenditure restraint, rather than strict discretion.

The third phase of confrontation takes place in the early 1980's. The central government that is the Conservative government of Thatcher, searches for means to control local, thereby overall public, expenditure mainly through manipulation of grant system. In this phase, the strong central direction is faced with a corresponding strong local defiance. Further grant reductions are accompanied by detailed spending "guidelines" for every council, and grant penalties for "overspending" these guidelines.

The final phase of mid-1980's and onwards, the central government recognizes that the local current spending is only fully controllable through statutory rate limitations and eventual abolition. The period is symbolized by the key-phrase of *"If you cannot persuade, abolish!"* Additional legislation take place to reduce the responsibilities and discretion of local authorities (WILSON, GAME, 1994, p:169). The initial key of balanced budget is replaced with the recent key of balance in economy, which requires that economical balance can only be achieved through free market conditions. This view is the motive beyond the strong movements of the period towards centralization.

Considering this historical perspective of the British fiscal system, the next parts of the study examine the existing fiscal structure of Britain with its each single fiscal tool, and the evolution of these fiscal means in the mentioned historical context. To what extent the fiscal tools are available and being used efficiently in today's context, are the main conclusions that are aimed to be derived.

A4.2 Fiscal Structure Of Local Governments In Britain

The analysis of the local finance can be made through two main items, being expenditures on one side, and income to finance these expenditures on the other.

A4.2.1 Expenditures

Local government expenditures make up the 28 % of the overall public expenditures in Britain. The main components of the item "expenditure" are considered to be current and capital expenditures.

A4.2.1.1 Capital Expenditures

Capital expenditures are the spending that produce long-term assets, often expensive, but whose benefits will last beyond the next financial year. (WILSON, GAME, 1994, p:134) Examples to this type of local expenditure are purchase of land, construction of buildings and roads, major items of equipment.

8 % of the local budget is for capital expenditures.

A4.2.1.2 Current Expenditures

The current expenditures are the day-to-day spending needed to keep services running. Staff wages and salaries, books for schools, office equipment, petrol for refuse collection vehicles, heating bills in children's homes are examples of current expenditures. (WILSON, GAME, 1994, p:134)

The share of the current expenditures in the local budgets is 92%, where the 30% is for the wages and the salaries of the staff.

A4.2.2 Income : Financing Expenditures

The means to finance the expenses can also be grouped under the two groups of "financing capital spending" and "financing current spending".

A4.2.2.1 Financial Capital Expenditures

There are basically four fiscal instruments to finance the capital expenditures. Borrowing, capital receipts, capital grants and current income are the means to finance the expenditures of this category.

A4.2.2.1.a Borrowing Up To a Prescribed Credit Ceiling

Since the 19th century, local authorities have been expected to raise capital by borrowing and paying back interest through the revenue account. Most of the equipment and properties of the local authorities were acquired through such means. The channels for the local authorities to raise capital were:

Borrowing money on the open market from banks

Borrowing money from the public by issuing interest-bearing bonds

Borrowing money from a body established by the government to facilitate capital spending

Raising small capital sums for recreational and social welfare purpose through local lotteries.

But since the early 1980's, borrowing has been very seriously limited by the central government. Today, every local council is given by the government a permission to borrow for each year. This permission that is known as the Basic Credit Approval (BCA), specifies the maximum sum the council can borrow to finance capital projects in education, housing, social services and various other services.

In addition, a council may be given a Supplementary Credit Approval (SCA) for specific, government approved projects and initiatives concerning, for example, the police, magistrates' courts, roads, rural housing and homelessness.

These credit approvals permit a council to borrow from the similar channels mentioned for the previous periods of borrowing before 1980's. In addition, the councils can borrow from a government agency called the Public Works Loan

Board. But all through these channels, the ceiling is determined by the central policies, not the local ones.

A4.2.2.1.b Using Capital Receipts

This category of raising capital was not a commonly used method before the central economic pressures to discrete local expenditures. Its validity has increased in front of the scarce fiscal opportunities led by the liberal policies of expenditure cuts.

This method of raising capital is realized by the councils' selling their assets such as land, buildings and housing. But, still these sales are in control of government prescribed limits. The councils are able to use for new investment a maximum of: 25% of receipts from housing sales, 50% of receipts from the disposal of other assets.

Through the central obligations, the remaining receipts are to be used by the local councils to pay off outstanding debts.

A4.2.2.1.c Capital Grant Programs

Capital grants are the financial aid from the central governments for the projects that succeed in being included in "urban programs" of country scale, or in international fund programs such as European Regional Development Fund.

This type of fiscal mean was mainly relevant with the late 1960's and 1970's. These years reflect a period of city growths in physical means, where the cities largened and dispersed. As a consequence, the old city centers started to decay, and slum inner cities came out to be a remarkable problem of urban areas. The analysis of urban poverty upon which the government relied in the 1960s led to policy proposals directed at supporting individuals or regenerating the worst-hit areas. The solution was to encourage the local residents to improve the decaying urban areas and urban social life as well, in their local environment.

The result of these movements was the Local Government Grants Act in 1969. The act made grants available to local authorities for 75% of the cost of approved social and community projects. For the purpose of determining the local urban areas that are critical and in need of treatment, two main research programs were

established: The Community Development Project (CDP) and The Inner Area Studies (IAS). (HAMPTON, 1987, p:209)

The research programs resulted in 1977, and central government entered into partnership arrangements with local authorities in seven selected areas of inner city slums. Necessary urban and social projects started to be held by this partnership of governments. Besides, further fifteen "program" authorities received advance allocations of urban program resources without the formal structure of this partnership, whereas the remaining local authorities continued to have access to the "traditional" means of fiscal opportunities.

This type of a central grant where the project implementation is also being directed by the center, is an important case in showing the centralization movements in urban economical activities, even before the Thatcher period, at 1970s.

As for the Thatcher period, after 1980s, the policies of public expenditure cuts resulted in the fact that, local governments were not able to actualize all the duties they have to do. This fact prepared an appropriate justification to transfer some of the local governmental functions to private entrepreneurs. The Local Government Planning and Land Act in 1980, therefore created Urban Development Corporations (UDCs) to operate as single-purpose agencies with special powers that place them outside the normal framework of local government. The membership includes businessmen and other prominent local people who do not hold any elective office. UDCs supplied project management and project finance from private markets, to the urban projects.

The recent arrangements in capital grant programs set up some conditions that can be considered as the means to limit local expenses. If a local government succeeds in receiving grants from any type of urban program, the central government decreases its Basic Credit Approval, so that the total expenditure of that local authority is taken under control. Either by receiving grants or not, local public expenditure is not approved in anyway.

A4.2.2.1.d Current Income

Current income includes the local taxes, annual rents, annual service charges, and it is a fact that they are not sufficient to finance capital investments which are long-term and generally in increasing scales.

However, this category of fiscal instruments is the only tool that is free from central controls.

A4.2.2.2 Financing Current Expenditures

There are four channels to finance current expenditures in British local governments: Charges, government grants, national non-domestic rates, and local taxation.

A4.2.2.2.a Charges

Finance through charges is by setting fees for the use of some of the local services provided by the local governments : passenger transport, car park, home helps, school meals, swimming baths and other leisure facilities (WILSON, GAME, 1994, p:143). It is important in Britain that, councils are able to set charges for any type of local service except education. As a result, 25% of the current spending are being met by the income derived from charges.

In the nineteenth century in Britain, local authorities were able to raise funds by charging for services such as water, electricity, gas, roads, public transport and so on. This ended in the era of municipal socialism; and in the post-war decades of the social democratic consensus, the idea of free access became a cornerstone of the welfare state (KINGDOM, 1988, p:177). In these periods, people were seen as citizens with rights to services regardless of their ability to pay. So, through this view, charges were never being used as efficient income raising instruments until the economic crises of late 1970s.

However, the era of Thatcherism questioned this view. According to the discussions of this era, if a service is offered below cost, a subsidy is required from some other source and total public expenditure rises. Consequently, a government wishing to limit public expenditure will be concerned and the Thatcher government argued for a great expansion in local charging.

The result of this policy was firstly seen in the Transport Act of 1985, which requires all local authority transport services to be self-financing and hence receive no subsidies from the general accounts of the local authority. Local transport undertakings must, therefore, pay their own way from charges direct to the public (CHANDLER, 1988, p:69).

Through a similar policy, the Housing Act of 1989 gave central government powers to increase the number of services for which charges could be made. Housing accounts, today, must be maintained separately from the general revenues accounts of the local authority and cannot receive subsidies from the rates or council tax. The act followed a gradual reduction in the considerable subsidy given as part of the block grant to housing which consequently increased rents for council houses. This policy not only fitted in with Conservative aims to decrease rates, but also with their privatization policy, since the higher council house rents the more sensible it becomes for tenants to buy their homes.

On the other hand, the New Urban Left movement (the movement of the local authorities that are governed by Labor Party), resisted the central pressures to raise the charges. They searched for means to finance their services without making an increase in charges. But such type of resistance only resulted in more conflicts with center, and in the abolishment of many functions of the local authorities by the center.

A4.2.2.2.b Government Grants

Grants are the money transfers from the central government to the local, in order to stimulate the development of new, or under-provided services and to improve provision in the poorer areas of the country.

Grants can be defined in two main categories: Block Grants and Specific Grants, consequently for the purposes of compensation and persuasion. Block grants are unconditional grants to be used to fund capital expenditure on any local authority's any service or any project. They are transferred from the central to the local government to compensate the economical deficits in providing local services. Specific grants on the other hand, are conditional grants to be used for specific spending that are determined by the center. The persuasion motive in

this type of grants is a straightforward wish by central government to influence or control some aspects of local council spending (WILSON, GAME, 1994, p:145).

Grants have been existing since the nineteenth century, for specific purposes, but they were never a major source of funding, as local government was expected to raise the bulk of its resources from its community. But, in the post-war periods, central government was much more sensitive to the local urban problems and social lives of the citizens, so grants were largely provided for specific functions by individual departments of state.

The separated chaotic pattern of grants was brought to an end by the 1958 Local Government Act that consolidated separate grants for education, fire services, health and welfare into a single general grant to be disbursed between local services (CHANDLER, 1991, p:65). This single general grant that was firstly given the name of Rate Support Grant (RSG), aimed to increase local autonomy by breaking the dependence of each service on an individual government department. It also simplified the complex system, and gave the government much firmer means of controlling the overall expenditure of local authorities (CHANDLER, 1991, p:66).

The determination of RSG and its allocation was based on a list of criteria representing the needs and resources of a local authority. The formulation included demographic factors, its geographical distribution and socio-economic factors. A very important additional element of this formula ensured that those local authorities that set higher rates (local tax) were considered to need a higher grant.

However, the nature of this grant was largely changed with the Local Government Planning and Land Act of 1980. The first step of formulation starts with the government's determination of the money in total that local authorities will be permitted to spend: The Total Standard Spending. The government then turns its attention from the aggregate to the individual authority level. It produces an assessment of what it feels each authority needs to spend in order to provide what it defines as a "standard level of service" (WILSON, GAME, 1994, p:146). This assessment is the Standard Spending Assessment (SSA). The government bases its calculations on a limited range of indicators, such as the total residential population of the council area, the number of people aged over 65 living alone, the number of school children aged 5-10. From the council's total SSA, two deductions are made: First for the total income the government estimates the

authority should receive, were it to set its council tax (local tax) at a specified standard level - the Council Tax at Standard Spending (CTSS); and secondly, for the income it will receive from the government-set National Non-Domestic Rate (NNDR). As a result, the Rate Support Grant which took the name of Revenue Supporting Grant today, is calculated according to the following formula:

$$\text{RSG} = \text{SSA} - (\text{CTSS} + \text{NNDR})$$

One very important difference from the previous implementations is that, the local authorities which set higher rates are no longer considered to need more grants; but punished because of high levels of expenditure; and their RSG is cut off.

A4.2.2.2.c National Non-Domestic Rate

The NNDR is a newly arranged at 1990, to be administered and managed by the central government. Central government sets each year a standard or uniform rate poundage for all non-domestic properties (offices, factories, etc.) in Britain. The revenue is gathered in a national fund and redistributed back to the councils in proportion to their populations.

Before 1990, NNDR has been included in the local tax RATE, so non-domestic properties were also paying their taxes to the local councils. But after 1990, the responsibility of collecting NNDR was taken away from local authorities. It should be mentioned at this point that, after being a national tax, non-domestic property tax came out to be a more efficient tax which can be justified by the figures given in part 3.3.2 of the study. In 1989/90 the non-domestic rates had provided over a quarter of local government current income: more than that from domestic rates. Therefore, the proportion of their income controlled by local councils fell from over a half to barely a quarter.

A4.2.2.2.d Local Taxation

The local governments in Britain are able to set only a single local tax. Local taxation in Britain has a very long lasting past. The earliest local tax in Britain is a domestic property tax called **Rates**.

was "benefit". The rate payers were only the ones who derive benefit from a service. The second indicator of the tax was the "rate". The rate payers pay according to the extend they derive benefit from a service. Later on through

implementation, "ability to pay" came out to be another important criterion for Rates.

But, in the twentieth century, the criteria of benefit, ability to pay or rate were no more valid determinants. Rates were being paid by every property owner in cities.

An important determinant was added to the implementation principal of the Rates with the General Rate Act in 1967. The act enabled local authorities to raise revenue through this tax on property, provided that they can justify in terms of expenditure the sum they wish to obtain. So, the local government firstly makes its budget, and determines how much it will expend for that year. Then it decides how much of that expenditure will be met by the Rate revenues. The amount needed from the Rates is then divided by the total ratable value of all the property in the area, and the amount that each property owner will pay is found out.

On the other hand, the ability to increase the rate levels was conflicting with the electoral efforts of the local governors. However, in 1960s, rapid expansion in local authority services was accompanied by major increases in government support, and two-thirds of local revenue was received as grants. The shift from local taxation to grants as the major source of local funds had clear advantages for local councilors concerned about the adverse electoral consequences of raising the rates (CHANDLER, 1988, p:116)

With the economical crises of 1970s, inflation increased the level of finance of urban expenditures. So, besides the grants received from center, local means of raising funds gained importance. The rate levels were increased to high levels, and for this reason the considerable disadvantages of the Rate system increased and came out to be an important concern of local economy and politics. The Rates were accused of being:

Regressive and unfair (taking a larger proportion of the income of the poor than the rich)

A disincentive to property improvement

Lacking buoyancy (unable to rise automatically with inflation)

Insufficient in yield

Highly visible, therefore unpopular

As a result of these arguments, in 1974 there existed attempts to reform Rates. A suggestion of Local Income Tax (known as LIT) appeared, but it was not agreed

to be implemented, and the Rates system continued in spite of all the bottlenecks.

When the Conservatives came into Government in 1979, still Rating abolition was a current concern of public economy, but economical reforms gave priority to grant reforms, as mentioned in the previous parts. In order to limit local expenditures, grant system was rearranged, and the fiscal opportunities of councils decreased at great extent. As a result, the councils' choice was to raise their fund through rate level increases, and in early 1980s, rates began to rise by almost 30%.

Consequently, in 1983, central government introduced a system called Rate Capping to take the excessive and irresponsible rate increases of high-spending councils. The Conservative Government determined a standard level of Rate revenue for each council, and if this revenue is increased by setting higher rates, this increment is taken by the center.

The rate capping system and the consequences of the grant reforms led to increasing conflicts between the two levels of governments, central and local, and in 1990, a total reform was made on Rates. Rates were abolished, and **Community Tax or Poll Tax was established as the only local tax.**

Community Charge was a tax to be paid by all adults aged 18 and over, at a level to be set by individual local authorities. Everyone who was registered to use his right of vote was responsible of the tax. The tax was a flat-rate payment, which means that every single payer will pay the same amount regardless of income, or any other socio-economic indicator.

The system of Community Charge came out to be a whole disaster. Local councils had to employ more than 15,000 additional staff to administer the tax. After the first year of the community charge, one billion pounds out of a total of 12 billion pounds remained uncollected. Nearly four million people received court summonses for non-payment. More than a million potential voters have "disappeared" from the electoral register since the introduction of the community charge. The chargepayers were being required to pay additional amounts to compensate the others' non-payment. As a result, the new system gained a great amount of public reaction. Over 1,000 local anti-poll tax unions had been formed, the largest with up to 500 members (WILSON, GAME, 1994, p.178).

In 1993, the system of community charge had to be changed and it was replaced with a new system of local taxation called the Council Tax. This is a tax on domestic property, not people, but includes a personal element. There is one bill per household. Like the previous systems of local taxation, each local government can set its level of Council tax according to its expected spending. But, just like the previous systems, central government performs the same implementation of Council Tax Capping. There are discounts relating to the numbers and types of people occupying the property: 25% discounts for all single householders, 50% discounts for those under 18, full-time students, the severely mentally impaired, and some careers for disabled people. Up to 100% discounts can be applied for tax-payers on low incomes.

A5. LOCAL BUDGET

Through the perspectives given in the previous parts of financial instruments, the nature of local budget will be examined in two dimensions: the process of formation of a local budget under the considerable central constraints; and the actual figures of the local budget in Britain through a historical perspective of 20 years.

A5.1 Process In Local Budgeting

Under the central limitations on the use of fiscal instruments, British local governments face a great amount of discretion in forming their own budget.

The general scene of the formation of a budget is as follows:

The annual spending of the local council is determined by the central government.

The maximum level of local taxation of the local council is determined by the central government.

The amount of grant to compensate the deficit between the annual spending and the local tax revenue, is determined by the central government.

If the local council increases its local tax levels, the revenue increment it derives, is taken by the central government.

If the local council finds a different source of money, such as international funds or aid programmes, the central government cuts the amount of the grant to be given to the local council.

As a result, when the local authorities make their annual action programs and budgets, they do not know the amount of money that they will have in that year. They find the solution in making several different action programs and different budgets, and apply one of them according to the actualized figures of their finance which is determined by the central government.

A5.2 Local Budgeting In Figures

When the local budget is viewed through a historical perspective of 20 years, the most significant point is the movements of grants versing local tax.

It should be reminded that, until 1970s, the economical crises led to increases in local taxation, but after 1970s, this increase had to be controlled by the central government. So until 1980s, governmental grants are increased. But after 1980, with the policies of public expenditure cuts, governmental grants have been limited, so the local councils again find the solution in increasing local taxes. As a reaction, the central government used the tax-capping system, and therefore limited the use of local taxes. So, by 1990s, local tax revenue levels face a serious decrease. For this last period, this decrease is also realized for the governmental grants.

Fiscal Tools	1973 (%)	1978 (%)	1983 (%)	1990 (%)	1993 (%)
Government grants	48.8	52	51	51	31
Local tax	32.4	29.5	34.3	25	15
Other	18.8	18.5	14.7	24	54
Total	100	100	100	100	100

TABLE 7: The share of fiscal tools in local budget (The data is supplied from HAMPTON, 1987, p:94, and from WILSON, GAME, 1994, p:136)

The decrease that is seen in the governmental grants in the above table, is mainly due to the policies to a more strict control on local councils. For the fulfillment of this policy, Service Specific Grants have gained validity in finance of local councils, because these grants are more available for influencing the councils to take actions that the center approve. Besides, non-domestic rates as a central income instrument also gained a great part in the local councils' finance, as it increases the dependency on central government. In **FIGURE-1**, on the next page, the net expenditures of local authorities between 1975 and 1993 are given with reference to how these expenditures are financed. (WILSON, GAME, 1994, p:161) (see Appendix 1)

A6. LOCAL FINANCE VERSUS CENTRAL LIMITATIONS : FINANCIAL SOLUTIONS INTRODUCED BY LOCAL GOVERNMENTS

In this part of the study, the reactions of local governments towards the central limitations will be examined. Especially, in the recent decade, local governments exercised many different means to overcome their fiscal inability. Besides the experienced ways of surviving, there are also some solution suggestions that are believed to make local finance better off.

A6.1 Recent Experiences To Overcome The Fiscal Problems

The experiences to handle with fiscal inadequacies, generally tend to improve the productivity of infrastructure investments and operations which cause the major fiscal problems in local budgets.

A6.1.1 Pricing Policies

Pricing policies are the most common measures designed to improve public sector cash-flow, with charging and taxation policies, and also including inflation-adjusted financing instruments such as indexed bonds.

Indexed bonds would go a long way in assisting public authorities where the inflationary component of nominal interest rates creates a "front-end" financing gap; but as inflation declines, the scope for alleviating the burden of servicing debt in the early years of investment equivalently diminishes (KIRWAN, 1989,

p:288). But in Britain as the borrowing conditions are also determined by the central government, this instrument of financing infrastructure loses its effectiveness.

Where infrastructure is normally priced, there is often scope for effectively increasing the cash-flow of the public authorities by revised pricing policies. For example cross-subsidization between old and new investments have been a common operation in all locally fiscally restricted governments: The first-year return on new investment is substantially below the cost of financing, the difference being made up from surpluses earned over the costs of servicing historic debts.

Where infrastructure is not normally priced, for example in the case of highways or open spaces, one reaction on the part of public authorities has been to look for opportunities to introduce prices-user charges. The example is tolls for highways, or for critical links such as bridges and tunnels, or charges as entry or parking fees in recreational areas. But on the other hand, as the central government in Britain sets limits on the operation of charges and user fees, this instrument of money raising is not considered to be valid.

A6.1.2 Private Sector Capital Contributions

Private contribution is an important response to the difficulty of financing infrastructure. The contribution can be "in kind", meaning that the private entrepreneur himself makes an amount of the infrastructure; and "in cash", meaning that the private entrepreneur invests a certain amount of his money.

Contributions in kind have a long history by private developers to public infrastructure needs. In United Kingdom, it is a standard practice for developers to construct local roads and provide local reticulation of water and sewerage in the larger urban developments (KIRWAN, 1989, p:291). The motivation is the overall return on the developer's investment, which is usually the developed land, new housing units, etc.

The other form of contribution is in cash where the entrepreneur finances the public investment. The motivation is again allocation of some land or dwellings in the proportion of his contribution.

After 1980s, this method of financing investments by private contribution of both types became so common that, central obligations came out. In 1983, official guidelines were established, indicating that "planning gain (private contribution) is justifiable if and only if the contribution is necessary to enable development to go ahead".(KIRWAN, 1989, p:293) As a result of this guideline, the private contribution agreements came out to be an element in a managerial approach to land-use planning, rather than being a response to fiscal crisis.

A6.1.3 Private Sector Direct Capital Participation : Joint Part

The method is to attract the private finance into the provision of public infrastructure, implying the transfer of infrastructure out of public ownership and control. This method can take the form of publicly established corporation; or full private financing and construction of infrastructure in return for the right to associated revenues; or asset reverting to public ownership and control after a pre-determined period.

Joint participation is a valid way of overcoming the fiscal local crisis, because this method is highly encouraged by the central government. The local councils who do not resist the central policies of privatization aim to experience this model of finance. But, joint participation raises difficult issues about how far the public authorities should be prepared to go in their desire to attract private capital, and how to weigh the demands of developers against the public interest (KIRWAN, 1989, p:298).

A6.1.4 Interest Swapping

As the local authorities in Britain, have no legal obligation to repay their dept., they leave the interests and moreover the dept. to be paid by the central government. This unlawful method leads to create more conflicts and tensions between the local government and the central government.

A6.2 Recent Solutions Suggestion Suggestions To Overcome The Local Fiscal Problems

There have also been some suggestions from academic studies for the bottleneck of local authorities' fiscal opportunities. These solutions generally cover a range of restructuring taxation and charging policies.

A6.2.1 Transferable Rate Entitlements

The proposal is directed to city water management. There is a baseline usage volume allotted for each month for every user. For the water consumed up to this base amount, the user pays additional charges for each additional unit. But, if the user consumes below that baseline, he is received credits. As a reward of water conservation, the user receives a credit for each conserved unit. Unused credits can be carried over to future bills; or can be diverted to cash. In the latter method, water management takes the form of market economy, because the overusing ones can buy the extra credits of the conserving users.

The proposal has the potential to generate efficient allocation of existing water supplies without need for any conservation mandates, equity in revenue incidence, technological efficiency achieved in conjunction with privatization and deregulation, and an approximately efficient source of municipal revenues (COLLINGE, 1994, p:62).

A6.2.2 Charging And Taxing With Linkage

There are proposals that taxation should be made on the principal of benefit. One sort of this taxation method is the establishment of a nexus between the tax payers and the development on which they are to be levied. For the maximum relation of tax payment and beneficiaries, there also should be a time limit on the expenditures that will be financed by the taxes. So the expenditures will be localized, and the affected tax payers will derive benefit as soon as possible.

Another proposal on the taxation policies, is to establish a tax that levies fees from new developments, particularly office and commercial development, within existing built-up areas, especially the CBD, to finance socially necessary capital works such as public transport or low-income housing. But the system is not commonly agreed on, because the nexus between large-scale CBD office and hotel development and the need for low-income housing or even for improvements to the public transport system is not so easy to demonstrate (KIRWAN, 1989, p:296).

At this point it should be reminded that, any restructuring concerning taxation policies is limited with the British legal frame that there can exist *only one local tax in Britain*. So the proposals towards taxation policies are not spontaneous and short-term fiscal solutions, but require a wide range local fiscal reformation.

A6.3 Evaluation Of The Recent Experiences

The fiscal opportunities and the recent fiscal experiences shaped the fiscal behaviors and investments of British local governments. In urban planning practice, the main principal came out to be a search for the ways of reducing the base need or demand for infrastructure. It is a common practice to apply urban policies to discourage urban sprawl. Because, urban sprawl leads to expensive additional lengths of highway and water or sewerage pipework. Besides, new settlements attract the already settled citizens. The loss of population in already built-up areas of cities is not a desirable result. So the urban policies in general are designed to raise or maintain or limit the decline of residential densities in already developed areas.

Another important effect of fiscal opportunities experienced by local councils, on urban management is the changing project management models. There are basically two types of fiscal structures in project management: Where public infrastructure generates a specific revenue stream; and where the development (or redevelopment) and sale or leasing of land will generate an income for the project. In the first case, the fiscal model limits the involvement of private capital to such investments as highways or bridges, or facilities where user-charges are well established, such as water supply. But in the case of land development, joint participation is in most instances based on private provision of finance and public provision of land. So, it is quite possible for the public sector effectively to obtain private finance for a range of public facilities, whether or not these are revenue-generating. In order to overcome the fiscal crisis, this latter form of project management model has become a very common practice in British local governments.

B1. SYSTEM OF GOVERNANCE AND FISCAL SETUP

America's most distinctive political invention is federalism which is a framework in which decisions about the provision and delivery of public goods and services are made. In federalism, the system of authority is constitutionally assigned between the central and regional governments. Therefore, it is mostly preferable in big countries having multi-nationality problem as in the case of United States.

In the American system, the central or national government is called the "federal government"; the regional governments are called the "states" and they have their own local governments. States and local governments are held increasingly responsible as centers of service delivery and policy generation. In the census of 1985, more than 82,000 separate governmental units were existing in which nearly 500,000 elected officials worked with more than 13 million appointed officials in performing the state and local responsibilities. (O'TOOLE, 1985,p: 2)

B1.1. Federalism And Intergovernmental Relations

One of the basic answers to the question of "why federalism" in the case of United States is political autonomy. The federal government makes no mention of the local governments, leaving the states entirely free to design their own substate systems. However, unlike in unitary states, American local governments are not legally autonomous. Their authority is carefully defined and their existence can be terminated at any time by the state legislature. Still, American local governments have a substantial degree of operational autonomy which is more meaningful in terms of their activities.

"How the American governments deal with each other, and what their relative roles, responsibilities and levels of influence are and should be" is the subject of intergovernmental relations. American governments at all levels are tied to each other in a very dense set of obligations and dependencies by various fiscal instruments. (O'TOOLE, 1985,p: 2)

The major trends in the American system of governance have been the decentralization of fiscal federalism since 1970s, additional assumption of roles by the states both from the national and local governments, and the increasing complexity of intergovernmental relations. This system of governance basically consists of the following administrative units:

In the 1980s there were approximately 80,000 American governments - one national, 50 state, and the rest local. The latter consisted of several distinct types. *Counties*, about 3,000 units, are general-purpose governments created throughout most of the country to administer state services at the local level. They are real local governments providing a range of local services to their citizens and many of them - especially the larger and more urban ones - are involved in complex intergovernmental relations with other local jurisdictions, states, and the national government.

Municipalities, about 18,000 units, are local governments established to serve people within areas of concentrated population. The nation's largest cities and small villages are all municipalities, although their power and the services they offer may vary considerably. They are created to serve the interests of the local community. They have extensive and highly conflicting relationships with their "parent" states. They - especially the large cities - have also dealt with Washington after the 1960s.

Townships, approximately 17,000, are usually subdivisions of rural counties and are relatively unimportant except in some parts of New England and the mid-Atlantic states.

School districts, about 15,000 in number, are separate governments established in many parts of the country to direct public school systems.

Special districts, 28,588 in a recent count, are limited-purpose governments established to handle one or a few public functions over a specially designated area. They have responsibility for activities such as managing public housing; building and maintaining bridges, tunnels and roads; supplying water and sewerage services to residents; assessing and regulating air quality in a region; and managing the mass transportation needs of a metropolitan. (O'TOOLE, 1985,p: 3)

B1.2. Fiscal Federalism

The concept of *fiscal federalism* is developed by Richard A. Musgrave in 1959. He intended to divide the functions of the government into three in a multi-unit system: (ANTON, 1989,p: 22)

1. Stabilization:

It refers to the control of economic cycles through the use of monetary and fiscal policies. In order to be effective this has to be nationally applicable. Thus, it is a function of the national government.

2. Distribution:

It refers to the provision of resources to the population, with emphasis on those who are unable on their own to achieve a satisfactory level of resources. Also, this function is appropriate for the national government.

3. Allocation:

It refers to the division of national resources between public goods available to all, and private goods available only to those who can afford them. Since governments at all levels produce public goods, they are all involved in the allocation function.

In recent years, there has been great interest in fiscal decentralization. Many developing countries, including Turkey, assume fiscal decentralization as a way of escaping from ineffective and inefficient governance, macroeconomic instability, and inadequate economic growth. On the other hand, the latest "new federalism" in the US has resulted in increased attention to concepts such as fiscal competition and fiscal equalization.

"Fiscal federalism" is said to mean whatever the person using the term intends to mean. However, broadly, there are two main approaches to be considered: (BIRD, 1993,p: 208)

1. Decentralization is viewed from the top down. For example, the stimulus may be to make the life of the central government easier by shifting deficiencies downward; or the central government may aim at achieving its allocative goals more efficiently by decentralizing authority to local governments. Still, an additional goal may be to increase the level of national welfare. In any case this top-down approach suggests that the main criterion for evaluating fiscal decentralization should be how well it serves the predetermined national policy objectives. The objectives of the local authorities are neglected.

2. Decentralization is viewed from the bottom top. This approach stresses both political values, such as the improved governance in the sense of local responsiveness and political participation, and allocative efficiency. As

opposed to the first approach, efficiency is defined in terms of improving local welfare, not the national one as a whole.

Arising from these two different ways of fiscal decentralization, the first problem in analyzing fiscal decentralization is to determine whether a "good" fiscal decentralization is one which better achieves the goals of the central government (or improves national welfare as a whole); or one which frees local governments most from central dictates (or improves local welfare most).

Decentralization may have many capabilities such as improving accessibility, local responsibility, and the effectiveness of the government. But it is not likely to produce exactly the expenditure pattern the central government would like to implement except the extremely rare case in which the local and the central governments' aims are exactly the same. In a heterogeneous society, it is not possible for the central government to decentralize decision-making to local governments and have the same decisions made. (BIRD, 1993,p: 209)

In fiscal federalism, everything - jurisdictional boundaries, assignments, the level and nature of transfers, etc. - is under the control of the federal government. Moreover, the federal government's policy preferences are clearly dominant. Accordingly, the federal government has the right to alter the jurisdictional boundaries, local government revenue and expenditure responsibilities, and intergovernmental fiscal arrangements to overcome the problem of asymmetry and differing objectives between itself and the local government. In other words, the role played by the local governments is assessed by the central government because of administrative efficiency or political choice to utilize the local governments as taxing, and especially spending agents. This is the so-called relationship between the principal and its agents. (BIRD, 1993,p: 209)

Economic analysis and democratic theory provide a strong rationale for the local governments which are responsive to the wishes of their citizens, instead of being simply the instruments of central planners. There are different preferences for public services: some would prefer good schools, whereas some others would prefer good roads. And many services are consumed in a spatially different manner. Following from these facts, the most efficient allocation of public sector resources can be secured only if provided and paid for by governments responsible to those most directly affected.

However, there are some other political and economical considerations which suggest some negative points for the existence of local governments. For

example, the existence of benefit and cost "spillovers" from one administration to another suggests that larger governmental units are needed to internalize such externalities. Moreover, the unit cost of collecting revenues from most tax sources is less for national governments rather than for local governments.

There are also other dangers in permitting local governments even limited freedom. For example, they may not utilize fully all the revenues available and therefore allow the level and quality of public services to deteriorate below the standard. (BIRD, 1993,p: 211) But according to the supporters of fiscal federalism, this is not a real problem: If the service provided under the standards is of national importance, it should be nationally funded at least in part and its achievement monitored. If it is not a matter of national interest, then why should the national government be concerned? If the local electors do not like what their local government does, then they have the right to change them in the next election.

Another danger is that, local governments may attempt to obtain revenues from sources which they are not accountable. "Tax exporting" like benefit spillovers, generally requires central intervention if local governments are to operate efficiently. It is often desirable to limit local government access to taxes that may be attributed to mainly non-residents, such as most natural resource levies, preretail stage sales taxes, and to some extent non-residential real property taxes.

However, it should not be forgotten that, as long as there are local variations in tastes and costs, there are clearly efficiency gains from carrying out public sector activities as decentralized as possible. The only services that should be provided centrally are those for which there are no differences in demands in different localities and where there are substantial spillovers between administrations that cannot be handled in some other way; or for which the additional costs of local administration are higher to overcome its advantages. On the other hand, the cost of political decision-making in terms of the non-satisfaction of preferences rises as the population covered expands. (BIRD, 1993,p: 210)

B2. HISTORICAL EVOLUTION OF THE FISCAL POLICIES AND PROGRAMS

B2.1. Pre-Nixon Era

Until World War I, the federal government was able to finance its limited activities such as defense, foreign affairs, postal service, and pension programs with limited sources of revenue: customs duties, the sale of public lands, and excise taxes. The more extensive education and other services provided by state and local governments were funded largely from property taxes, sometimes supplemented by the sale of public lands. Neither national nor state and local tax levels were particularly heavy, amounting to 5% or less of the gross national product (GNP) until the second decade of the 20th century.

A fundamental change occurred when first a world war, then a major economic depression, then another world war brought great amounts of new expenditures and consequently extensive use of new taxing authority. The little used income tax was increased to fund World War I and quickly became the major source of national government revenue. The national government further increased the income tax in the 1930s due to the economic depression. This quadrupled the national government's share of the GNP. Because of the same economic difficulties, local governments drastically reduced their reliance on property taxes which had become a local tax by the end of the 1930s, replacing them with general sales and excise taxes. (ANTON, 1989,p: 133)

World War II resulted in an increase of the income tax burden to pay for the war at the national level, while restraining state and local spending for less essential goods and services. (ANTON, 1989,p: 134) By the early 1950s, President Eisenhower government channeled capital to finance construction of housing, schools and highways due to the post-war boom in babies and automobiles. Shocked by Sputnik of the Russians, the government then gave money to schools to enrich their instructional programs.

This government's attempt to make a clear separation between state and federal functions and revenue sources made little progress. It was during the Eisenhower administration that national activism became significant due to the wealth earned at the end of World War II. This national activism included new programs of construction, social assistance, and education together with the largest public works project of the 20th century: the 1956 Interstate Highway

Program. Later administrations, both Democrat and Republican, built on these social security benefits by adding social service programs and expanding social security benefits, leading to very large increase in federal spending and taxing that took place during the 1970s.

State and local officials had largely abandoned the property tax in favor of sales tax during the 1930s. Particularly after 1950, they had to establish other revenue sources, for the new construction and service programs. So, an increase was made in revenues raised from state personal and corporate income taxes. The most remarkable result, however, was the very rapid increase in the federal aid to state and local governments. Federal sources became the largest single source of state and local revenue during the 1970s, surpassing sales, property, and income taxes. This led to a greater fiscal centralization and greater financial interdependence among all American governments. (ANTON, 1989,p: 134)

B2.2. The Era from Nixon to Reagan

"Since taking office, one of my first priorities has been to repair the machinery of government and to bring an end to this chronic failure to deliver the services it promises" (CONLAN,1988,p:1)

"Government is not the solution to our problem; government is the problem" (CONLAN, 1988,p:1)

Before 1930's, the responsibility for most public services and spending rested with state and local governments. Then 1960's, the intergovernmental system began to evolve at an accelerated pace.

One leader sought more effective and efficient government, the other a reduction of governmental initiative at every level. Both prescribed

intergovernmental changes to address what they perceived as fundamental questions about the government's role in the society.

New Federalism were the responses to perceived policy failures of the past; both of the leaders, thus, advanced decentralization as a goal for responding to these failures. Both shared certain instruments of reform such as block grants, but the were remarkably different in their policy objectives, philosophical assumptions, political coalitions and policy outcomes.

In the brief period from Nixon to Reagan, the primary objective of policymakers moved from rationalizing and decentralizing an activist government to rolling back the modern welfare state itself.

The Nixon years were characterized by a degree of political fragmentation which was unusual even by American standards. In contrast, the Reagan administration has generated a far more interdependent policymaking process.

Nixon's new federalism sought to rationalize the intergovernmental system by restructuring the roles and responsibilities at all levels.

1- He designed an array of management reforms

2- He proposed a series of block grants that were to consolidate individual federal aid programs into comprehensive grants

3- He suggested an expansion upon the block grant principle of flexibility with general revenue sharing. That is, the revenue sharing sought to use the dynamic and progressive federal income tax to increase overall levels of public sector spending by providing larger grants to the most active states and localities with the greatest needs.

4- Nixon endeavored to nationalize public sector responsibilities in those areas which the federal government was deemed to be more efficient

Nixon administration supported fiscal and regulatory policies that substantially increased the size and influence of the federal government, the Reagan's nondefense policies have reduced the federal government's fiscal profile and sharply circumscribed its role in a variety of domestic functions.

At philosophical level, although Nixon and Reagan shared a belief that the federal government had grown too large and influential and that local decisionmaking is generally preferable to national, they differed fundamentally in their beliefs about desirable ends of decentralization and the role of the public sector.

Nixon was deeply suspicious of federal bureaucracy and the national policy making system. He viewed his federalism as a means of improving and strengthening government. Programs like revenue sharing and block grants were designed to reward and promote governmental activism

Reagan in contrast has viewed new federalism as a part of broader strategy to reduce the role of government in society at every level. He said in one of his speech: "We need relief from the oppression of big government" (CONLAN,1988,p:12). He argued that a reduced role for the federal government would by itself mean an enhanced role for state and local government.

Nixon was an activist conservative with an idea of energetic government. His principal concern was how this governmental energy should be channeled and where the wellsprings of activism should reside. He evaluated decentralization as a key to action.

In sharp contrast, Ronald Reagan has been far more skeptical about domestic governmental activism. He believed that he should leave to private initiative all the functions that individuals can perform privately. He simply rejected Nixon's managerial approach to federalism.

However, Nixon left behind a system of massive intergovernmental interdependence and institutionalized higher levels of federal fiscal and regulatory dominance. The emerging system of decentralized fiscal federalism relies on shared fiscal, service delivery and policy making responsibilities among states and their local governments.

The highly rationalized approach of the Nixon administration was incapable of generating sufficient passion and commitment to gain enactment. The strongly ideological agenda of Reagan administration was passionately advocated but only a minority of Americans support its stance against welfare state. By this way federalism provided for multiple arenas of collective decision making and preserved local diversity within a framework of nationally shared values.

Traditionally, public policies have been interpreted as governmental responses to outside pressures and demands. Managerial reforms, one of these public policies, consisted primarily of grant simplification. The Nixon administration built upon and expanded this framework of managerial efforts.

Nixon sought to simplify and standardize federal grant applications and program administration through the Federal Assistance Review process(CONLAN,1988,p:22). He helped enact the Joint Funding Simplification Act of 1974 which allowed state and local governments to combine and expedite applications for several related federal programs of assistance (CONLAN,1988,p:27).The block grants he proposed, entailed the

legislative consolidation of numerous overlapping programs under a few large grants. He endorsed block grants as a means of remedying the confusion, arbitrariness and rigidity of the present system.

Nixon altered his grant reform strategy in January 1971 with his sweeping proposal for six highly decentralized special revenue sharing block grants(CONLAN,1988,p:27).

General revenue sharing was proposed as a replacement of or supplement to existing categorical grants. Revenue sharing was to provide a source of virtually unrestricted federal funds to state and local governments, to be spent in almost any manner deemed appropriate. As 1950's and 60's general revenue sharing received growing support in political parties.

Nixon's first revenue sharing bill proposed that 1% of personal taxable income be allocated to state and local governments. Grants were to be distributed to states partly on the basis of tax effort.

After Nixon left office, in the remainder of the 1970 s, no additional block grants were established and few were proposed. Instead, the Congress proceeded to recategorize and recentralize the existing ones. For example, between years 1975-77, the block grant portion of CETA Program was reduced to 23% from 42%(CONLAN,1988,p:95).

The Advisory Commission on Intergovernmental Relations concluded in 1980 that the federal system had not been reformed during 70's and had become even more unbalanced and in need of restructuring than ever before(CONLAN,1988,p:97). Reagan pointed out the demand to recognize the distinction between the powers granted to federal government and those reserved to the states or to the people. To accomplish the goal, Reagan set forth a sweeping agenda of budget reductions, tax cuts, personnel freezes and block grants. Unlike Nixon who hoped to rationalize active government, Reagan has tried on the whole to restrain domestic government.

President Carter stopped the expansion of the federal aid to state and local governments in 1978 (CONLAN,1988,p:134). Then Reagan succeeded him in 1981. In this year, large reductions were made in many of the social assistance programs. In addition, 57 previously separate programs were combined into 9 block grants, giving the states more discretion in the use of the reduced funds (CONLAN,1988,p:135). Unfortunately, for state and local governments, these reductions took place at the time of the severe recession

of 1981-1983 which had already reduced state and local revenues. On August 13, 1981 Reagan signed the Economic Recovery Tax Act (ERTA) (CONLAN, 1988, p:135). The individual tax reductions were the political core of the tax reform plan. Income taxes were cut by 25%, business taxes were reduced an additional 50 billion dollars, federal spending for domestic programs was reduced by 325 billion dollars (CONLAN, 1988, p:98). However, these tax cuts lacked sufficient support in the Congress. The Tax Reform Act of 1986 (TRA) will be remembered as the most important tax legacy of Reagan administration. This enabled the president to lower top marginal rates (CONLAN, 1988, p:136).

B2.3. Late 1980s And The Clinton Era

1980s were characterized by the increasing role of the states and the national deficiency. The national deficit decreased the ability of all governments to create jobs and overcome the negative effects of deindustrialization. Whereas productivity increased, the need for labor has decreased. This condition has affected the transformation of the metropolitan areas where 80% of all Americans live and work. Clinton administration began to make plans to both reduce this deficiency and boost the economy.

Another problem is the income inequalities across the governments. In 1990, the top one-fifth accounted to more than 4 fifths in terms of wealth. The rich make their own self-sufficient communities and the disparities widen.

Thirdly, the interjurisdictional competition for population, investment, external aid, etc. have threatened the revenue base of many jurisdictions and redistributed wealth within regions causing equity and efficiency problems. State and local debt levels increased substantially through 1987. Poorer states possessed a higher debt burden than richer ones. (CIGLER, 1993, p: 182)

Due these debts, states continued to reorganize their structures and improve their management capabilities. However, in 1991 many states suffered from budget cuts partly due to the Persian Gulf War. And the budget worsened even more in 1992 due to the national recession.

Many states suffer from the fact that, expenditures to maintain the current services is rising faster than revenue from the existing tax system. The fastest growing state spending is for education, health, and correction. The school reform movement has been exerting great pressure for more spending on

education which is already consuming about half of the general fund expenditures in the states.

Whereas Medicaid accounted to less than 5% of state budgets in 1970, in 1990 its share became 14%, and in 1991 22%. Most states have, therefore, applied for changes in their medical assistance systems that would shift more of the fiscal burden to the national government.

The costs of corrections and public education are increased by judicial obligations. The federal courts have urged the states to make large expenditures for prison construction. This is due to the great increase in the prison population which became 1,000,000 rising from 300,000 through the 1980s. Consequently, spending on corrections became the fastest growing area of state spending for most of the 1980s. (CIGLER, 1993,p: 183)

In 1991 and 1992, many states had to make major budget cuts together with considerable tax increases to restore balance. These recent tax increases were the largest since 1971 making state tax revenue a higher proportion of personal income tax than ever before. The slow national economic expansion that began in the second half of 1992 has had a positive effect on state budgets. Most states have met or exceeded the revenue objectives they set. However, the recovery is uneven across the regions. Whereas the increase in revenues is 8% in the south east and south west; it is 3.2% in the west. (CIGLER, 1993,p: 182)

B3.4. Forecasts

The slowdown in economic growth in the 1990s make it unlikely for the states to take on additional responsibilities from the national and local governments; or increase aid to local governments. The fiscal situation will also be affected by the demographic, economic and social trends: Between 1990-2010 the population growth will slow down. Suburbs will continue to be the most preferred sites of residence. This will certainly increase the demand for services and expenditure on their infrastructure. Rising school needs will generate fiscal stress for local areas with underdeveloped educational infrastructure. (CIGLER, 1993,p: 182)

The fastest growing age group in the 1990s will be seniors over 75 years old. Young seniors (65-74) will decline in number. This will increase demand for costly long-term health care services.

The "edge" cities in the periphery where the investments took place in the 1980s will be the growth corridors for the decentralized economy in the future. These new metropolitan areas will have major implications for decentralized fiscal federalism. However, the problems of infrastructure, growth management and traffic congestion will increase. (CIGLER, 1993,p: 183)

The status of local governments' with respect to the states and the federal government has been undergoing a period of reidentification. In this process, there will be mainly four areas of reform to shape the fiscal federalism of the 1990s:

1. Capacity building (provision of technical assistance): It aims to increase local governments' managerial and fiscal abilities. The existing tax systems need to be modernized including property tax administration. (CIGLER, 1993,p: 184) States are making attempts to provide more targeted assistance by changing the distribution formulas and the conditions of assistance, as well as better monitoring state grants. Many states also provide financial management technical assistance to local governments. This ensures that when adequate authority is achieved, local governments will have the ability to make use of these powers. (CIGLER, 1993,p: 185)
2. System changing (assumption of functional responsibilities; elimination of local governmental units): Fiscal relationships between the states and local governments are being modified in three ways:
 - a. Relationships among jurisdictions and their revenue bases within a region are altered by annexation or the creation of special districts.
 - b. Tax base sharing is established to overcome destructive interjurisdictional competition.
 - c. Powers among governments are being transferred. For example, in California, poverty related activities and the financing of the courts are undertaken by the state. States are also making it easier for local governments to enter into agreements with each other and with other sectors including partnerships with the private sector.
3. Mandate flexibility (regulations, court orders): One of the greatest reasons for disagreement between the state and local governments are unfounded legislative mandates, such as school finance. The recent improvements in

legislations aim to reduce the negative financial effects of mandates for the localities.

4. Inducements (provision of incentives): States sometimes award greater points in a grant competition to governments that have a "desired" behavior, such as intergovernmental cooperation. (CIGLER, 1993,p: 185)

B3. THE FISCAL INSTRUMENTS OF THE STATES AND THE LOCAL GOVERNMENTS

B3.1 Local Own-Source Revenues

In the United States of America, states and local governments prefer to make investments on capital goods. Examining the period of 1950-1985, significant recession is worth paying attention in 1968-1970. That trend kept valid until 1984.

In 50's, state and local governments financed their capital investments heavily by long term bonds. In 1960's, however, this way of borrowing left behind; alternatively in mid 60's and 70's, federal grants were dominating. In the following 80's, the figure shifted to the previous style where long term bond issues were preferable and federal grants were not significant. (CIGLER, 1993, p: 210)

B3.1.1 User Charges

The first rule of local finance should be "Wherever possible, charge." For efficiency, charges should be levied on the direct recipients of benefits, whether residents, businesses or "things" (real property). Attempting to correct fundamental distributional problems by inefficiently pricing scarce local resources is almost always a bad idea, resulting in little, if any, equity being purchased at a high price in terms of efficiency.

At least three types of local "charge" revenue exist almost anywhere:

1. Service fees: license fees (marriage, business, dog, vehicle) and various small charges levied by local governments for performing specific services. There is the question of whether people should be charged for these specific services as they are required to do so by the laws.

2. Public prices: revenues received by local governments from the sale of private goods and services. In principle, prices of locally (CIGLER, 1993, p:

212) provided services to individuals should be set at the competitive private level with no special tax or subsidy.

3. Specific benefit taxes: unlike the previous two categories, these revenues do not rise from the sale of a specific good or a service to an individual. Taxes represent compulsory contribution to local revenues. Specific benefit taxes relate to the specific benefits supposedly received by the specific taxpayers. They are related in some way to benefits received by the taxpayer.

B3.1.2. Local Taxes

A truly local tax is:

1. Assessed by a local government
2. At rates decided by that government
3. Collected by that government
4. Whose proceeds accrue to that government

In reality, taxes often do not possess all of these characteristics. However, the most important characteristic of a local tax is the freedom of the local government to determine the tax rate. (CIGLER, 1993, p: 215)

Characteristics of a good local tax can be stated as:

1. The tax base should be immobile to allow local authorities some freedom to vary the rates without the tax base vanishing.
2. The tax yield should be adequate to meet local needs.
3. The tax yield should be stable and predictable over time.
4. The tax yield should be perceived to be fair by the taxpayers.
5. The tax should be easy to administer efficiently and effectively.
6. It should not be possible to export much of the tax burden to nonresidents.

7. The tax base should be visible to ensure accountability.

Both levels of government may agree on the first five; but only the central government is likely to be concerned about the last two.

Unless local governments have some degree of freedom to alter the level and composition of revenues, neither "local autonomy" nor local accountability is a meaningful concept. Rate flexibility is essential if a tax is to be adequately responsive to local needs and decisions. The purpose of local taxes is to finance locally provided collective public goods for local residents.

B3.1.2.a Local Income Taxes

The principle alternative or supplement of property taxes is some form of local income tax. If a country wants its local governments to be both large spenders and less dependent on grants, it must provide them with access to the personal income tax, in the form of locally established surcharges (taxes) on the national income tax. It is a visible tax as well. (ANTON, 1989, p: 216)

The principle argument against local income taxation is administrative. Local income taxes are the most promising source of local finance.

A fundamental change occurred when first a world war, then a major economic depression, then another world war brought massive new expenditures and extensive use of new taxing authority. The little used income tax was increased to fund World War I and quickly became the major source of national government revenue. The national government increased the income tax in the 1930s due to the economic depression. This quadrupled the national government's share of the GNP. (ANTON, 1989, p:132)

World War II enlarged the income tax to pay for the war at the national level, while restraining state and local spending for less essential goods and services. (ANTON, 1989, p:134)

B3.1.2.b. Sales Tax

State and local officials had largely abandoned the property tax in favor of sales tax during the 1930s. Particularly after 1950, they had to establish other revenue sources, for the new construction and service programs. So, an increase was made in revenues raised from state personnel and corporate income taxes. The most remarkable result, however, was the very rapid escalation in the federal aid to state and local governments. Federal sources

became the largest single source of state and local revenue during the 1970s, surpassing sales, property, and income taxes. By 1979, federal aid as a proportion of (ANTON, 1989, p:135) source revenues amounted to more than 36% for state governments and 17.6% for local governments, although federal aid to hard-pressed big cities often amounted to 1/5 of source revenues.

Increases in national assistance to states and localities allowed those jurisdictions to increase their services without proportionate increases in state and local taxes. Although this had the positive effect of shifting much of the state-local tax burden to the generally more progressive national income tax base, there were other consequences that were less positive. One was greater financial centralization, both national and state. As the national government assumed the role of banker for state and local programs, Washington's influence over those programs increased more and more.

In response to demands from local officials, states replaced the property tax with increases in income and sales taxes that grew rapidly with inflation and could better meet demands for education and social services. By 1986, "state funding of local schools surpassed 50% of their revenues for the first time in history". Finally and somewhat ironically, the tax-revolt of the 1970s added a further push towards state centralization by removing discretion from the local officials who controlled the property tax in favor of the state politicians who controlled the larger and more elastic sources of revenue.

With this growing centralization, the local governments became more dependent on external funds. The Local Government Dependency Index rose from \$0.44 in 1962 to \$0.73 in 1975 and to \$0.79 in 1980, i.e., for every \$ of revenue raised by local governments themselves, state and national aid contributed 79 cents. While still the major local source of local revenue, the property tax has been the casualty of the recent trend towards fiscal centralization. (ANTON, 1989, p:137)

The severe recession of 1981-83 which had already reduced state and local revenues. To sustain their programs, states - which had enacted 54 separate tax reductions during the tax revolt period of 1978-80 - enacted 28 income tax increases and 30 sales tax increases during the 1981-83 recession. As the economy improved in 1984 and 1985, many states drew back the increases, sometimes even to a level less than that of the pre-recession period. (ANTON, 1989, p:137)

The federal tax code subsidizes state and local governments by allowing interest earned on state and local bonds to be exempt from federal taxation. This reduces the price and improves the marketability of such obligations. State and local governments, in turn, subsidize the federal government by permitting interest earned on federal securities to be exempt from state income tax, by exempting purchases made on military bases from sales tax, and by exempting federal buildings from local property tax. The federal tax code also subsidizes state and local taxpayers by permitting them to deduct state and local taxes in calculating their federal tax obligations. In turn, 16 of the 41 states with income taxes allow federal taxes to be deducted in calculating state tax obligations. American tax systems may be legally separate, but in practice their operations are both interrelated and interdependent.

B3.1.2.c. Local Property Taxes

The property tax is the main source of revenue for local governments in a number of countries, particularly in English-speaking countries, in which it is well-established. Although relatively hard to administer, property tax is quite satisfactory in terms of both efficiency and equity. Moreover, if levied at a local level, it may serve as a good means of financing local public services. Dislike of the property tax seems to arise from its visibility and the difficulty in its administration.

Local taxes on real property are more visible on others for several taxes:

1. Unlike the income tax, the property tax is not deducted at source, but has to be paid directly to the municipality.
2. The inelasticity of the property tax has a similar effect. Since the base of this tax does not necessarily increase automatically over time, the periodic nominal increases in property tax needed to maintain real revenues when price levels rise, require increased tax rates.
3. Local property taxes finance municipal services such as roads, garbage collection, and in some countries education. The quantity and quality of these services is thus (p. 213) linked to the property tax. When there is something going wrong with these services, the taxpayers tend to question the taxes.

There are at least two substantial constraints on the use of property taxes for local finance:

1. It is difficult to administer in a horizontally equitable fashion, particularly when prices are rising rapidly. Heavy reliance on local property tax implies that there will be a dependency on intergovernmental grants to finance their activities.

2. The incidence of "tax exporting" means that some constraints should be placed on local taxation of nonresidential property.

Property taxation has been the basic local source for American local governments since the Colonial period, the 17th century. For 200 years, it has been used as a basic type of tax levied on possessions. After the Civil War, due to administrative difficulties property tax's application area narrowed and it became a decentralized type of tax solely left to local authorities at the same period.

Examining the quantitative features of the property tax in the country, it is evident that the share of the local taxation in total revenues kept drawing back between 1900-1980.

YEARS	THE STATE	THE STATE	LOCAL GOVERNMENT S	LOCAL GOVERNMENT S
	Share in Total Revenues (%)	Share in Total Tax Revenues (%)	Share in Total Revenues (%)	Share in Total Tax Revenues (%)
1902	43.2	52.6	73.1	88.6
1927	18.4	23.0	73.9	97.3
1932	13.5	17.4	73.1	97.3
1942	5.1	6.8	60.0	92.4
1952	2.8	3.8	48.9	87.5
1961	2.2	3.3	48.4	87.7

1973	-	-	40.5	82.3
1979	-	2.0	30.5	78.4

As it can be seen in the above table, the share of property taxes in state total revenues and tax revenues decreased even to negligible levels (TEKINBAS, Fall 1994, p:2). This depends on the fact that, states left the money generated from property taxation solely to the local bodies. However, the tax profits preserved their important share in local revenues.

The deficiency of the property tax has been the basic argument because while the total tax revenues increased in years, since the local government expenditures increase more rapidly than economic development, this financial tool of local authorities became economically insufficient and ineffective. In order to meet the local expenditure level, widely applied procedure has been to increase, even double, the property tax rates like happened in 1902 (TEKINBAS, Fall 1994,p:4).

In U.S. historically, education services has been a function of local governments and the costs of this function accounts for 45% of the local expenditures performed by the authority (TEKINBAS, Fall 1994, p:5). Basically, the property tax revenues are channeled to finance these costs but alter due to the quality of education services supplied. However, the method of financing education services with property taxation results in mentioned alteration because in every locality tax base differentiates so does the total tax revenues.

Considering, the assessment procedure of the property tax, the assessed value can be found either by declarations made by the owners or by an assessment made by selected assessors who work for a county, a township or perform the task independently.

In America, the value of property subject to taxation is decided by the assessment system. However, the imposed tax amount is generally lower than the ad valorem of the same property.

Tax payers have the right to raise an objection which has to be directed to the Commission but it is known that any chance of acceptance for their disapproval is very limited.

The tax rate is calculated with a single ratio of total assessed value to the total proceeds in need. This rate varies from one state to other, thus, the upper limit changes in the range of 1%-10% of the assessed value (TEKINBAS, Fall 1994, p:13). The total amount of assessed value is a very critical fiscal capacity parameter since it is accepted as a distinguishing figure in federal transfer decisions. The worst tax assessment is, the least fair fiscal transfer criteria used which negatively effects the fiscal balance of federalism in States.

According to D. Netzer, what is imposed by property tax is a serious burden for the citizens (TEKINBAS, Fall 1994, p:13). In highly urbanized areas, total revenue of total taxation accounts for more than 10% of personal income tax or 25% of sales tax (TEKINBAS, Fall 1994, p:16). Thus, tax base for this kind of taxation is wider than any other and leading to unfair geographical distributions due to malfunctioning of the assessment mechanism.

All experts concluded that, the assessed value of the property does not reflect the real market value. As a general figure, Musgrave states that, in 1972, against 800 billion dollars of total assessed value, total property ad valorem accounts for 2.5 trillion dollars which is 32.5% (TEKINBAS, Fall 1994, p:16). Diversions from the real market prices fosters above mentioned distortions in balances among settlements and unfair distribution of federal grants to states. In addition, higher market prices in CBD, existence of more than one tax zone in metropolitan areas and high-income group's possible strong influence on assessors support the distortion.

However, in local perspective what is economically feasible may not match the politically adaptable. For example, due to political preferences and perceptions, assessments which are advised to be performed annually are generally done after long intervals.

In every period, local authorities are supported to find out new sources of revenue. Meanwhile, it is pointed that, changes in the price of the property in time as a result of planning decisions or some other public interventions, stand for a potential; in other words, redistribute rents in the property markets can function for local budgets. Taxes can be assigned to be tools of recapturing these generated rents in hands of public. Thus, an administrative reform may be needed to change the procedure in action.

D.Netzer declared that, real estate industry representatives consciously act against annual assessment . They favor paying their taxes assessed on their annual rents. However, this avoids taxation of vacant lands and will lead to speculation which will further increase the market prices of properties .

D.Netzer also states that local public sector perceive the redistribution of revenues as a function to be performed . Nonetheless, the tool of this function, property taxation, is a serious burden for the urban poor and thus, became operational.

Income Groups	Rate of Mean Tax to Income	Rate of Mean Tax to Income	Rate of Mean Tax to Income
Income Range (US\$)	All Families (%)	Households (%)	Tenants (%)
- 1,000	5.7	9.7	4.2
1,000-1,999	4.0	6.4	2.1
2,000-2,999	3.6	5.9	1.6
3,000-4,999	2.3	3.4	1.3
5,000-7,499	1.8	2.4	0.9
7,500-9,999	2.0	2.5	0.7
10,000 +	1.8	2.0	1.7
All Groups	2.1	2.6	1.0

(TEKINBAS, Fall 1994,p:28)

In real life, in a metropolitan region, new investments remote from possible cost items and vary due to locality. In addition, their final decision of site effect the local demand level for public services.

According to NeoClassics, inefficiency is due to the priority of cost minimization rather than optimal resource allocation.

There exists several forecasting models for the residential tax base. One of them formulated by Sexton is as follows:

H_0 : given stock of housing

In this aggregate context, heterogeneity within the stock is unimportant and valuation is to be done only with the use of an average unit of the stock.

h_0 : average unit of the stock : discounted streams of expected rental income - discounted streams of property tax liabilities

$$h_0 : \sum_{t=0}^{\infty} (1-k)^t Q^t (pR_t - h_0 E_0)$$

(1)(SEXTON, 1987, p:47)

R_t : expected average rental rate per unit of housing service in period t

p : conversion factor between housing services and housing stock

E_0 : expected effective tax rate which is assumed to be constant at the current rate for all t

k : depreciation rate

Q : real discount rate

To specify the determinants of rental income, the model focuses on two key aspects of housing markets: 1. The housing stock may be regarded as fixed for a short-run period coinciding with time required to plan and produce new housing services, and 2. Housing services may be provided in perfectly elastic supply in the long-run.

R_0 : short-run rental rate for the fixed stock: determined solely from the demand for housing services which is formulated via a linear expenditure system (LES) model: expressed as a function of the current population N_0 , real permanent income Y_0 and the level of housing stock H_0 in the taxing jurisdiction.

The long-run equilibrium rental rate R^* must generate a discounted income stream net of property taxes just equal to the long-run real price h , for an average unit of the housing stock. Perfectly elastic supply, in turn, implies that h is a constant value determined by the long-run equilibrium prices for the land, labor and capital inputs used in housing construction.

$$R^* = g_1(h^*)$$

(2)(SEXTON,1987,p:47)

$$h^* = g_2(W)$$

(3)(SEXTON,1987,p:47)

$$R^* = g_1(g_2(W))$$

(2')

W: vector of prices for housing construction inputs

Returning to (1), it follows that $R_t = R^*$, $t = 1, \dots, \text{infinity}$, where h^* is defined in (3). R_0 , the short-run rental rate, is determined from the aggregate demand for housing services via the LES.

Substituting these expressions into (1) yields h_0 as a single non-linear equation in terms of total permanent income, population, housing stock, effective property tax rate, and real prices for housing construction inputs. The current value of the housing stock, MV_0 is merely the product of H_0 and h_0 .

$$MV_0 = f(H_0, Y_0, N_0, E_0, W_0)$$

(4)(SEXTON,1987,p:48)

Then Sexton, developed a new model based on income elasticity:

$$\ln MV = a + b \ln Y + \mu$$

b: income's direct demand-side effect on MV and also the sum of its indirect effects based on income's possible influence on the omitted MV determinants

B3.1.3. State And Regional Differences

Southern and western states are more reliant on sales taxes and northern states on property and income taxes. Southern states make relatively little use of income taxation and western states have the most diversified tax structures.

These differences reflect the differences in service responsibilities. Where local government involvement in the delivery of services is strong, there is heavier use of the property tax. Since the southern states tend to be more state government dominated, there is less reliance on property taxation.

Another very important source of variation is the distribution of federal grants. They are allocated according to a formula or project-by-project basis. (ANTON,1989,p:138)

The extraordinary volatility of the federal tax system as a whole during the 1970s and 1980s further increased in 1986 by the first comprehensive reform of the federal income tax. Its effects are not yet clear, but it will certainly alter the revenue system defined by the following 20th century trends:

1. Sudden emergence and later growth of the income tax as the dominant source of national government revenue
2. State government reliance on sales, and more recently on income taxes as major revenue sources, after abandonment of the property tax in the 1930s
3. Continuing reliance on property taxes by local governments, but a decline in the share of local revenue produced by property taxes
4. Substantial increases in federal aid to state and local governments in the 1960s and 1970s, leading to a greater fiscal centralization and greater financial interdependence among all American governments (ANTON,1989,p:140)
5. A recent period of extreme tax volatility, during which increases in federal aid to state and local governments were stopped and then reduced; state taxes were reduced, increased and reduced again; and the first comprehensive national tax reform in more than three decades was passed

B3.2. Federal Grants

Equalizing grant can be used by the federal government to equalize fiscal outcomes or resources among subnational governments, or by states to do so among the local governments. Although equalizing grant can sometimes be justified in terms of efficiency, we focus on its prime function, namely, to achieve fiscal equity objectives. However, as a whole, grants should be evaluated in terms of their effects on allocative efficiency, distributional equity, and macroeconomic stability. (BIRD, 1993, p: 217)

There are certain equity standards. One of them requires that all citizens have access to a minimum quality of public services, such as all students having the minimum predetermined level of education. The second is easing the burden of providing standard-quality public services. To achieve this, the donor government should give more aid to jurisdictions that have larger fiscal disadvantages, measured by the need-capacity gap. This approach makes it possible for all jurisdictions to move toward standard-quality services at a standard tax rate. The need-capacity gap is the difference between a jurisdiction's expenditure need and its revenue-raising capacity, all defined in per capita terms. (LADD AND YINGER, 1994, p: 212) The third case is ensuring that every jurisdiction willing to make a certain level of sacrifice will receive the same level of public services, regardless of its own tax base. "Sacrifice" is defined as the effective property tax rate. Grants to achieve this objective are called "power-equalizing" grants. In 1991-1992, eight states used some form of power-equalizing grant, usually with severe restrictions to help finance local education. (LADD AND YINGER, 1994, p: 214)

In most fiscal systems, the following basic tasks are assigned to transfers: (BIRD, 1993, p: 220)

1. Closing the fiscal gap:

Transfers aim at achieving "vertical fiscal balance", that is, the case in which the revenues and expenditures of each level of government are approximately equal. However, this is generally the case only for the richest local governments.

2. Equalization:

Horizontal fiscal balance is to be achieved within the local government sector. In the United States, there is no formal system of horizontal equalization of transfers.

3. Pricing externalities:

A matching grant program designed to encourage the optimal provision of public services should vary primarily with the nature of the activity depending on the level of the associated externalities.

4. Stretching the central budget:

All transfers have income effects and all grants for specific activities have price effects. But in reality we do not have any idea about the income or price elasticity of demand for local public goods.

5. Achieving political objectives:

It may be necessary to transfer some resources to certain jurisdictions that do not need them in order to make it politically feasible to transfer needed amounts to other jurisdictions. It may also be essential to transfer resources simply in order to keep some economically nonviable local governments alive for political reasons.

Most state and local governments are said to be under heavy federal influence often at their own request. This is demonstrated by the growth of federal aid. Prior to 1972, many of the smaller counties, municipalities and townships did not receive federal aid, largely because of the eligibility requirements. With the General Revenue Sharing program in that year, all the states and local governments now receive and spend regular quarterly payments without even applying for them. At latest count, 37,704 state and local governments out of 38,776 were found out to receive these payments. (A.C.I.R., 1992, p: 139)

Public school districts are also fundamental in the federal aid system. All of the nation's 16,500 public schools receive federal aid. 80% of these funds is distributed by the states, while the rest goes directly from the federal government to the school system. There are 15,714 school districts. Also 82% of the private elementary and secondary schools receive federal aid.

Finally, special districts - most numerous type of local governments in the US - share in federal aid to a great extent. 38% of the special districts are eligible for federal aid, including districts for soil conservation, housing and urban renewal, sewerage, hospitals, libraries and transit systems.

63,000 out of 80,000 (80%) of the units of state and local government are receiving federal funds. The substate regional organizations are also receiving federal aid which makes up more than 80% of their budgets. (A.C.I.R., 1992, p: 141) Thus, they are the most affected ones by federal aid out of the state and local units. Their funds are mostly categorical grants which have quite firm and detailed program requirements.

About 74% of the state agencies receive federal aid. The percentage of the state agencies receiving 50% or more of their budget from federal aid has increased from 10% in the mid 1960s to over 25% in the late 1970s. (A.C.I.R., 1992, p: 142)

Intergovernmental grants can be analyzed in terms of three points of concern: (O'TOOLE, 1985, p: 145)

1. How funds are used by a recipient:
 - a. Unrestricted
 - b. General, with limited restrictions
 - c. Block, within broad program areas
 - d. Categorical or functional, within narrow program areas
2. How funds are allocated to the recipient
 - a. Formula, unrestricted
 - b. Formula, subject to limited restrictions
 - c. Formula, with administrative checks
 - d. Competitive applications by grantees (project grants)
3. Degree of participation by grantor
 - a. None (beyond provision of grant funds)
 - b. Administrative oversight

c. Technical services; cooperative management

d. Grantee matching requirements up to the limit of grantor funds (closed-end matching grants)

e. Grantee matching requirements with unlimited grantor funds (open-ended matching grants)

Broadly, the federal grants can be classified into four main groups: categorical grants, block grants, project grants and the general revenue sharing program.

B3.2.a. Categorical Grants

They have the economical effect of stimulating state and local expenditure in designated functional areas (1d) by lowering the price at which grantees can acquire the program. The grants are allocated by formula with administrative checks on their use (2c). Federal grants for public assistance and Medicaid, which accounted for about 18% of total federal grant expenditures in 1978, fall in this category. The US Congress determines the amount to be transferred annually and distributes them based on formula. (O'TOOLE, 1985, p: 144)

The categorical grants have quite firm and detailed program requirements. These requirements cover nondiscrimination, environmental protection, planning and project coordination, relocation and real property acquisition, labor and procurement standards, and public employee standards. (O'TOOLE, 1985, p: 141)

Despite the variety of fiscal instruments, and despite the recent interest in block grants and revenue sharing, categorical aid is still dominating the system. In fact, the development of the American federalism since the Civil War is mostly the story of the categorical grants. This emphasis on the categorical grants can be analyzed in terms of (A.C.I.R., 1992, p: 160):

1. Economic and fiscal considerations

Spillovers or externalities in the provision of many state and local government services are one of the factors for the growth of categorical aids. The benefits generated by the public programs are not restricted to the residents of the jurisdiction that provides and finances them through its taxes. Waste water treatment, highways and higher education are good examples for such cases.

Such spillovers may be corrected by properly designed categorical grants. (A.C.I.R., 1992, p: 161)

2. Political factors

The categorical grant system is supposed to be the best to express the American political pattern and institutions.

The use of categorical aid programs also has been encouraged by a set of attitudes shared by many officials. This attitude is that, the government that raises money by taxation should also control the expenditure of that money. Therefore, categorical grants are preferred as they are more adequate to let the grantor take control.

Another important factor has been the social pluralism in the US great social diversity had also a great impact on its public policy. The nation is composed of a very large number of cultural and economic groups, each having different political objectives and concerns. Therefore, the Congress is more responsive to new categorical programs specifying their aims than to basic fiscal rearrangements. Besides, most new grant programs give additional benefits to some groups while rarely disturbing the others.

Education is a good example for this. It was the first area of federal assistance. The current variety of categorical education programs reflects the inability to agree on a system of general education support. Legislation to create a program of general assistance for education was considered repeatedly by the Congress after 1870. However, pointing at the great heterogeneity with religion and race being the most divisive factors, no agreement could be made. In the late 1940s, consensus could be reached on programs for specific education services, but not for general aid. (A.C.I.R., 1992, p: 166) Similarly, in the early 1960s, attention was focused on higher education which has drawn less opposition than aid to elementary and secondary schools.

B3.2.b. Block Grants

These are the most preferred type of grants in the US, accounting to 88% of the federal grants in 1978 and over 85% of the state grants in 1972. It is mostly preferred by the grantee, because the grantee may act as if he will use the fund for the specified purpose, but use it for any local purpose desired. (O'TOOLE, 1985, p: 144)

Block grants gained importance in 1980s by the transformation of categorical grants to certain areas in the form of block grants. They are assigned according to formula in which the two most important variables are population and need. Most of the time they are used together with categorical grants of the same purpose. The Housing and Community Development Act of 1974 is an example for this. (TEKINBAS, Fall 1994, p: 9)

Other block grant programs are (TEKINBAS, Fall 1994, p: 10):

- Anti Recession Countercyclical Assistance - ARFA
- Community Development Block Grant Program - CDBG
- Partnership For Health - PH
- Law Enforcement Assistance - LEA
- Comprehensive Employment and Training Assistance - CETA

B3.2.c. Project Grants

The grantees compete for the available funds by submitting detailed plans concerning their use (2d). They are more preferable for the grantor, since the

grantor has the right to reject low-priority proposals and adjust the support to maximize public benefits. In 1972, project grants accounted to 21% of the federal government grants, but less than 2% of state grant spending. (O'TOOLE, 1985, p: 145) They are used mostly when there is no suitable criteria for evaluation such as population, fiscal need and capacity. (TEKINBAS, Fall 1994, p: 5) It is most adequate when new techniques are to be established for service provision and when there is limited time for project realization. Sometimes matching is also desirable.

They are most commonly used in fields of education, environment, transportation and economic development for establishing sample projects.

A major disadvantage is the high rates of management cost and bureaucracy due to the competition involved. (TEKINBAS, Fall 1994, p: 6)

B3.2.d. General Revenue Sharing

Their effect is to increase the money income of recipient governments but not to change the prices at which they can purchase goods and services for their citizens. It was enacted in 1972, but its implementation was given up in 1986.

Goals of the general revenue sharing:

1. To reduce fiscal disparities between states and among local governments

The general revenue sharing program is a function of the "something for everyone" philosophy. However, the equalizing impact of general revenue sharing is relatively limited. Other federal programs - particularly income-transfer programs and social service grants - are more appropriate for this purpose. (O'TOOLE, 1985, p: 147)

2. To stabilize state and local taxes and thereby help produce a more progressive national tax structure

Those who support general revenue sharing state that it has a desirable effect on the national tax structure by causing a heavier reliance on more efficient federal tax sources, and less reliance on state and local sales and property taxes. It really has been an important factor for some governments to stabilize or limit tax increases. However, there has been some other jurisdictions under no fiscal pressure which have used a relatively high portion of their shared revenue to cut or stabilize taxes.

Some other are against general revenue sharing, saying that, it may increase fiscal disparities among recipient governments. This is the case when the second case in the upper paragraph overtakes the former. The dominant view is that, revenue sharing is a general purpose program. (O'TOOLE, 1985, p: 148)

3. To assist in the finance of the needed state and local services

It is said to expand the capability of state and local governments to meet public needs. However, this objective conflicts with the idea that revenue sharing should cause a heavier reliance on federal taxes and provide tax relief at the state and local levels.

4. To move in the direction of governmental decentralization by increasing the alternatives of state and local governments in determining the uses of federal grants

Decentralizing objective of revenue sharing was the most prominent reason for its enactment in 1972. Revenue sharing is viewed as a symbol of the willingness of the federal government to reduce the control on federal subventions to give greater emphasis to subnational governmental units in contemporary federalism. (O'TOOLE, 1985, p: 149)

There are certain priority programs in general revenue sharing. They are as follows in descending order of priority (TEKINBAS, Fall 1994, p: 14):

1. Public safety
2. Environment
3. Public transport
4. Health
5. Recreation
6. Libraries
7. Social services for the elderly and the poor
8. Fiscal administration

In case of any discrimination with respect to race, national origin or sex, the payments are terminated.

The general revenue sharing program was primarily designed to have the fewest eligibility requirements. However, there are still numerous requirements (A.C.I.R., 1992, p: 142):

1. prohibition of funds for the use of lobbying purposes,
2. requirements for citizen participation,

3. restrictions on debt retirement with revenue sharing funds,
4. conformity with the accepted wage provisions of reconstruction projects under the Davis-Bacon Act,
5. requirements with respect to wage rates for employees of recipient governments,
6. protections against discrimination in selection and employment of various sectors of the population,
7. prohibitions against discrimination by the subcontractors,
8. restrictions against discrimination in the provision of municipal services or the selection of facilities to be financed with federal funds.

Despite these eligibility requirements, the grantee does not even have to apply for grant. The amount to be distributed is determined once in a 5-year period by the Congress. The last amount determined was \$6.5 million. The payment is made four times a year. And the local government receiving the aid should use it within at most two years. The allocated amount is kept in the Trust Fund.

There are 2 alternative formula to determine the shares. The one resulting with the highest share to the receiver is considered. (TEKINBAŞ, Fall 1994, p: 12)

Variables in the 1st formula: (all variables have the same weight)

1. Population
2. Tax effort
3. Ratio of national income per capita to local income per capita

Additional variables in the 2nd formula:

4. Urban population
5. Local income tax revenue

What Nixon had proposed was diverging from the case in use in two ways. One of the differences was that in the formula all public revenue was taken into consideration, not only tax effort. The second difference was the exclusion of urban population and local income tax in the alternative formula. (TEKINBAS, Fall 1994, p: 19) The share of local governments from general revenue sharing was to be calculated with respect to the ratio of their own revenues to the state revenues. Therefore, as long as the local governments increased their revenues, it received more grants from the general revenue sharing program. (TEKINBAS, Fall 1994, p: 22)

Another proposal was made by A.C.I.R., suggesting that the amount to be collected in the general revenue sharing fund be found by adding 1% of the previous year's (also the concept of "previous year" was an innovative approach) federal personal income tax and 25% of the state's personal income tax; and dividing this sum by two. The reason why the state's personal income tax was included in the formula was to create an incentive to make the states utilize this tax more effectively. (TEKINBAS, Fall 1994, p: 22) Another difference was brought about with the exclusion of jurisdictions with a population less than 50,000 from the general revenue sharing program. However, all school districts, regardless of their populations were taken into consideration. It was also notable that as the population increased, the share from the general revenue sharing program also increased. (TEKINBAS, Fall 1994, p: 23)

B4. SAMPLE CASES OF IMPLEMENTATION

B4.1. City Of Syracuse - The "Dependent" City

City of Syracuse was unable to raise its own revenues beyond a certain level dictated by the State of New York. Any activity above that level should have been financed with non-city raised revenues. Within 4 years, the constitutionally imposed tax ceiling for the City of Syracuse was made \$25,000 and it could not persuade the State of New York to permit the city to exceed it as other cities did (Buffalo, Rochester, Yonkers). As a result, the tax rate of City of Syracuse became lower than the rates in the other communities. Therefore it had been cutting back local staff for years, and not confronting their bonding and credit problems. On the other hand, it could not provide the same level of service that the other three cities did, because it was not able to raise local revenues to permit such extensive service delivery. The budget adopted was also lower on a per capita basis than the other three

communities. What is more is that, the governor tried to impose cutbacks in local assistance in the state budget in three categories of aid:

1. State revenue sharing
2. Municipal overburden assistance grant
3. The education formula

This discussion shows the city's extreme dependence on state and federal aid. The only real federal program that gave general purpose revenues which could be used against the city's basic service requirements was general revenue sharing. For Syracuse, it involved only \$2.4 million a year, or slightly more than 2% of the city's annual expenditures for basic city services. (The figures belong to 1970s) (O'TOOLE, 1985, p: 169)

B4.2. Fly Paper Effect

The fly paper effect is the empirical observation that increases in intergovernmental aid stimulate greater local government expenditure than do increases in voter income (TURNBULL, 1990, p: 207).

The fly paper effect is an unresolved local finance issue. Many attempts to explain the fly paper effect incorporate the representative voter framework. Another popular explanation of the fly paper effect introduces the notion of fiscal illusion that the tax payers do not correctly perceive the marginal tax price of additional output and therefore use the average tax price as the relevant datum when making public expenditure decisions. Voters make decisions without perfect information about how the policy sector translates their desires into policy. Public sector administration in the standard fiscal illusion model are budget maximizers and therefore have no incentive to correct voter's perceptions of the tax price. Voters who are not aware of the increases in intergovernmental aid, just do know that average tax prices fall at all expenditure levels so they support greater public expenditures.

B4.3. California Proposition

The interdependence of the public revenue sources often leads to unintended consequences.

In California, voters approved Proposition 13 in 1978 which reduced property taxes to 1% of the market value (ANTON, 1989, p: 141). However, this also

reduced the amount tax payers could deduct from the federal tax returns. As a result, the federal income tax of Californians increased by 30 billion dollars (ANTON, 1989, p:142). Meanwhile, the federal grants to California municipalities were reduced as a result of the interaction between the property taxes and federal grant programs. General revenue sharing distributed funds according to formulas that included "tax effort" where "effort" was defined as total taxes divided by total personal income in a given jurisdiction. By lowering property taxes, California voters were decreasing their level of federal dollars they could get.

In U.S., the borrowing procedure alters from one state to other. In California, rooted in State Law and City Legislation, the inspection authority limitedly is given to the Security Commission (TEKINBAS, Fall 1994). Basically, the Debt Consultancy Commission is active for the supervision of borrowing (TEKINBAS, Fall 1994).

Due to the above mentioned Proposition 13, the usage of traditional tool in revenue generation, the bonds, abandoned. In 1986, thus, Proposition 46 was enacted enabling the availability of bond issues once more (TEKINBAS, Fall 1994).

B4.4. Miscellaneous Managerial Examples

It is a fact that urban fiscal crisis is not over. According to a recent survey of the National League of Cities, close to one third of the nation's cities and towns saw an actual reduction in revenue during late 80's since new sources of income could not be found. (MORGAN, 1988, p:69)

Cities react to mounting fiscal pressures in different ways. Decisions made in response to fiscal pressures are a class of municipal decision making in general.

There exists a first type of decision making: rational model. Decision makers operate to "satisfice" rather than "maximize" the net benefit and that a strong reasoning exists; choice is always exercised with respect to a limited, appropriate, simplified model of the real world situation.

Secondly, incrementalism is supported. This approach is based on the assumption that decisions are built on a sturdy foundation of prior decisions. Policy is, thus, often influenced by the operation of "iron rectangles" whereby coalitions of politicians, bureaucrats and clientele groups negotiate (MORGAN, 1988, p:70). However, some suggested that

incrementalism presupposes an organizational stability and routinization that may rarely exist.

Municipal revenue decline forced a number of cities to reconsider their traditional approaches to budgetary decision making. Many believe that city budgets grow indefinitely and some argue that local officials are ill-prepared to cope with serious financial trouble. The retrenchment processes are rather closely parallel to the way which municipal budget decisions are made in general. In this process, the chief executive is the dominant figure in his actions that reflect his perceptions of what the situation demands. Many cutback measures can be implemented by the chief executive without the necessary approval of the Council. The city manager cities had more success with retrenchment than non-manager communities.

The capacity of interest groups to affect local policy has been studied a lot. It is evident that declining resources stimulate interest groups to resist efforts to reduce spending and program levels.

The Retrenchment Strategies Employed by a group of U.S. Cities of 25,000 and over in 1980-1983

<u>Revenue Strategies</u>	<u>Mean Score</u>	<u>% of cities using</u>
1. Increase User Fees	2.4	87.3
2. Seek new local revenue sources	2.1	76.5
3. Draw down surpluses	1.7	66.9
4. Increase taxes	1.7	60.8
5. Obtain additional IGR	1.2	53.7
6. Increase long term borrowing	0.7	36.3
7. Sell assets	0.6	40.4
8. Defer some payments	0.6	36.3
9. Increase short term borrowing	0.6	35.3

Productivity Improvement-Reorganization Strategies:

1. Improve productivity by better management	2.1	75.2
2. Improve productivity by adopting labor saving techniques	1.7	63.7
3. Contract out services		

with private sector	1.0	45.6
4. Joint purchasing agreements	0.9	45.6
5. Shift responsibilities to other units of government	0.5	29.7
6. Contract out services with other units of government	0.5	27.7
<u>Cutting Strategies:</u>		
1. Attrition	1.8	71.6
2. Reduce expenditures for supplies/travel	1.5	70.1
3. Reduce capital expenditures	1.5	60.3
4. Impose hiring freeze	1.4	60.3
5. Impose across-the board cut	1.4	57.1
6. Reduce overtime	1.5	5.9

(MORGAN,1989,p:75)

C1. INTRODUCTION

In 20th century local authorities began to gain importance. That's why authorities of the local administration have been increased. In this report local authorities were examined in financial dimension. First theoretical frame of local government finance, fiscal federalism and new local financial resources were studied. Then examples of mediator institutions of certain countries were studied comparatively. Besides the financial structures of local authorities in Asia, Africa, America and Europe were examined. In those regions only specific examples were taken. This report is only the beginning part of the real study. Because this study will be helpful in order to make local financial models effective in Turkey.

C2. THEORETICAL FRAME OF LOCAL GOVERNMENTS

C2.1. Why Did The Local Authorities Gain Importance?

As a result of the rapid urbanization, the local needs occurred with very many problems of infrastructure and the other urban problems. Since the central government couldn't solve all those problems in time and couldn't use the scarce resources efficiently, the central authority decided to transfer the local authorities and certain amount of central resources to the local governments.

On the other hand, through the end of the 20th century there seemed globalization process because of the rapid change in life all over the world, democratically developments, the developments in human rights, and the international level research about the solutions of environmental problems. Moreover there seemed the development of transportation and communication, the rapid transmission of the scientific knowledge.

In sum, all of those changes emphasized the concept of "local" and "local administration". So that, the tendency of being far away from the centralization has been occurred. Then, it was seen that the subject of autonomous local governments, support to the local governments, diminishing central control on local authorities took place in the international documents and national constitutions.

With arising importance of the local governments, the concept of fiscal federalism has been argued. Because if assuming that, the local authorities provide publicly good and services, they should finance themselves mostly with their local tax and revenues (in addition to the grants). Moreover in order to be autonomous government, local governments should have autonomous fiscal resources. At this point, there are four key questions about fiscal federalism: [KING, 1992, p:23]

- 1) What powers should be given to sub central government rather than central government?
- 2) How large should central authorities be?
- 3) How should sub central authorities be financed?
- 4) How far does the central government need to control the activities of sub central authorities in order to prevent them from frustrating its policies, especially its macroeconomics policies?

According to general consensus, the local government should play a sizable part in the allocation function, no part in the stabilization function and only a modest part in the redistribution function. It is said that the local authority should play no part in the stabilization function since the local authority could hardly be given powers to control the money stock and interest rates. However in aspect of efficiency and productivity, the local authority should play in the function of allocation and redistribution. Because when variations in consumption among different subsets of the population are possible, people need different level of output of a publicly provided goods and services. [PADDISON & BAILEY, 1988, p:10]

Actually economic efficiency is attained by providing that mix of output that best reflects the preferences of the individuals who make up society. Naturally central government couldn't provide efficiently all types of the necessities of each groups in all over the country. In this sense, the best satisfaction from providing publicly goods and services (in the local areas) is attained by the local authorities.

C2.2. Optimum Scale For Local Government

It was said that the aim of fiscal federalism was supplying and allocating the publicly goods and services in various levels according to the different demands and tastes of the people. Also this was valid for economic efficiency.

Now, the new question is how large the local government should be. According to David KING, it is suitable that the local government should be small scale organization or decentralized structural organization in order to supply publicly goods and services efficiently for various demands and tastes.[KING, 1992, p:11]

On the other hand also large scale local governments have some advantages as follows:

- 1)Such authorities might be able to exploit economies of scale in the provision of their services.

- 2)Local services might generate benefits for non-residents. In small scale authorities, the amount of non-residents might be fewer. However in large scale authorities the amount of non-residents might be so fewer. That's why it is negligible. In other words the degree to which each area is likely to under provide will be diminished. (diminishing externalities)

As a result, it could be said that the optimum scale for local governments changes according to the publicly goods and services supplied sufficiently. For example; in Sweden if the health care service is considered, the optimum population serving by the local authority is 300.000. But if the primary education service is considered, then the optimum population serving by the local authority is 8.000.

C2.3. Financial Sources Of The Local Governments

a) "Pollution Tax" As A New Source Of The Municipal Finance

"Pollution Tax" on which economists have argued for years, serves to provide the cost that prevents the disuse and overspending of the environmental scarce resources. But the economists couldn't find anyone supporting themselves in political area, yet. The law-makers still prefer the precautions of control whose limits change from polluter to polluter. Nevertheless the researches show that the expenditures of that kind of program are so high. Besides, that kind of approach couldn't achieve success. Without a few exceptions that kind of study wasn't so effective on occurrence of the environmental policy.

Recently the rate of showing interest in "Pollution Tax" becomes higher and higher. Especially the United States Representatives' Council and Senate began to show serious interest in pollution tax in order to diminish the dept of federal budgets.

WHAT IS POLLUTION TAX?

Mostly, market demand and supply determine the optimum prices of commodities and services. But under certain conditions, prices couldn't reflect the real social costs. Especially "pollution" is the most classical example about this subject. Since the scarce environmental resources (like water and fresh air) haven't any optimum price, these resources are over wasted. For example; a producer whose factory spreads fumes, consumes a scarce resource namely, fresh air. In other words the producer refers the real costs to the people who have to live in air pollution. Here that firm doesn't need to pay the real costs as it is seen in other resource consumption. While the prices of labor and raw materials encourage the financial savings of firm, exhausting of fresh air couldn't affect the firm similarly.

In this respect, the main reason of the over depravation of environment is absence of optimum price for scarce environmental resources. The government intervention is necessary in the case of assessment for the polluted commodities while the demand-supply mechanism doesn't work. It could be easy to say that the tax will be a suitable encouragement in

controlling pollution when the value calculation -with the assistance of microeconomics terminology- is done equally with the amount of damage occurred by pollution unit. The rate of tax should be imposed according to the level supported optimally for the quality of air and water. "Pollution Tax" is not only a method of protection against the environmental pollution but also a good source of income in public sector. Pollution Tax could be an attractive part of the system of public income. It is not only the provision of environmental protection but also substitute of the sources of income gave damages to the economy. (For example; income tax could become an application to fetter the working group. That's why this could support unemployment. Pollution Tax doesn't bring considerable benefit comparing with the whole needs of public income. However it has potential to affect the budget. It may brings more income if a Seri of assessments including most of the air, water and soil polluters, will be realized.

In order to work this system there are main four points: (According to Greg Law)

- 1) The assessment should be defined completely.
- 2) The concerning law should provide to diminish the debt of government with the help of Pollution Tax income.
- 3) It is desired that there should be a little elasticity in rate of the tax.
- 4) There should be an efficient program to control technologies of pollution in order to make the pollution tax effective. [OATES, 1992]

b) Mediator Institutions In Local Authority Finance

In order to provide financial support for local authorities there are institutions which gives medium and long term credits to the local authorities in all over the world. Actually, the financial institutions were already existed in order to supply the needs of local authorities in West Europe and Japan. But only the large scale local authorities could benefit from the long term credits of that kind of institutions. On the other hand the small scale local authorities could only benefit from short term credit or sales credits. Because of those reasons, it was necessary to established specialized institutions and to arrange

municipal funds. At this paper only the cases of Belgium, Denmark, Colombia, France and United Kingdom are taken as the examples:

BELGIUM (Credit Communal de Belgique)(Municipal Credit Bank)

Credit Communal de Belgique is an example of a specialized credit institution established to extend short, medium and long-term credit to provincial or regional authorities, municipalities and their dependent entities. It was established in 1860. Now it is a limited company which is governed by a Shareholders Assembly representing provinces and municipalities. Daily operations of CCB are managed by Administrative Council. Normally the state does not participate in the management or operations of CCB but the Ministries of Finance & Interior appoints the controllers of CCB.

The main source of finance for CCB are private demand deposits mobilized from individuals by 1300 authorized agents located through out the country, temporary budget surpluses of certain public administrative organs, current accounts opened by local authorities, and bond offerings. No state guarantee is provided to ensure municipal repayments. Only in the case of the payments made by central governments to local authorities which are channeled through CCB, CCB is authorized to deduct such payments.

This system of ensuring repayments has obvious advantages for CCB as it amounts to a central government guarantee on its lending for each authority up to a ceiling level. However there may be disadvantages to such a system for the government and local authorities. By reducing the credit risks faced by CCB, the system dilutes market signals which should guide CCB lending. Moreover, as central government transfers represent varying shares of local revenues depending on the local taxbase, this partial approach to revenue and expenditure forecasting may overestimate the creditworthiness of small municipalities and underestimate that of large municipalities.

The importance and volume of CCB has increased parallel to the local authorities. In 1990, investments by local authorities were 45% of the total public investment, and expenditures 6.7.5 of GNP. Again in 1990, CCB provided about 85% of the total long term loans advanced to local authorities. In recent years, CCB has diversified its lending by providing short and long

term credits to individuals for housing and personal loans.[The World Bank Report, 1992, p:2]

DENMARK (Danish Credit Institution For Local Authorities-DCLA)

As another example of the specialized credit institution is Danish Credit Institution established in the middle of 19th century. DCLA is organized as a cooperative whose members are municipalities and county governments. The State doesn't interfere the management of DCLA but the Minister of Interior must approve amendments to its by-laws, may request information on its operations, and may close the institution if its creditors are judged to be at risk.

DCLA's main source of finance is bond market where it enjoys a rating equivalent to that of the government of Denmark. After it approves a loan for one of its members, DCLA raises the capital by issuing bonds of various maturities ranging from 5-32 years. The proceeds are then placed at the disposal of the borrower with the terms and conditions of the loan determined by the yield and maturity on the bond. Index-linked bonds are used to finance housing and energy investments. DCLA accumulates reserves to cover possible losses by charging borrowers. 0.5% of principal as an origination fee and biannual membership payments. As the institution is a cooperative whose members are jointly and severally responsible for its debts, no further state or municipal guarantees are required to qualify local authorities for loans. The exception are loans extended to local public utilities which require a guarantee from a member county or municipality. There have been no significant losses on lending activities during its history.

As in Belgium, local government spending in Denmark accounts for a substantial portion of economic activity.(32% of GNP, 54% of public expenditure, 74% of government employees in 1989) On average, DCLA provided 20% of the total loans raised by local authorities from 1987-89 with a modest staff of only 18. In 1990, DCLA extended loans of Denmark Kr. 1.9 billion.(US\$ 345 million) [The world Bank Report, 1992, p:3]

COLOMBIA (Banco Central Hipotecario=Central Mortgage Bank; and
The Urban Development Fund=UDF)

Another example of mediator institution is The Urban Development Fund which was established as a specialized division within the Central Bank in 1968. Also it was transferred as a division within the Banco Central Hipotecario(BCH) in 1968. BCH shareholders include the Central Bank(87%) and other public and private financial institutions. Its board of directors is composed of representatives of the public and private sector.

The Urban Development Fund provides long term credits to local authorities by rediscounting up to 85% of commercial bank loans. The aim is that the fund should encourage the private banking sector to respond to local government credit requirements. As local governments demonstrate their creditworthiness and capacity to implement capital investments to the commercial banks overtime, it should be possible for such a fund to eventually reduce its operations or the proportion of loans it rediscounts.

The main source of financing for the UDF are external borrowing(with a government guarantee) from international agencies such as the World Bank and Inter-American Development Bank; government loans; some deposits from the government pension fund; and Urban Development Bonds which it offers to local authorities. Eligible local authorities with investment requirements must first approach participating commercial banks with loan applications. The banks appraise the projects and municipal credit worthiness. Participating banks are responsible for all loan administration including loan contracts, disbursements and repayments. The banks also arrange their own guarantees or collateral. If a loan is approved by a bank, it is then forwarded to the UDF, whose technical and financial staff review feasibility and, if approved, assist the banks in technical supervision of the project investment. The UDF agrees in turn to rediscount 75-85% of the amount that the participating bank has agreed to loan to the local authority. The term of credits 15 years including three years grace. The rate at which the UDF lends to participating bank is based on 3 month certificate of deposit rate plus 2-5% depending on the size of municipality. To cover their credit risk and overhead, the banks charge the local authority an additional spread of up to 2.5% over the cost of UDF funds on the amount which has been rediscounted.

The UDF has grown steadily since its creation in 1968. Between 1983 and 1986, UDF approved 660 projects amounting to US\$ 300 million equivalent. About 45% of disbursements during the period were for water supply, sanitation and solid waste, 30% for urban transport, and the remainder for various urban investments. The UDF benefited greatly from its close relationship with Banco Central Hipotecario. Besides, UDF was able to develop high professional standards, prevent undue political interference in its lending and take advantage of BCH branch network and logistic to support its operations. As a result of its rapid growth and success, the government decided in 1989 to establish the UDF as an autonomous financial corporation affiliated to the Ministry of Finance and regulated by the superintendency of Banks. The new name of the institution is Financiera de Desarrollo Territorial(FINDETER).

Its mode of operations as a rediscount facility offering variable interest rates remains unchanged. FINDETER's shares are held by the Government of Colombia(86%) and local government departments(14%). [The World Bank Report, 1992, p:4-5]

FRANCE (Caisse des Depots et Consignations=CDC/ Credit Local de France)

Caisse des Depots is one of the largest and most diversified financial groups in the world. It is established as a state bank which has wide autonomy, in 1816. The main sources are tax exempt savings accounts from the public; various funds of public and social institutions such as social security, housing and pension funds; mandatory deposits from notaries and other officials. The establishment of Credit Local within the Caisse des Depots group is recent.(1987)

During its long history, Caisse des Depots has played a major role in lending for social housing and to local authorities for urban investments. CDC's own finance of local government projects was often supplemented by another subsidiary, Caisse d'Arde a l'Equipment des Collectivites Locales(CAECL), established in 1966.

Until the early 80's, the finance of CDC with its subsidiary Societe Centrale pour l'Equipment du Territoire(SCET), was often packaged with technical assistance to local authorities. Parallel to the governmental decentralization

policies in 1982 CDC was separated the financial services and technical services into different subsidiaries. In 1987, CDC established Credit Local de France, a separate joint stock company whose shareholders included Caisse des Depots(25%) and the Government of France(47.5%) as well as banks, pension funds and foreign financial institutions. The government financing activities were centralized in this new entity. At the same time, CDC reorganized all its subsidiaries as engineering, consulting or management services into a separate holding company called Caisse de Depots-Development(C3D). C3D is one of the largest and most diversified engineering and public sector management firms in the world. Each company is financially and operationally autonomous and competes within its segments of the market. Former subsidiaries such as SCET were brought under C3D.

Credit Local operates under a Supervisory Board representative of its shareholders and clients. Members of the Board are occurred by local authorities(4), the Government of Finance(2), Caisse des Depot(2), Caisse d'Epargne Ecureuil(1), and other investors(3).

The financial resource of Credit Local is bonds which it issued. Credit Local provides a diversified range of financial products for local authorities including short and long term credits and lease-financing. Through its subsidiary, Credit Local also offers more favorable access to the bond market by pooling local authorities' capital requirements and issuing bonds on their behalf. Funds are then passed on to the individual local authorities with interest and repayment conditions based on the yield and maturity of the bonds. through its subsidiary Credit Local International, it transfers own expertise in local government financial services to countries which are also attempting to strengthen their financial framework for decentralization.

Drawing on the considerable resources and experience of Caisse des Depots and its subsidiaries, Credit Local has quickly positioned itself as the lead bank for local authorities. It advanced loans of US\$ 5.8 billion in 1988, about 42% of all long term credit to local authorities. [The World Bank Report, 1992, p:5-7]

UNITED KINGDOM (Public Works Loan Board=PWLB)

The example of mediator institution in U.K. differs from other examples discussed in many respects. The Public Works Loan Board is an independent

statutory body established on a permanent basis in 1817 to consider loan applications from local authorities and to collect repayments. Since World War II, the PWLB has been governed by a commission made up of 12 unpaid members who are appointed for 4 year-term by the Prime Minister and Chancellor of the Exchequer. The 4 commissioners represent local authorities, 7 represent various branches of the financial community and 1 represents the accounting profession. The commission sets policy and operational guidelines to be adhered for local government applications. But the approval of application is delegated to the secretary of the PWLB.

The U.K. government established a two-step process for local government financial intermediation. First, each local government must submit its investment proposal to relevant spending Ministry based on the category of investment. After reviewing each proposal, each Ministry with oversight responsibility includes the projects which it approves in its own budget submission to the Treasury. After budget negotiations loans sanctions are issued which authorize local authorities to seek financing up to a certain ceiling for the projects that were approved. It is important to note that "sanction" at this stage does not assure the local government of project financing, but constitutes an approval for the local authority to go to the second stage, which is to seek actual financing for its capital investments.

If the local government has loan sanctions for its projects, it has two options for obtaining necessary credit; first, it may borrow on the open market, including issuing its own bonds; or second, it can approach the PWLB for a loan. The source of funds of PWLB is the U.K. Government, which issues bonds on its behalf and on-lends the proceeds to PWLB at the market determined rate. The average repayment period in 1987-88 was 12.8 years for fixed rate and 7.4 years for variable rate loans.

Before approving a loan application, the PWLB is expected to ensure that;

- 1) the local authorities borrowings will not exceed quotas established for each jurisdiction,
- 2) the local government has the necessary sanction,
- 3) the current financial position of the municipality is adequate.

Loans are secured by local taxes and other revenues.

This system of local government financial intermediation is judged to work efficiently in the U.K., where local governments generally exercise appropriate restraint in borrowing. Nevertheless, the system has been criticized by some for not controlling local government expenditure. As it is generally seen in Western Europe, local authorities in the U.K. account for a relatively large share, about 40%, of public sector capital expenditure. Similarly, a large proportion of local investment is debt financed. The total amount of credit advanced by the PWLB in 1987-88 was 6.3 billion pounds.[The World Bank Report, 1992, p:7-9]

c) Evaluation

The purpose of each mediator institution which is discussed so far, is similar: "Providing the long term credits for local authorities in order to respond to the need of capital investment ". But the approaches differ from country to country. (An independent commission in U.K., a rediscount window operating within a large public sector bank in Colombia, a credit cooperative in Denmark, an independent banking subsidiary in France, and a limited company in Belgium) Here it is tried to emphasize the success of each approaches or institutions. It is useful to review the main characteristics of each institutions and to make comparison as in the following table:

COUNTRY	INSTITUTE	TYPE	RESOURCE	AID	CREDITS (US\$)	WORKER NO
BELGIUM	Credit Communal de Belgique	Limited Company	Private Demand Deposits, Budget Surpluses, Current Accounts, Bonds	Credits	2.25 billion (1990)	4000
DENMARK	Danish Credit Institution for Local Authorities	The Cooperative Credit Institution	Bonds	Credits	345 million (1990)	18

COLOMBIA	Urban Development Fund	Autonomous Financial Institution	External Borrowings, Government Loans, Deposits From Government Pension Fund, UDF Funds	Redis countand Commer cial Bank Credits	300 million (1983-84)	90
FRANCE	Credit Local	An Independent Banking Subsidiary	Bonds, CDD Credits, External Borrowings	Credits	5.8 billion (1988)	1000
UNITED KINGDOM	Public Works Loan Board	An Independent Commission	Bonds	Credits	11.3 billion	23

C3. THE LOCAL AUTHORITY MODELS IN THE WORLD

So far the theory of municipal finance and the source items of local authorities have been examined. And now some specific local authority models with financial structures will be examined.

C3.1. European Countries' Models:

a) HUNGARY:

There are two types of local authorities in Hungary namely, municipality and county. Municipalities are divided into three parts as villages, towns and capital city including its towns. There is no hierarchical or administrative relations between county and municipality administrations. However they could work collectively for common regions or common groups that they serve.

Municipalities: The main duties of municipalities are public works; housing; conservation of natural and urban environment; water; infrastructure; cemeteries services; construction of local public roads; planning public areas; local public transportation; collecting garbage; local security; service of fire-brigade; solution of unemployment; nursery; primary education; health and

social aid; support of cultural, scientific, artistic and sports activities; assurance of national rights, and the rights of minority.

Municipalities can decide what kind of services will be done primarily according to the needs of that local area. But the body of parliament can make some services compulsory in the frame of laws. Since the municipalities have legal entity, the decision making body of municipality uses the rights and authorities. The representative decision making body is mayor. The municipal council by the purpose of providing publicly good and services, can establish economic and other types of institutions and appoint the chiefs of those institutions. Municipalities could establish the legal entity unions. Everybody lives in the municipal boundary have the right to participate in referendum and other citizen enterprises.

Municipality of Capital City: The municipality of capital city has the same rights with the other municipalities'. Besides, the local authority of capital city is given extra authorities by the special laws. The capital municipality has administrative dual structure as center and agents. The decision making body is the general municipal council containing 88 members. 66 members are elected from citizens and the rests are elected by the town councils.

Counties: Also counties have legal entity. The decision making body of county (council of county) is occurred by elected representatives of the municipalities in the province. The county could provide services which is not compulsory in law for municipalities. Counties are able to spend their revenues according to their budget and program without any upper control. Authorities of counties can establish the unions with other counties and municipalities in order to work efficiently. The decisions about the inner authority, the working principles and expenditures are taken by the council of the county.

Finance of Local Authority: The local authority expenditures are financed by self-supported sources, the share of the central government tax, the transfer income of economic institutions, central grants and aids.

The self-income of the local authority contains local tax which the municipality limits and collects; the income attaining from activities of local authorities; expenses; fines and other local incomes. According to the special law,

another local income is attained by selling of economic institutions governed or controlled by the local authority.

In the frame of budget the Parliament gives block aid to the local authority considering the criteria of population and other aspects. The block aids couldn't be spent without determined purpose. The Parliament can decide to give block aids for high cost investments and public works. [IULA-EMME, TOKI, 1993, p:70-75]

b) SWEDEN:

In Sweden, the function of the King is only symbolic and it is governed by parliamentary democracy. The main principle of Constitution of Sweden is "local autonomy". Since 1634, Sweden has been divided into the county administrations. Recently, there are 24 counties in Sweden. The basic local authority unit is municipality. The boundary of municipality is determined according to the amount of optimum population which is suitable for primary education services. (8'000 population) The second type of local authority is county administration. The boundary of county is determined according to the optimum population which is suitable for health services. (300'000 population) All the authorities of the county are used by the council of county. Within the same limits, there is the council of management which represents the central government and executes the services providing by the central government. Members of the council of management are elected by the council of county. The president of the council of management is the governor of province appointing by the central government.

Counties are responsible for preventing medicine and health care, care of unabled people and children, nutrition and advisory services for families. Counties through the channel of union occurred with municipalities provide the services of regional transportation and communication, local train, intermediate education, education of adults. As an agent of central government Council of Management has the authority of control on local governments' health and social welfare services.

Municipalities are responsible for primary and intermediary education, housing, some of the social services, fire-brigade, roads, recreation, sports

grounds, cultural and artistic facilities, electricity and gas as it is seen in other countries.

In Sweden, all the meetings of local authority councils are open to the citizens and press. Since 1977 with the change in the law of local authority, members of council have become full-time working group receiving salary.

Financial Resources: The most important resource of both county and municipality administration is tax revenues. Central government grants and service receipts are other financial sources of local authorities. Municipalities receives the income tax from the revenues of private and legal entity works in the municipal boundaries. State portion of total income tax is 13% while the portion of municipality is 17%. Revenues attained from taxes are 41% of total municipal incomes and 62% of county incomes in 1985. 20% of municipal incomes and 18% of county incomes contains central government aids. Beforehand, grants from central government was conditional grants, then they have been block grants since 1993. So that, local governments take decisions more freely for using grants.

In 1993 Financial Equilibrium System was accepted for municipalities. This system is applied as follows:

- Giving assurance for undiminishing tax revenues under certain level
- Increasing or decreasing amount of aid as a result of the development out of municipal control according to the change in municipal conditions
- Giving extra aid according to the differentiation of municipal population

20% of municipal incomes and 16% of county incomes are attained by service receipts. Other financial source of local authorities are sales of properties, interest rates, credits. [IULA-EMME & TOKI, 1993, p:56-60]

c) SPAIN:

In 1978 the new model of administration was brought in Spain by the Constitution of Spain. This model was decentralized, three-step hierarchical model. Three basic administrative steps of the model are:

- 1- Central Authority
- 2- Autonomous Regional Authority
- 3- Local Authority:
 - a) province
 - b) municipality

In this structure local authority is divided into two units, namely, province and municipality. Nevertheless the municipality is the main unit of local authority.

In 1983 Spain was divided into 17 autonomous community units. Besides devolution from central government to 17 regional governments was realized by the Constitution. But any devolution wasn't occurred from regional government to municipalities.

Municipalities: There are more than 8000 municipalities in Spain. 90% of the municipalities have less than 5000 population. 805 of the municipalities have less than 2000 population. As a result, most of the municipalities haven't capable resources and organizations to provide services efficiently. The dependency increases for the small municipalities with respect to the financial resources.

Each municipality has municipal council which the number of members changes from 5 to 25 according to the own population. Members of municipal council are elected for four years. The mayor is elected from the municipal council.

The mayor presides over the council, prepares the municipal budget, controls the management of daily municipal works, applies the decision of the council. In the municipality whose population is over 5000, there is a council of management which contains the mayor and mostly 1/3 of members of municipal council appointed by the mayor. Besides there is a secretary in each municipality to help the mayor for daily works and coordination.

Services of the municipality are about city health, parks and other recreational areas, enlightenment, cemetery, urban transportation, traffic police, trade-fair and exhibition.

The main sources of municipalities are property-tax, profession-tax, user's charges, and aids from the central government.

Especially, small scale municipalities come together and establish the "Union of Municipalities" to realize planning and infrastructural works and to share the costs.

Provincial Administration: The province is a geographical part of the central government and legal entity unit of local government. The province includes more than one municipalities. Each province has the president and the provincial council whose number of members changes between 25 to 31 according to the population. The members of the provincial council are elected from the members of municipal councils according to the portion of municipal members to provincial members. The president of province is elected by the provincial council. The province has also executive council which contains the president of province and mostly 1/3 of provincial council's members.

As a local authority, the province is responsible for the provincial roads, agriculture, forestry, public health, culture, exhibition and trade-fair. The province helps the municipalities in technical and economical terms. With the central authority, the province provides the energy, water and credits. Provinces could establish "Unions" to do common works as it is seen in municipalities.

The representative of central government in the province is the governor. He is responsible for the management and coordination of the central government establishments in the province. In those works the provincial management council helps the governor. The central government has an authority to control the provincial council and service units.

The revenues of province is similar to the revenues of municipalities. (property-tax, profession-tax, user's charge, central government aids)

Regional Administration: According to the Spanish Constitution, the country is divided into 17 autonomous regions. Each region has the council which contains the deputies from that region in the Parliament. Each council prepares and approves the regional constitutions. Each region has the authority of promulgation, execution, and jurisdiction.

The regional administration has the authority of change the municipal boundaries. Moreover it is responsible for the land-use planning, regional planning, housing, regional public works, tourism, agriculture, forestry, environmental conservation, water provision, maintenance of historical places.

The region has an authority to make assessment in certain fields. Other revenues of region are the portions of the central governmental taxes, the portions of "Inter-zonal Equity", central government aids and grants. [IULA-EMME & TOKI, 1993, p:63-68]

C3.2.Asian Countries' Models:

a) CHINA:

During the thirty-year period between 1950 and 1979, Chinese public finance was dominated by strong centralization policies. Then in 1980 provincial-level governments began to be invested with more and more fiscal autonomy, but would proceed at a rate of increase far beyond the expectations of policy makers at that time. As a result, this over accelerated separation of powers gave rise to a number of contradictions. First, there was the creation of running deficit to support central government spending and overall weakening of centralized fiscal influence within the economy. Secondly, government spending on the provincial level showed large-scale increases, as provinces took on more of the responsibility for developing the economy. Next, county-level governments experienced no expansion in their fiscal authority; and finally, large discrepancies began to be seen between fiscally rich township where the development of rural industry was vigorous and the poorer ones whose industrial sectors were still in a state of underdevelopment.

What this state of affairs means in part is that the growing fiscal authority of provincial-level governments marks a revival of traditional Chinese

regionalism, a phenomenon that will surely be an important factor in political change to come. [KOJIMA,1992, p:311-312]

b) INDIA:

India is occurred by 24 provinces. Local authorities show differences from province to province. But in general, local authorities are divided into two groups, namely; Rural Local Authorities and Urban Local Authorities.

1. Rural Local Authority Units: Hierarchical structure of rural local authority is occurred by (from bottom to top) village council (*PANCHAYET*), block council (*PANCHAYET SAMITY*), city council (*ZILA PARISHAD*).

Village Local Authority: Authority and responsibility of village council changes from province to province. Village councils are also the application units of rural development program.

The members of village council are elected by the villagers. The president of village council is elected either by villagers or by the members of council. The president of village council is also the member of upper level council.

Block Local Authority: The block council contains approximately 48 village councils. Generally the block council is more powerful than both village councils and city councils. The block council consists of two different groups of members; representative members and corporate members. Representative members consist of "needed duty" members, elected members and indirectly elected members. Corporate members consist of women, representatives of private benefit groups and honorary members. Honorary members have no right to vote.

City Council: There are 300 city councils in the whole country. According to the functions there are three types of city councils:

1. Councils having coordination and controlling functions
2. Councils having completely executive function

3. Councils having coordination, controlling and executive functions

In general, city councils consist of the presidents of block councils, directly elected members, corporate members, members of municipalities, cooperatives, school commissions, honorary members, and public officials in some provinces.

2. Urban Local Authority Units: In India there are five types of urban local authorities. These are; municipal institutions, municipal councils, regional committees, private area committees, town committees.

Municipal Institutions: Municipal institutions take place at the top of the urban local authority's hierarchical structure. Municipal institutions are occurred in the big cities. The duties of municipal institutions are classified as compulsory duties and optional duties. Municipal institutions are established by law which the province parliament promulgates. The decision making organ is the council and the executive organ is the general secretary. Municipal institution could establish commissions in different field of study.

Municipal Administration: There are more than 1750 municipalities in India. Municipalities are established according to the municipal law of province. This type of local authority could be seen in the medium scale cities. Members of municipal councils are elected by the citizens. The president of the council is elected by the members of municipal council. The president of the council has executive authority. Besides he controls the administrative and financial works of municipalities. The general secretary who is appointed by the members of councils, is responsible for the administration of the municipality.

Private Area Committees: Private area committees are established around the newly developing cities. Committees have the same authorities with municipal councils. However the

provincial administration could give another tasks to committees. The president and members of the committee are appointed by the provincial government.

Town Committees: By the laws the town committees are established in small towns. Some of the members of the committee are elected and some of them are appointed by the provincial government. Town committees are restricted authorities.

Responsibilities and Authorities of The Rural Local Administration:

Duties of rural local authorities are classified as compulsory and optional duties.

The main duty of village local authority is to apply society development program in the villages for improvement facilities. the compulsory duties of villages are water provision, construction of public roads, enlightenment of streets, conservation of public areas, cleaning, storage of solid wastes, prevention of fire, struggle with epidemics, control of bazaar areas, development of social education, organization of village volunteer power and communal works, restoration of historical places, opening nurseries, development of animal husbandry, agriculture, irrigation and industry. Optional duties of villages are about forestry, recreational areas, sports grounds, festivals and fairs.

The basic duties of block councils are agriculture, animal husbandry, fishing, health, communication, social education, operation of cooperatives, small scale industry and forestry. In addition the block council has administrative function and development function. Local functions of block councils are; health and preventing medicine, provision of drinking water, construction of public places, enlightenment of streets, conservation of publicly historic building, education, social services for unabled people. As an administrative function, registration of birth and death, control of bazaar areas, provision of security and welfare, exhibition and fairs could be determined.

The main function of city councils is coordination of block local authorities in city level. Actually city local authorities are responsible for coordination and advertising. The duties of city local authorities are to control the decisions and

activities of block councils, to approve the budget of block council, to allocate the provincial aids among block councils and, to review the program of development and agriculture.

Responsibilities and Authorities of The Urban Local Administration:

The duties of urban local authorities are classified as compulsory and optional duties. Compulsory duties are construction of public buildings and areas, provision of water, infrastructure, services of preventing medicine, fire-brigade, slaughter house, struggle with epidemics, family planning, registration of birth and death, private education, food control, and milk selling control.

Optional duties are about parks and recreational areas, libraries, old people's home, hospitals, forestry, environmental arrangements, housing for low income groups, public transportation, art and cultural facilities, exhibition and fairs, and car parks.

Financial Resources of Rural Local Authorities:

Villages have rights to collect taxes. These taxes are property tax, vehicle tax and profession tax. Other financial resources are tolls from slaughter house, shops and bazaars; government grants and aids; loans.

Revenues of block councils are taxes and fees that are collected by block councils, portion of land taxes from cities, grants and credits from province, other grants and aids, project revenues that provincial government transfers the applications.

There are two main resources of city administration:

1. Taxes & fees
2. Grants & aids

Taxes are profession and commercial taxes, water tax, entertainment tax, property tax, and Pilgrimage tax. Besides building permission fees, bazaar fees, fees of selling animals, stamp fees from selling real estates are another types of revenues.

All rural local authorities should prepare annual budget. Upper level authority approve the budget. Unless the upper level authority approve the budget in a certain period of time, the budget is automatically approved. "Local Fund

Accounts Controllers" control the accounts of local authorities. Local fund Accounts Controllers work under the Ministry of Finance.

Financial Resources of Urban Local Authorities:

Revenues of urban local authorities could be classified as tax revenues and out of tax revenues. Tax revenues are attained from property tax, Oktroi tax which is the tax taken from the goods which enter the local government boundaries, vehicle tax and profession tax. Other revenues are attained from fees, revenues from municipal properties, provincial grants and aids, and revenues from penalties.

In 1989 65% of the urban local authority revenues consist of tax revenues, 25% of total revenues consist of grants and aids, 10% of total revenues consist of other revenues. Oktroi tax is an important tax for local governments. Because its revenues is equal to the 40% of whole tax revenues while property tax is equal to the 25% of whole tax revenues. [IULA-EMME & TOKI, 1993,p:90-100]

c) INDONESIA:

Indonesia's public finance system, like China, has four vertical levels:

- The Central Government
- First Stage and Second Stage Autonomous Regions
- Administrative Villages

The strongest level in this system is the oil-rich central government, while the first and second stage autonomous regions act as agents of centrally-determined fiscal policy. In contrast, budgets of administrative villages, while in fact receiving subsidies from higher level governments, are mainly financed through self-generated sources of revenue stemming from village self-help funds and village assets.

However, changes have been gradually taking place in this state of affairs beginning in 1985 with large decreases in available revenue from petroleum enterprises. At the present time the Indonesian government is making do via the incursion of foreign debt in order to maintain its clearly over-centralized fiscal system. Therefore, as this foreign debt grows more burdensome, it will

become more and more difficult for Indonesia to support such a system.
[KOJIMA, 1992, p:312-313]

d) THE REPUBLIC of KOREA:

With the declaration of democratization issued in 1987, Korea started revising its policies of fiscal centralization that had reigned for almost thirty years. The centralized development policies carried out by the authoritarian central government were funded by a system of taxation that concentrated revenue at the center. The legacy of that system cannot be easily wiped out and even today the national tax collected by the central government comprises 81% of all tax revenues.

Korea's centralized development policies have given rise to three contradictions: serious economic imbalances between regions, large economic differences between the urban and rural sector, and a sudden jump in social cost of maintaining in urban areas as the country's population continues to concentrate there. Today the capital of Seoul, neighboring Incheon City, and the province of Gyeonggi are highly developed areas that account for 40% of the nation's GNP, while 2/3 of the country's 260 local administrative units (cities, counties, and wards) have been left behind in development and cannot generate enough local tax revenue to pay the salaries of their government officials.

In response to this state of affairs local citizens are today issuing strong demands for both greater investment in regional, social and economic development and strict implementation of local autonomy, a movement that will surely bring about changes in Korea's brand of centralized public finance.
[KOJIMA, 1992, p:313]

C3.3. African Countries' Models:

a) EGYPT:

Republic of Egypt is divided into 26 cities, 145 towns, 869 villages. Cities, towns and villages are also local authority units. Each local authority unit has "Local Public Council". Local public councils elected the president and the

attorney in their first meeting. According to the laws each council should have "Moral Commission" in order to control members of council works.

In each administrative level the executive organ helps the governor or the governor of sub district. Executive organs provide the coordination of local services and help to prepare annual investment budget.

Local authorities are responsible for education, health, water, infrastructure, culture, youth centers, housing for low income groups, development of agriculture, distribution of basic foods. Some of the local services change according to the level of local administration.

The governor makes connection between local and central authorities. Because the governor also the chief of local government while he is the representative of central government in the city. approval of other administrative level financial decisions, election of local public council are the duties of the governor. The governor could decide to establish village administration based on the proposal of town council and the approval of the city council.

Financial Resources of Local Authorities:

The revenues of local authorities could be classified as self-revenues, income portions, and central aids. Revenues and expenditures of local authorities are shown in the annual budget of government. Self revenues consist of user's charges, local taxes and expenses, revenues from other local facilities. Income portions consist of portions from property, building, entertainment, motor vehicle taxes; import tax; export tax; added portion of Suez Canal tax. Central aids consist of "Local Services and Development Fund", "Housing Fund", "Cleaning Fund", and "Oil Fund".

Every year local councils give the proposals to the central government investment budget. Those proposals are sent to local government executive committee and then to Planning Commission of the Ministry of Planning. The Ministry of Planning controls the allocation of investment fund with the intermediation of Investment Bank. [IULA-EMME & TOKI, 1993, p:104-106]

b) ZIMBABWE :

Local authorities in Zimbabwe are the extension of the central government. Ministry of Local Administration Urban & Rural Development is the upper authority of whole local authorities. The Ministry could help local authorities in many fields.

The basic local authority unit is municipality. Members of municipal councils are elected by the citizens for four years. Members of municipal council elect the mayor and the assistant of mayor annually.

The mayor is responsible for the application of council and the central government policies. The municipal general secretary who is responsible for the daily works of municipalities, is another authority in each municipality.

Local authorities provides the local services as follow:

- Housing, cleaning, road construction, infrastructure
- Water provision, health services, primary school, nursery
- Parks, public cultural centers, recreational areas
- Cemeteries

In Zimbabwe, since the local authority is the extension of central authority, coordination between the two authorities is important to provide services efficiently.

Financial Resources of Local Authorities:

In Zimbabwe, local authorities could create their revenues and prepare budget by themselves. The intervention of central government is very restricted at this respect. Resources of the local authorities are portions from the taxes(57%); revenues from infrastructures, garbage, car park, and properties.

Central government helps the small scale local authorities more than the others. In order to make financial plan of small scale local authorities, "Urban Development Institute" was established. Central government also helps the local authorities in order to demand aids or loans from the international financial institutions such as The World Bank, African Public Work Bank.

The greater city municipalities such as Harare and Bulawaye could sell bonds for urban projects. [IULA-EMME & TOKI, 1993, p:108-110]

C3.4. American Countries' Models:

a) BRAZIL:

Brazil is a Federal Republic. The basic local administration unit is municipality. According to the constitute municipalities are all autonomous.

Each municipality has city center and rural area. The center of the administration takes place at the city center. Rural areas are divided into the sub municipalities. Each settlement center of the sub municipality is village. The president of the sub municipality is appointed by the mayor and approved by the municipal council. But only in one of the province whose sub municipalities has more than 5000 people, presidents of the sub municipalities are elected by the people directly. The mayor of the capital city is appointed by the President and approved by the Senate. But normally, mayors are elected by the people for four years.

The municipal council controls the annual accounts of the mayor. Besides the municipal council responsible for the budget approval, decision of the tax and the fee, approval of city plans, establishment of public enterprises, control of bazaar areas.

Municipalities are responsible for the education, public health and social services. In rural areas they are responsible for seeds, fertilizer, tools of agriculture, distribution of agricultural insecticide chemicals.

In 1988 the tax-reform was realized in Brazil. Then municipalities have new financial resources. In sum the revenues of municipalities are as follow:

- All of the revenues which are attained as a stoppage
- 50% of the tax which is collected from properties
- 50% of institutional tax and vehicle tax
- 25% of Value Added Tax

[IULA-EMME & TOKI, 1993, p:87-89]

b) ARGENTINA :

The question of how to decentralize Argentina's public finance system has been debated since the 1970s. It was international rather than national considerations that gave rise to the problem in the first place. Recommendations from such organizations as the World Bank and the International Monetary Fund urged that the debt being accumulated by the central government be cut substantially. The measures adopted by the government included attempts to decrease spending by transferring the burden for such areas as social security and welfare services to local governments and there were also moves to privatize public enterprises. However, the former measure only caused mounting deficits on the local level, while the latter failed to contribute much to increasing tax revenue. And so beginning in 1988 a method was introduced for balancing in a rational manner both budget allocations and responsibilities between the center and local governments. However, due to the insufficient tax revenues on all levels, the measure was not successful, causing instead "the decentralization of public debt".

C4. CONCLUSION

So far we examined the local authority models in the world. Each model has some advantages and disadvantages, however those models have reached to the successful points in the frame of their countries. In the study; although they are not analyzed comparatively, we could deduct the useful approaches from those models in order to reconstruct our local financial models.

D1. FINANCIAL STRUCTURE OF LOCAL GOVERNMENT IN FRANCE

D1.1. Local Government In The General Political Setting In France

The origins of the French local government structure are found by many observers in the reforms initiated by Napoleon Bonaparte between 1799 and 1815. So entranced are these creations that some parts of their structure, such as the *commune*, have remained almost unchanged since their foundation despite the major upheavals in the nature of French government that have occurred since the beginning of the nineteenth century...-Napoleon did not devise a brand new structure but a system that streamlined existing practices, *reconciling central control with local independence* which had evolved during centuries of monarchy.

For today, although many of the structures of the French state have changed between the First and the Fifth Republics, the underlying culture of the administrative system remains essentially the same. Successive attempts at reform either by left or right-wing parties have operated within a broad consensus about the nature of the nation-state. *Article 20 of the Constitution specifically lays down that it shall be the government which decides and directs the policy of the nation.* Anglo-Saxon notions of pluralism and limitations on executive power are not a traditional element of French political culture. There is an understanding that *France is a centralized nation in which local institutions of government are subordinate to the center* (CHANDLER, 1993,p: 53).

On the other side, however, local interests play a major role in national policy-making in France, where mayors of larger cities are frequently elected members of the Assembly and the Senate and, although holding a national office, still retain their local posts in order to gain resources from the center for their communities (ASHFORD, 1982; CHANDLER, 1993,p: 1-2).

It is also important for the understanding of the French local government to stress that the French Parliament is far from being the wholly powerless organization. Parliament is principally composed of two chambers, the Assembly and the Senate. The Assembly is the most powerful and is elected currently by proportional representation. Its deliberations are checked by the Senate, which is elected indirectly from major public organizations in France but is principally composed of local government representatives. Local government is also represented strongly in the Assembly, with a majority of Deputies serving as mayors of the communes. The French Parliament thus

enfolds a very strong corporate interest in local government at the heart of the centralized decision making process (CHANDLER, 1993,p: 54-55).

D1.2. The Legal Status Of The Local Governments In France

In France, both central and local government are creatures of the state and, in that sense, local governments are dependent upon the state for their status and powers but can claim an independent existence for their own. At the same time, the functions of government are not provided by either local authorities or central government as in Britain, but in large part by deconcentrated offices of the central administration operating principally at the level of the department to form a hierarchy whose apex is in Paris. Through these offices, therefore, the political and administrative rulers of France are directly involved in, and able to control, many of those services normally regarded as 'local' in Great Britain.

A counterbalance to this centralization is provided by the activities of the mayor and communal councils, the departmental councils and also by organizations such as the Economic and Social Committee of the Regions. Representation also occurs more importantly through actions of the deputies and senators in the National Assembly, many of whom will have strong administrative ties with the area they represent. In France these links, which safeguard and continue the unity of the state and the interests of quite small areas of the country, are an integral part of the decision making apparatus of the state. French public administration can not, therefore, operate effectively unless it accommodates the political demands of localities(CHANDLER, 1993,p: 55).

D1.3. The Structure Of Local Government In France

On a macro-organizational level France is divided for local government purposes into five tiers:

1. *regions*, of which there are 22;
2. *departments* (96);
3. *arrondissements* (320);
4. *cantons* (3350);
5. *communes* (about 36000).

Of these the arrondissement and the canton play a limited role in government, the former serving as a geographical area for a sub-prefecture and perhaps for a road engineer, while the latter may serve as a police division but is principally an electoral area(CHANDLER, 1993,p: 56).

D1.3.1. Communes

Communes remain the key to local government in France, having undergone only limited reform since their inception in the Napoleonic era. They are an organic element in the local government structure, having evolved over centuries around populations and areas of very varied identities. In contrast, the departments and regions are creations of central government. A commune may, therefore, be anything from a hamlet or a small village to a city the size of Marseilles or Bordeaux. From time to time it has been proposed that the small communes are merged for the sake of efficient government. However, attempts to amalgamate the smallest communes by creating joint syndicates have met with strong local opposition. Reform proposals have had limited success and left France with about 36000 communes, of which the majority have less than 2000 inhabitants.

For those who value efficient management above community loyalty, reform is of particular importance given the limited resources enjoyed by the communes and the varied functions that they may be required to perform. These include the construction and maintenance of minor roads, refuse disposal, and, in towns, the construction and upkeep of schools. However, it is in the provision of discretionary services that the differences between the larger communes and their rural counterparts is most keenly felt. Many towns provide libraries, theaters, public transport and tourist offices, but the smaller communes find it impossible to fulfill these functions and, indeed, may only be able to provide mandatory services by collaborating with other communes (CHANDLER, 1993,p: 56).

D1.3.2. Departments

These form the second tier of the administrative structure initiated by Napoleon and provide the principal point at which centralized and decentralized services come together. The powers of the department as an entity in itself are limited and comprise principally the building of some roads, personal social services and the provision of tourist facilities. However, the key official in the department, the prefect, is the principal representative of centralized services, whose role is complemented by the departmental council, which comprises representatives from each of the cantons. In practical terms councils are less important than their title might suggest, meeting only for about six weeks in any year. Many of the functions of the council are delegated to the departmental commission, in effect a small executive, which normally meets monthly.

One of the major roles of departmental councilors is to represent the needs of their area to the prefect. Of particular significance are the functions performed by the departments for the communes. These tend to be carried out on an individualized basis by the separate services of the department, and often involve acting as a form of missionary in advising the commune on practical projects that the commune would like to develop but which it lacks both the technical knowledge and finances to implement. Individual departmental officers are, of course, able to provide advice because of their professional knowledge, and may also be able to assist in obtaining grants for projects through their administrative and political contacts in the Ministry. An important aspect of the unitary state is not, as it is sometimes seen in Britain, the imposition of additional burdens by the center on the locality, but, more frequently, an attempt made by ministry officials to meet with representatives of the localities to help them understand their needs and, where possible, to help in the provision of those needs. This is particularly important in the rural communes, which, in most cases, lack the resources to employ technically qualified staff themselves. In this way the disparities between urban and rural areas might be minimized (CHANDLER, 1993, p: 56-58).

D1.3.3. Regions

Regions are the most recent creation in the structure of local government, dating from a decree of 1964. This marked the consolidation of previous piecemeal attempts at reform by recognizing the region in formal terms and by creating the regional 'super' prefect to co-ordinate this area, together with the regional mission, conference and council. Under this reform the prefect assumed responsibility for land and economic planning in the region. The decree of 1964 also states that the prefect has the function of stimulating:

the activities of departmental prefects within his region as well as the administrative heads of field services and the chairmen or directors of public companies or mixed economy enterprises which may embrace several departments within the area and which do not have a national character.

It is difficult to be precise about the role of the regional prefects, although clearly they form a crucial link between the department and the planning commissariat. The person appointed to these duties is invariably a departmental prefect who becomes *primus inter pares* in relation to colleagues.

of carrying forward the economic and social development of the region. This was to be achieved primarily by carrying out studies to establish the economic requirements of the region, and to forward proposals for public investment policy in the area. The regional governments could then pursue these policies by generating financial support for public works projects and by undertaking projects of regional interest in conjunction with appropriate local authorities... The continuing expansion of the European Community also provides an enhanced role for the region, since the Commission prefers to use such units as the base for economic planning rather than national states (CHANDLER, 1993,p: 58-59). (see Appendix 2)

D1.4. Financial Structure Of The Local Governments In France

While central governments in many liberal democracies are progressively binding local finances to the center, there has been a trend in France towards loosening central fiscal control. Central distrust of local expenditure was such that, *although there was some measure of local determination of tax levels, it was always central government that collected and distributed local taxation.* The means of raising funds were, moreover, highly complex and subject to frequent piecemeal change (CHANDLER, 1993,p: 59).

Local government resources of French financial system are not different than other liberal countries. These can be listed as:

- tax revenues,
- central government grants,
- borrowing,
- fees and charges.

In 1982-83, a series of laws -the so-called '*decentralization laws*'- considerably altered the distribution of powers and competence between central and local governments in France. Whereas the idea was to give more autonomy and more functions to local governments, partly in order to increase efficiency in the provision of some public goods and services to enhance local democracy, French legislators have shied away from any major change in the administrative structure of local governments or indeed in the local tax system. Except for the transfer of a few minor, indirect taxes from the central to local governments, the only substantial modification in the financing of local expenditure has been a marked increase in centrally provided funding, through various channels, as well as the consolidation of the previously existing myriad central government specific - purpose grants into a small

number of block grants -with, however, extraordinarily complex formulae (GIBSON AND BATLEY, 1993,p: 28).

In this part, the financial structure of the local governments in France, after the decentralization laws, will be explained in four steps. In the first step, an analysis of the local tax system will be done. Secondly, some indications on debt-financing of local investment expenditures will be provided. In the third step, central government's involvement in financing will be discussed. Finally, conclusive remarks on the evolution of the financial structure of the local governments of France will be given.

D1.4.1. Local Tax System

Along with the decentralization move, the share of own tax revenues in total local government resources has been steadily increasing over the last decade, from 30.8 per cent in 1983 to over 38 per cent at the end of 1980s.

French local governments can draw from as many as 41 different taxes. But, in spite of the transfer of a few indirect taxes -such as driving licenses and automobile tax- to local governments, the 'old four' direct taxes make up the bulk of the total tax revenue. The so-called '**old four taxes**' are:

1. Land tax (*taxe sur le foncier non-bati*, TFNB).
2. Building tax (*taxe sur le foncier bati*, TFB).
3. Residential tax (*taxe d'habitation*, TH).
4. Business and self-employed tax (*taxe professionnelle*, TP).

These taxes form the 85 per cent for communes; 58 per cent for departments; and 51 per cent for regions, of the total tax revenue, in 1990. The overall evolution and distribution are depicted in Figure 1 (GIBSON AND BATLEY, 1993,p: 30).

Total tax revenues of local governments have increased very fast over the last decade, reaching about 6 per cent of GDP in the early 1990s. To some extent, such a growth is expected outcome of decentralization, especially considering the fact that most of the functions transferred from central to local governments are among the fastest growing expenditure items. But it might also signal a certain *lack of accountability* in the local tax system, due to some of its characteristics that may be deemed undesirable.

First of all, it certainly suffers from a *lack of transparency*. All four major taxes are shared amongst the various levels of local governments, each one using the same basis and voting its own rate, while tax-payers receive a single bill,

giving the details of the amount levied by each level. In addition, three out of four direct taxes are based on conventional rentable values, rather than current market values; and contrary to what had been envisaged, tax-base reassessments have not been carried out at regular intervals: for property taxes, the last revisions were conducted in 1961 (land tax) and 1970 (building tax).

Probably one of the most troublesome features of the French local tax system arises with respect to business taxation. The often criticized formula used in the calculation on the business and self-employment tax -a mixture of payroll and fixed-assets tax, somewhat similar to the German *Gewerbesteuer*- bears little relation to the tax-payer's actual ability to pay.

The trouble is rather with the excessive share of local tax burden being borne by businesses; in 1990, 53 per cent of total direct tax revenues of local governments came from business taxation (TP and TFB). From an accountability point of view, this tendency to overtax businesses is obviously not desirable, since it effectively lowers the tax-price of local public goods and services for individual tax-payers. Moreover, it is the single major cause of tax disparities and tax competition amongst local governments: those local governments with few businesses have to have high tax rates on all four taxes, while those benefiting from the presence of many businesses can afford to have low rates. Along with generating serious disparities amongst individual tax-payers living in different jurisdictions, this feature of the local tax system tends to reinforce the natural tendency to business concentration. By transferring the business and self-employed tax to the new groupings of communes, the February 1992 law seeks to alleviate this problem and lessen the distortions caused, at the local level, by such a tax competition (GIBSON AND BATLEY, 1993,p: 30-33).

D1.4.2. Local Government Borrowing

All levels of local government in France have traditionally been allowed to borrow in order to finance public investment expenditures: the legal obligation is to vote annually a balanced budget for current revenues and current expenditures, including servicing outstanding debt, but excluding investment and new borrowing. In this domain, the decentralization laws have lifted all forms of a-priori control by the state administration on local government borrowing; because of the various transfer of competence, they have also induced a surge in local investment expenditures, now representing the bulk of total public investment. Along with this reform, financial deregulation has profoundly altered the conditions of local government borrowing: whereas

most of the financing used to be provided by a specialized, state-owned bank drawing on low-cost resources and granting below-market interest-rate loans, with borrowing authorization conditional on central government subsidies, local governments now have access to all credit institutions and financial markets, but at market conditions. Such a change has produced a diversification of the resources of financing, as well as a market increase in its costs.

Due to the small size and limited tax potential of most local government entities, direct access to financial markets has remained rather exceptional: there is still no such thing as a true market for municipal bonds, and only a handful of large cities, some departments and regions have floated debt on national and, sometimes, international financial markets. The bulk of borrowing is still channeled through the banking system, with the major specialized bank (*Credit local de France*) retaining a dominant position with a little less than 50 per cent of new loans in 1991.

These changes have tended to widen existing disparities amongst local government entities with respect to access and conditions of borrowing. Although there has not been a marked increase in total borrowing -mostly due to higher interest rates- some local governments have embarked on excessively risky debt accumulation paths, and over the last couple of years isolated cases of bankruptcy -or at least critical financial situations- have emerged, leading major banks to develop better credit rating procedures and inducing a reform of local government accounting that has recently been undertaken by the central government (GIBSON AND BATLEY, 1993,p: 33-34).

D1.4.3. Central Government Grants

Even though one of the major purposes of the decentralization laws was to increase local government autonomy and fiscal responsibility, they have been accompanied by a marked increase in state involvement in the financing of local government expenditures; and, in spite of the initial effort to consolidate the various existing grants and simplify the procedures, there has clearly existed, since then, a tendency towards increased complexity.

The central government has retained control over the general principles of the local tax system: definition of tax bases, rules and limits for the various tax rates, and tax collection. In addition, because taxes are collected at the end of the year, the central government lends, each month, one-twelfth of the voted

budget; conversely, all funds have to be deposited on non-interest-bearing accounts at the Treasury.

Moreover, the central government directly provides funding through a complex system of grants, representing, in 1990, 135 billion francs, that is 27 per cent of current expenditures and 18 per cent of investment expenditures of local governments. While the latter are still mostly specific purpose, matching grants, an effort has been made since the late 1970s to consolidate the major state subsidies to current expenditures into a small number of block grants, with, however, quite complex distribution criteria and various indexation formulae, usually amended and capped various times since their enactment. Other general purpose grants have been instituted in the 1980s to compensate for the added financial burden resulting from the decentralization laws and for various, centrally decided measures taken in favor of specific taxpayers.

Until 1990, there were four major grants, three of which accrue to all three levels of government: their relative importance is presented in Table 1.

TABLE 1. MAJOR GRANTS IN 1990

	Beneficiaries	Amount*	% of total transfers
DGF	C.D.	82,151	47 %
DCTP	C.D.R.	21,786	12.5 %
DCTVA	C.D.R.	15,073	8.6 %
DGD	C.D.R.	12,890	7.4 %

Notes: C: commune; D: département; R: région

* million Francs

Source: GIBSON and BATLEY, 1993, p:35.

The most important central government block grant (91 % of the general purpose grants for current expenditures, in 1990) is the *Dotation globale de fonctionnement* DGF, created in 1970 through the consolidation of various previously existing grants. Its distribution is dictated by rigid criteria, some which include equalization formulae. The amounts are revised annually and indexed on the CPI and the real GDP. Table 2 shows the total amounts at current prices over the last decade.

TABLE 2. EVOLUTION OF THE DGF.

	Amount (million francs, current prices)
1979	34,261
1980	39,012
1981	45,022
1982	51,966
1983	56,560
1984	60,775
1985	64,437
1986	67,256
1987	72,100
1988	77,214
1989	82,734
1990	85,546

Source: Cour des comptes, Novembre 1991. (GIBSON AND BATLEY, 1993, p:35.)

With regard to the state participation in the financing of local government investment expenditures, the most important grant (69 % of total state financing of local public investments, in 1990) is a matching grant, *Fonds de compensation de la TVA*, **FCTVA** created in 1977 to compensate local governments for the non-deductibility of VAT paid on investment expenditures.

The decentralization laws have also instituted a special grant, *Dotation générale de décentralization*, meant to compensate part of the increase in tax burden due to the transfer of specific functions. It is, in fact, a series of grants, some of which are specific purpose grants. The total amount is indexed on the DGF.

In addition to these subsidies, the state compensates local governments for reductions or exemptions granted to local tax-payers by national legislation. This is, in particular, the case for *Dotation de compensation des allègements de base de la taxe professionnelle*, **DCTP**, created in 1987, when the National

Parliament decided a uniform, 16 % reduction in the tax base of business and self-employment tax. The amount accruing to each local government was initially calculated on the tax revenue perceived at the time and is now indexed on central government net tax revenues.

More recently, three new transfer mechanisms have been added to this already complex state subsidization system. Two of them are equalizing grants: *Dotation de solidarité urbaine*, DSU, is financed by a reduction of the DGF accruing to rich communes and benefits poorer ones in the same metropolitan area; a similar, but specific, equalizing mechanism has been instituted within the Paris area for communes and departments. Finally, a new grant, *Dotation de développement rural*, DDR, has been created in February 1992 law to induce communes in rural areas to form newly instituted groupings (GIBSON and BATLEY, 1993,p: 34-37).

D1.4.4. Conclusive Remarks

In spite of the recent attempts at reform, some of the traditional problems of the local financial system remain unresolved. One of these obviously is the degree of control exercised by the government both over budgets and, less directly, over the amounts of money that might be raised to fund local activities. Although a limited ability to decide their own rates on some trades eases this control slightly, centralist pressures still remain extremely strong.

A second problem is the variation in the size of the communes and their diverse requirements and expectations. Too proud to wish to unamalgamate, yet in many cases too small to operate many of their own services, they remain inevitably dependent on government support, which frequently requires joint arrangements with other communes. This problem may partly be alleviated by the development of local controls over finance.

A third problem is the tendency of central government to place additional burdens on local units without due to their financial ability to carry out these tasks. Even without that, the increasing expectations of the public, together with developments in services, has put severe pressures on the resources that local authorities are able to command. A particular has been the pressure created by urbanization, which has frequently resulted in loans being sought from outside agencies. So rapidly have these loans grown, and so extensive have they become, that some of the loans now being taken out are being used to repay previous loans rather than to indulge in further expansion (CHANDLER, 1993,p: 61-62).

The 1982-83 decentralization laws have clearly altered the balance of powers and competence between the central and local governments in France. But, because they have failed to change jurisdictional structures and to reform the local tax system, the outcome suffers from some glaring deficiencies, most notably in terms of transparency and local government accountability. The ways in which the central government intervenes in financing of local government expenditures tends to reinforce the perverse effects of local taxation. Confronted with these difficulties, as well as with the spatial inequities and risks of geographical concentration businesses generated by this complex system, the National Parliament has reacted by adding ever more complex redistributive mechanisms that do not seriously seem to alleviate the problems (GIBSON AND BATLEY, 1993,p: 37).

D2. FINANCIAL STRUCTURE OF LOCAL GOVERNMENTS IN GERMANY

D2.1. General Political Structure Of Germany

The reunited German state has largely been formed through the extension of the West German structures to the former communist areas. The technical distribution of power within the political system is delineated by the constitution known as the Basic Law (*Grundgesetz*) drawn up by a Constituent Assembly in 1948. The format adopted has been widely seen as reflective of the determination of the western occupying powers to establish a system of government firmly grounded in the principles of liberal democracy and with a clear-cut separation of powers (CHANDLER, 1993,p: 99).

West Germany is a federal country with federal government (*Bund*), 11 state governments (*Lander*), three of which are city-states (Berlin, Hamburg and Bremen), increased to 16 *Lander* with the unification in 1990, and a wide range of local governments (GIBSON AND BATLEY, 1993,p: 39)

Although elected assemblies have been created at both state and federal level, legislative power lies largely with the federal assemblies. Under article 73 of the *Grundgesetz*, the *Bund* holds exclusive right to legislate in areas such as defense, foreign affairs, currency control, rail traffic, postal services and telecommunications. Although technically the *Lander* are free to legislate in all other areas, there is also a provision for concurrent powers whereby the federal government reserves the right to legislate in areas of national interest. Through the use of this wide-ranging power, federal legislation now effectively covers the legal system, economic management and most aspects of social welfare. In addition, through the establishment of framework legislation whereby the federal government lays down the broad policy guidelines but

gives wide discretion to the Lander in the implementation of policy, the federal government has extended its influence into further areas such as higher education and land use (CHANDLER, 1993,p: 99).

D2.2. The Legal Status Of Local Governments In Germany

Local democracy in Germany has a tradition that can be traced back to the rights granted to the medieval cities, although the modern format is largely credited to the measures initiated in Prussia by Freiherr von Stein in the first decade of the nineteenth century. Although the franchise was restricted primarily to the middle class until 1918, as Gunlicks notes, the reforms outlined by von Stein:

created a national system of well ordered and state supervised local government that enjoyed considerable autonomy in an otherwise authoritarian framework of central administration (GUNLICKS, 1981,p: 169).

The autonomy of local government was severely curtailed during the National Socialist era; therefore, given the collapse of German society in 1945, the establishment of an effective system of local government was one of the central goals set by the Allied powers in the political and administrative reconstruction of occupied Germany. The basic unit of government below the level of the state established to fulfill this role is the municipality (*Gemeinde*), of which there were originally some 30,000, ranging in size from 8,000 to 1,000,000 citizens. Rationalization of the Gemeinden in the past two decades, however, has reduced their number to just under 9,000 and it is now unusual for a unit of local government to exercise authority over an area containing less than 10,000 inhabitants.

The right of the Gemeinden to direct their own affairs is explicitly stated in article 28 of the Grundgesetz which guarantees:

the right to regulate under their own responsibility and within the limits of the laws all the affairs of the local community.

In effect, this gives the Gemeinden sweeping powers to act in all areas not specifically reserved for the Bund or the Lander. Gemeinden have made full use of this freedom and often provide a wide and varying range of services to the community. The organization of local government, however, is not explicitly outlined by the Grundgesetz, other than that it should conform to the principles of a republican, democratic and socially just political system. The

actual format of local government is determined, therefore, by the individual states, with the legal status and structure of the Gemeinden being established by the constitution of the Land within which they operate. While, therefore, there is an element of uniformity -for example, the affairs of the municipality will be run by a council (*Gemeinderat*) elected by a system of proportional representation drawn from party lists- the frequency of elections and the distribution of power between elected and appointed officials varies amongst states.

All of the Lander, however, have basically a three-tiered system of elected government. Operating at an intermediate level between the Gemeinden and the Land is the county or *Landkreis*. The affairs of the Kreis are generally directed by an official (*Landrat*) selected by the elected body (*Kreistag*), although once again there are variations on this format, particularly in Bavaria. The role of the Kreis is to act as a general supervisory body over the Gemeinden within its area, with the exception of many of the larger cities which, due to their size, have effectively been granted county status. Over one hundred cities hold the status of *Stadtkreis*, which gives them freedom from county direction and confers powers equivalent to those held by the Kreis. Some of the largest cities are divided into districts (*Bezirke*) with elements of administration delegated to each district. Within this network of organizations one further anomaly must be noted. Bremen, Hamburg and Berlin hold the distinction of enjoying the status of both Gemeinde and Land and combine both functions (CHANDLER, 1993,p: 101-102).

D2.3. The Structure Of Local Governments In Germany

The Gemeinden operate a wide and startling variety of services. Yet, while the number of services offered is indicative of the premium placed upon freeing local initiative, the vast majority of local responsibilities are, in fact, delegated from either the Bund or the Land, with the Gemeinden acting as administrative agents. The degree of supervision of the operation of these services, however, varies considerably. In areas such as

- public health,
- organization of elections,
- taxation,

- and various forms of licensing, particularly of buildings,

local government acts on behalf of the Lander and is closely supervised. In other areas of delegated responsibility, however, while minimum standards are established by law, Gemeinden have considerable discretion in the implementation of their responsibilities. Services covered in this category include the major public utilities;

water, electricity, gas,
the provision of school buildings,
public transport,
health care,
and fire services,
in addition to the construction and maintenance of housing and
certain categories of roads.

To this list can, occasionally, be added the organization of a local police force, although in most instances, along with the appointment of teachers, this is a responsibility reserved for the Lander. While all of these services are subject to an element of regulation and are partially dependent on financial assistance from the Land, the format adopted and the extent of provision can vary markedly between communities.

In addition to this vast array of responsibilities the Gemeinden are given a free hand to move into areas which are not the particular reserve of the Bund and Lander. In most instances they have made full use of the opportunity with the provision of

transport networks;
shopping facilities;
social services;
and a vast array of recreational and cultural facilities.

It is the enterprise and innovation displayed in this latter area which distinguishes local government in Germany from many other countries. As might be expected, however, the finance necessary to provide many, even basic, services is beyond the means of the smaller Gemeinden. In order to overcome this problem several solutions have been adopted. In some instances, neighboring Gemeinden have been amalgamated into larger units termed *Samtgemeinden* or *Verbandsgemeinden* in order to pool their resources, while it is not unusual for a particularly expensive service, such as the provision of water or electricity, to be delegated to an ad hoc agency formed by agreement between groups of Gemeinden.

Frequently, even the creation of such organizations is inadequate to sustain a satisfactory level of service provision, and the past decade has witnessed a steady drift of responsibilities away from the Gemeinden to the Kreis. Unlike the Gemeinden, the Kreis can only administer those services assigned to it by law. Yet, while technically this gives the Kreis only a limited range of functions, in practice financial necessity has led to the Kreis increasingly adopting responsibility for the provision of such services as hospitals,

secondary education, gas, electricity and water (CHANDLER, 1993,p: 102-103).

There is, however, considerable difficulty in defining the real range of local responsibilities. In practice, then, there is a complex web of shared responsibility among the central government and the all units of the local government. At one extreme, are Land functions performed at local level with no discretion; mandated functions from the Bund give some local discretion and have been increasing within the total of local responsibility. At the other extreme, some welfare services are open to considerable discretion and local political factors can be important in affecting this. Many of these services are strongly income-related and so it is likely that they show considerable spatial variation in incidence between areas. The result is to generate greater local service expenditure needs in the industrial cities. This has stimulated many of these to develop economic development departments (GIBSON AND BATLEY, 1993,p: 40-42).

It has to be noted, however, that the power of the state to regulate and direct local government is far greater than the ability of central government to control the state. Therefore, although local government has maintained a remarkable degree of autonomy, the growing financial burden of providing a wide range of services has significantly reduced its freedom of action. It is this development that has led observers to fear for the future role of the Gemeinden. Increasingly the responsibilities of the local government have been progressively eroded, owing to their reliance on central finance and to the proliferation of specialized field units, organized by the Lander and federal agencies for the operation of major projects in the areas of housing, regional development and health care (CHANDLER, 1993,p: 104).

D2.4. Financial Structures Of The Local Governments In Germany

The legal status of the Gemeinden is clouded by the fact that, although under the provisions of the Grundgesetz they are guaranteed a degree of autonomy, with the right to make decisions concerning the administration of their own affairs within a legal framework established by Bonn and the Lander, in effect the organization and format of the Gemeinden are determined by the provisions contained within the constitutions of the individual Lander. This position is also reflected in the financing of the Gemeinden, with the establishment of the principle of *budgetary autonomy*, while in reality the financial base is determined by the Land (CHANDLER, 1993,p: 104).

There are two main financial resources of the local governments in Germany. The first one is the taxes, and second one is the network of grants and subsidies provided by the Bund and Land to assist the Gemeinden.

D2.4.1. Taxes

Most of the areas of the German local government rely mainly on local taxes, chiefly those on businesses. Smaller communities usually rely mainly on shared taxes, and fees. The property tax provides a small source of revenue for almost all localities, and most localities also have minor and relatively insignificant taxes such as land transfer tax, amusement tax, drink and ice cream tax. The business tax, property tax, fees and minor taxes provide autonomous revenue sources for which tax rates vary considerably. Valuation of the tax base is a Land-wide function under federal legislation. In addition to autonomous taxes, a major contrast to the UK is the importance of shared taxes. These are taxes which are legally the responsibility of one level of government through the constitutional provision.

The federal VAT provides the major source of income to the Lander through sharing. Federal income taxes are shared 15 per cent with local authorities (14 per cent 1969-1979), whilst 40 per cent of the local business tax is shared with the federal government (up to 1979, decreasing to 14 per cent in 1985). In addition there is a complex network of federal and Lander, general and specific grants. The result is a network of interrelationships among federal, state and local levels which is like the USA, although rather more uniform across the country.

The extent to which fiscal and political imbalance can develop within this system depends on the developments of local tax rates and state level grants, but is most fundamentally determined by federal legislation which adjusts the size of autonomous local tax bases and shared revenues.

Table 3 shows the business taxes and the income tax share are the predominant sources of local tax revenue, with a share of 80.5 per cent in 1970 increasing to 84.4 per cent in 1981. Due to reforms, the relative trend in the importance of the business taxes was downwards in 1970s (44.5 per cent of local government income in 1973 to 39.7 per cent in 1981), while conversely the importance of the income tax share grew steadily (37.8 per cent in 1970 to 44.8 per cent in 1981). The share of property taxes has remained stable, fluctuating around 12 per cent. Property taxes and business taxes are regulated by federal legislation but are levied by local authorities

which are free to set the actual rate of tax (GIBSON AND BATLEY, 1993,p: 42-43).

TABLE 3
PERCENTAGE OF TAXES IN TOTAL TAX REVENUE (NET) FOR GENERAL
GEMEINDEN FOR SELECTED YEARS.

	1950	1969	1970	1984	1990
Property tax	42.3	13.8	14.7	12.5	11.7
Business tax on assets/profits	39.6	75.0	35.1	40.8	44.6
Business taxes on payroll	7.6	6.2	7.6	-	-
Income tax share	-	-	37.8	44.2	42.2
Other taxes	10.4	4.5	4.8	2.5	1.5
TOTAL (in million DM)	2,748	18,829	18,240	56,370	74,620

Source: GIBSON AND BATLEY, 1993, p:43.

D2.4.2. Intergovernmental Grants

The distribution of intergovernmental grants in Germany is governed by two general principles:

1. The constitution severely restricts federal grants to local governments; they can concern only investments and can not support current expenditure, they must be categorical grants, no unconditional aid is possible, and there must be no strings attached to the exact destination of funds; the federal government may only pass earmarked funds to the Lander, which do have right to determine the final destination of funds.
2. The federal constitution obliges the Lander to provide grants to local governments out of a percentage of their tax receipts. The Lander, however, decide the percentage of funds distributed, their degree of specificity, and the manner of their distribution.

As a consequence of these constitutional procedures all current account grants are administered by the Lander. The various forms of intergovernmental transfers which result are shown in Figure 2 and fall into three main categories:

- (i) Lander-Gemeinden general grants.
- (ii) Specific grants supporting current expenditure (mainly 'formula' grants).
- (iii) Specific grants supporting local investments.

(i) The Lander-Gemeinden grants are tied to the level of receipts of shared taxes and are governed by each Land constitution. As a result, the size of support varies. Overall this support is equal to about 17 per cent of Gemeinden income (in 1990). The common objectives which influence all Lander governments' general grants are: to increase local revenue; to seek equalization of tax potential; and to compensate for variation in local needs. The form of allocation of these general grants depends on the tax potential (tax base multiplied by a standard tax rate), and on measures of local need (mainly determined by population level weighted by population size and special factors). These grants are open to a number of criticisms: first, because the richer states generally can provide a higher level of support; second, the level of need equalization adopted is usually small, the grants being mostly based on population; third, there is inadequate account taken of special needs such as population decline and infrastructure renewal costs.

(ii) The current expenditure-specific grants from Lander to the cities also vary widely among Lander. Most of these grants are aimed at equalization, and again tax potential and population size are the main criteria used in allocation.

(iii) The investment grants derive from both Bund and Lander and fall into six groups:

1. Joint tasks; the most important category, and used to aid lagging regions, universities, agricultural investments, and coastal protection. They are the main instrument of German regional policy and have major importance for rural communities.
2. Education and research coordination.
3. Restitution for federal delegated functions, for example, military administration, airports, roads, student grants, housing subsidies.
4. Short-term stabilization; mainly in local transport, urban development, housing and hospitals. Important for many older cities but declining in magnitude.
5. Miscellaneous Bund grants, mainly for housing.
6. Lander investment grants: mainly to match Bund investments in hospitals, urban renewal and local transport, and school construction.

It is generally felt that these grants have stimulated local expenditures, especially in public transport, roads, hospitals and urban renewal, and have generally benefited the older and larger cities. They have also diffused

funding to rural areas through the joint task grants. Although benefiting the central cities they have been criticized as undermining local autonomy and having confused and contradictory objectives. They have also tended to aid middle and upper income groups rather than the poor, and have often increased the procyclical nature of local spending. Overall, total grants from the Lander amount to about 26 per cent of total income of Gemeinden in 1990.

In addition to these vertical intergovernmental transfers there are also flows between counties (Kreise) and Gemeinden and there is also a small but important set of horizontal transfers between communities, particularly in urban areas to offset spillover effects, for example, of transport benefits, and so on. In some cases, special bodies (Zweckverbände) have been created to administer these functions. Their incidence and effects vary greatly from city to city (GIBSON AND BATLEY, 1993, p. 44-46).

Certainly, within this framework, despite the outward autonomy enjoyed by the Gemeinden, control of finance appears to be gravitating slowly, yet steadily, to the center. (see Appendix 3)

E1. THE EXPENDITURE AND REVENUE STRUCTURE OF URBAN GOVERNMENTS IN DEVELOPING COUNTRIES

Subnational governments in developing countries account for an average of 15 percent of total government spending, and an average of about one-third of all urban area spending is financed through local government budgets. Perhaps, the most important, the expenditure responsibilities of local governments often include major development functions.

The trend and pattern of growth in consolidated local government expenditure (general purpose local governments and autonomous agencies) are perhaps surprising; real per capita expenditure increased during the late 1960's and first half of the 1970's. The ability of some local governments to raise per capita expenditure during this period (despite rapid increases in population, limited resource bases, inflation, and constraints placed upon them by higher government authorities higher government authorities) was a remarkable achievement (BAHL, R.W., 1992).

This situation changed somewhat in the 1980's, local revenues were not buoyant enough to cover expenditure needs, and there was a noticeable shift toward central financing of urban services and a slower growth in real per capita local government expenditure. Even so, there is enough evidence here to suggest that urban governments have a significant fiscal potential and that they may make an important contribution to rational resource mobilization. Thus the expenditures and revenue structures of local governments in developing countries are;

E1.1 Expenditures Structures

Especially, the role of autonomous agencies in providing urban public services in the cities of developing countries are very important in cities where public utilities are provided by autonomous agencies, the central governments is less involved in financing capital projects when capital facilities are not financed through autonomous agencies, central government financing is much more important. The implication is that the autonomous agency is seen to have a comparative advantage over general local government financing and implementation, perhaps because of its autonomy in management or its potential for relying on user charges.

E1.2 Revenue Structures

The financing patterns of urban governments is distinguished between local and external sources of revenues. The three categories of local revenue considered here are;

- a) locally collected taxes,
- b) user charges and benefit charges,
- c) other locally raised revenues, such as license fees, penalties stamp duties, and the like.

The external sources of local financing are transfers (grants or shared taxes) from higher-level governments and borrowing.

The distinction between locally raised and external revenues is important because it describes the degree to which urban governments draw on the resources generated by the urban economy.

Furthermore, there is a presumption that local authorities have more discretion in managing their local sources of finance than is the case for external revenues. There are negative correlation between the ranking of cities according to the share of local government spending in total public expenditure. This supports the hypothesis that the broader the expenditure responsibility of general purpose local governments, the less they can depend on their own revenue sources, that is, the more they rely on external sources which tend to be controlled by higher-level governments.

E1.2.1 Locally Raised Taxes

Taxes provide more than half of locally raised revenues in the average city, and self-financing revenues about a third. These averages hide a wide variety of local financing patterns and preferences.

And, local governments draw on a large variety of tax. And also, the property tax is levied in virtually all cities and often dominates the revenue structure. Taxes on motor vehicles and on entertainment are levied in many cities, but very few exemptions neither is of substantial importance for revenue. Industry and commerce taxes are common in Latin America and parts of Africa and can account for a significant amount of revenues. Some other forms of sales tax raise significant revenue in some cities.

Local income taxes are not common but have been important in some African cities. Property taxes are a local tax instrument in a few cities, but only in a few instances did this source raise a substantial share of local taxes. Finally, the category labeled all other taxes contributes a sizable share of local taxes.

There are quite noticeable changes in the pattern of urban government finance from the 1970's to the 1980's (BAHL, R.W., 1992).

- There is a trend toward more or less over all on locally raised revenues.
- Locally raised revenues from charges are increasing in importance, and those from taxes are declining.
- Among local taxes, there appears to be a shift from property based to consumption-based taxes.

E1.2.2 External Financing

On average, about 30 percent of all local revenues in these cities are raised from external sources, mostly from grants and shared taxes. In developing countries, relatively few cities more than half their revenues from external sources but the one or more get more than half their revenues from external sources. As, urban local governments in developing countries should receive less intergovernmental assistance than those in industrial countries.

This is because public service provision in cities in developing countries tends to have fewer spillovers to the rural hinterlands, and cities in low-income countries do not perform as many central places functions as do those in industrial countries. Moreover, since cities in developing countries tend to suffer less from jurisdictional fragmentation than is the case in developed ones, there is less need for equalizing transfers from higher-level government to relieve intra metropolitan fiscal disparities.

Loan financing generally is the smallest revenue source for cities in developing countries, contributing less than 10 percent of total financing. In this respect developing countries, where capital outlays are largely financed from borrowing (BAHL, R.W., 1992).

Autonomy face severe constraints in choosing their fiscal patterns. Even when they have had substantial freedom of action, however, their existing revenue authority has not always been fully utilized. The revenue instruments which seem most under utilized are property taxation, motor vehicle taxation, betterment levies, and user charges. Thus, the degree to which a city's government is able to meet its rapidly rising expenditure requirements

depends only in its revenue capacity, as determined mainly by the economic base of the city and by the restraints imposed by higher level.

E2. LOCAL GOVERNMENT TAXES

E2.1 Property Tax System

The property tax is the single most important local government tax in developing countries. It is however, not necessarily the best revenue-raising instruments for a city because it is very difficult to administer efficiently can have undesirable land use effects, and is very unpopular with taxpayers. Yet local governments often have few other sources of revenue and important strides have been made to ward improving the fairness and revenue productivity of property taxation. Also, urban property tax systems vary widely among developing countries.

E2.1.1 Types of Property Taxation

There are three forms of property taxation. The property tax may be levied on the annual or rental value of property, capital value of the land and improvements or the site value of the land. The annual value form may be seen as an attempt to tax the yearly income from properties, where as the capital and site value forms are partial wealth taxes.

Tax systems are also differentiated by varying coverage, different rate structures, and perhaps most important of all, different assessment practices. In a sense each country and each city implants its own style on its property tax system.

Also, the tax systems are;

E2.1.1.1 Annual Value System

In annual value system the base is defined as the expected or national rental value of a property. The common feature of annual value systems is property assessment according to some estimate of rental value or net rent. In theory, a discounted stream of net rent payments is equivalent to the capital value of a property; hence, the capital and annual value bases are equivalent. In practice; there is no such equivalence because annual value systems are based on market prices. There is usually wide divergence between assessed annual value and net market rent. And there are there reasons for such divergence:

- a) legally allowable reductions in annual value,
- b) rent controls,
- c) assessment difficulties, particularly for non-residential properties. The tax base under rental value systems is further reduced by exemptions of certain classes of property and by a range of preferential assessments. Most annual value systems, fully exempt properties of the government, properties of religious and charitable institutions, and foreign embassies.

Also, there are important differences among cities in the level, structure and flexibility of annual value property tax rates. And also, variations across cities in the effective tax rate-the ratio of taxes paid to market rent or market value-are probably as much influenced by variations in assessment practices as by variations in either the definition of the legal base or the statutory rate structure. No matter what the base and rate structure is stated to be, evaluation of the equity, elasticity and performance of annual value systems must begin with a careful examination of the methods used to determine annual value (BAHL, R.W., 1992).

E2.1.1.2 Capital Value System

There appears to be much more diversity in practice among cities using capital value systems than among cities using annual value systems. There also are some important common features in assessment practices among capital value systems. The more important of these are

- a) a differential tax treatment of and improvements,
- b) an objective assessment practice for residential properties,
- c) a uniform assessment procedure for various types of land.

Another common tendency is for capital value systems to in value central and state governments much more heavily in the administration of the tax.

In capital value system, the tax base is defined as the assessed value of land and improvements, or as only the assessed value of land under the site value version. In fact, most capital value systems in developing countries assess land independent from improvements; hence, the site value approach differs from most other capital value systems only in that it does not tax buildings.

There important features of capital value rate structures distinguish them from annual value systems; the use of flat rates is more common, there is more

frequent use of differential taxation of land and improvements, and the capital value rate structures tend to be more complicated.

E2.1.1.3 Site Value Taxation

Site value taxation is a special case of capital value property taxation, and one that is particularly interesting because of its potential for improving the efficiency of urban land use. The argument for this form of taxation is straight forward; if only the land is taxed, the owner will have no disincentive to developing the land its most efficient use (BAHL, R.W., 1992).

There are two disadvantages to site value taxation, which may think limit the possibilities for its use in other countries. The first is an assessment problem. The second disadvantage is that site value alone provides a limited tax base and can produce sufficient revenue only at high rates.

Also, site value taxation has two important advantages aside from the removal of a disincentive for investing in improvements. The first, paradoxically assessment advantage, it stands to reason that the job can be done more cheaply and uniformly if improvements need not be considered. The second advantage, has to do with the equity of property taxation. A pure land tax is likely to be borne proportionately more by owners of the land.

E2.1.2 Optimal Property Tax Structure

There is a trend in property tax practices in developing countries. It is away from the annual value base and toward capital value assessment. This change reflects the fact that, as urban areas modernize, the virtues of the annual value system become less and less important, and the comparative advantages of a capital value system become more apparent. The move toward a capital value basis implies more than simply a change in the method of assessment. The administration of rental based systems is more likely to be left with the local authority than is the administration of a capital value system. Capital assessment is more difficult and more technical and requires a larger staff of qualified assessors than does rental value assessment as currently practiced. But the annual value systems were completely administered by the local government, where as the assessment function tended to be shared or centralized under the capital value system (BAHL, R.W., 1992).

E2.1.3 Property Tax Administration

That the property tax is difficult to administer is an often lamented fact in industrial as well as developing countries. The problems are particularly severe in developing countries because of a shortage of skilled staff and because records of landownership and property transfers are often notoriously bad. Yet urban property values are growing rapidly, and local governments have little option but to make the most of the property tax. It should not be surprising, therefore that some notable improvements have been made in administering the local property tax in some cities of developing countries.

The administrative constraints to improving the fairness and revenue productivity of the property tax lie in all four facets of property tax administration : Identification of property site and ownership, record keeping, assessment, and collection. Reforms that attempt to improve any one aspect without considering the other three are not likely to be successful. Indeed, when the poor revenue performance of the property tax is attributed to administrative shortcomings, the reference may be to any or of these four areas.

Property tax structure and administration go hand in hand and cannot easily be separated when undertaking a reform. A second is that there are four critical aspects to administration of the property tax. Property identification, record keeping, assessment and collection. Unless all are considered administrative reform will not necessarily produce a better property tax as system rather than as a set of independent activities.

A third conclusion is that it is important to monitor and if possible quantify the importance of the property tax in order to plan for effective reform. The major weaknesses in the administrative practices of property taxation can be identified by quantitative measurement of such components as assessment, exemptions and collection.

E2.1.4 Generalization About Property Tax Policy

Formulating tax reform in cities of developing countries(BAHL,R.W.,1992):

- 1- The property tax should be kept as simple as possible. Exemptions should be kept to a minimum and rate structures kept as uncomplicated as possible. Reform should emphasize improving the general property tax administration rather than adding special features to affect resource allocation or income distribution.

2- The property tax needs to be viewed as a system and reforms need to be coordinated by all parties involved in structuring and administering the property tax. Decisions about assessment and collection practices, exemption policy, and rate structure design may be the responsibility of different offices but must not be made independently.

3- In general, a flat rate property tax on all real estate is not likely to be regressive in either the short or long run.

4- The distribution of property tax burdens will be more progressive if the preferential treatment granted to owner occupants is eliminated.

5- The exemption of low value properties or, better yet, granting all taxpayers a deduction from assessed value will make the property tax more progressive, favor low-income housing development, and ease property tax collection problems. The revenue costs will be small.

6- On balance it is preferable to tax land more heavily than improvement. Therefore if increased revenues are to be raised from an existing capital value tax, it is worth considering raising the tax rate only for land, rather than for land and buildings a like.

7- If a special tax is to be levied on vacant urban land to speed up its development, this tax instrument should be explicitly linked to a land use development plan rather applied indiscriminately to all vacant property in the metropolitan area.

8- A property transfer tax is likely to interfere with efficient operation of urban land markets and should be replaced by more effective administration, and possibly a higher rate, for the general property tax.

9- A land value increment tax is not likely to be effectively administered in developing countries. Efforts to raise property tax revenue would do better to focus on improving the administration of exist property tax systems.

10- The four facet of property tax administration-identification of properties, record keeping, assessment, and collection must all be improved to make the property tax more productive. Improving collection efficiency alone will increase revenues in the short run but will not provide the broader base necessary for long-run growth.

E2.2 Automotive Taxation

The ownership and use of motor vehicles represent excellent, but much neglected, tax bases for urban governments in developing countries. The growth in the number of automobiles is more rapid than the growth in city population, automobile ownership and use are easily taxable, and such taxes are likely to raise on persons with high incomes. In addition, the grouping number of motor vehicles results in larger expenditures for urban roads, and increased congestion and pollution costs. Thus, for purposes of revenue, efficiency, equity and administration, automotive taxation represent a nearly idea revenue instrument for urban governments. Annual automobile registration fees, restrictive area licenses, and tolls have been applied with substantial success to some cities in developing countries, for example, Jakarta and Singapore. These, however are exceptional cases. Although in many cities the main elements required to administer an effective set of automotive taxes-automobile registration, and taxation of gasoline and diesel fuel at the retail levels are in place-much more could be done in most cities to draw more extensively on the significant revenue potential of this set of taxes.

E2.3 Other Local Taxes

Some local governments in urban areas also draw on income and sales taxes. The major practical problem with these two types of taxes is that their success depends on effective coordination between local and higher-level authorities. Higher level governments frequently do not accept them as a suitable instruments of local taxation, because of the apparent competition with their own tax collection efforts. As a result, local income, and sales taxes are not often found in the cities developing countries, despite their substantial revenue despite their substantial revenue potential. In the absence of such obstacles, however, local sales and income taxes can be effectively integrated into the local revenue structure.

Much more common is another set of local taxes, taxes levied on industry and commerce and sumptuary taxes. The main reason for their existence is that they can raise substantial amounts of revenue, with the little need for coordination an with higher-level authorities. However, they almost invariably distortion the allocation of resources. However, they almost invariably distortion the of urban resources. They are quite regressive and result in considerable administrative and compliance costs. In practice, these draw backs tend to be given little weight by local legislators and administrators, to whom the expanded use of these taxes offers a path of least resistance in meeting their revenue objectives. An interesting example of the dilemma

faced by local authorities in the imposition of these types of taxes is the "octorio" tax, levied in many cities of India and Pakistan on goods entering the city boundaries. This tax is highly inefficient because it interferes with intermunicipal trade and imposes substantial administrative cost. However, its use on the Indian subcontinent continues because it is so productive in generating revenue.

Finally, urban governments generally still draw on a wide variety of "nuisance" taxes (selected excises, licenses, stamp duties, and poll taxes) which perform poorly in terms of revenue generation on, efficiency, and distributive effects, and have high collection and compliance costs. Nuisance taxes continue to exist despite their drawbacks, again because their use is generally unencumbered by higher-level interference and because they are conventional and thus politically acceptable sources of local revenues (BAHL, R.W., 1992).

Overall, these other local taxes show only limited potential for financing urban services, either because they are not likely to be acceptable to higher, level governments (sales tax or income tax) or because they are inappropriate, on grounds of their negative efficiency and equity effects and their high administrative cost (industry and commerce taxes, sumptuary taxes and nuisance taxes).

As result local taxes fall into five broad categories. The first group includes property taxes, vehicle license taxes, and entertainment taxes. These taxes are generally uncontroversial on efficiency grounds, with the exception of the issues of taxation of buildings, and tend to improve the distribution of income. Most important, each of these sources can raise substantial local revenues at relatively low administrative cost. Although they may require some coordination with higher-level authorities, local authorities are given a relatively large degree of freedom to manage these taxes. Finally, these taxes tend to be quite well established and accepted by politicians and taxpayers alike as fair and reasonable bases for local revenue generation, provided that their administration is moderately effective in avoiding unnecessary horizontal inequities and compliance costs. These are, therefore, the taxes which should generally be expected to finance a major share of urban expenditures (BAHL, R.W., 1992).

The second group of taxes includes industry and commerce taxes, terminal taxes, and sumptuary taxes. The main reason for their existence is that they can raise substantial amounts of revenue in politically and legally acceptable ways and with little need for coordination with higher level authorities.

But they potentially distort allocation of resources in production and consumption, they can be regressive and usually involve horizontal inequities, and almost invariably they have considerable administrative and compliance costs.

The third group of taxes includes income taxes and general sales taxes. The major problem with these taxes is their success requires a large degree of coordination between local and higher-level authorities and that the higher level frequently does not accept them as suitable instruments of local taxation. The efficiency losses and horizontal inequity associated with local income taxes and general sales taxes likely to be small.

The fourth group of taxes consists of what may best be called nuisance taxes (selective excises, licenses, stamp duties, poll taxes, and so forth), most of which are highly inefficient and inequitable, perform poorly in raising revenue, and have high administrative costs. They continue to exist because their use is generally unencumbered by higher-level governments and because they are a conventional and thus politically accepted source of local revenues in many countries.

The fifth group, are charges which are primarily intended to increase efficiency. The main examples are of congestion charges on motor vehicles in urban areas. They are also generally desirable on grounds of equity, revenue performance, and the relatively low need for coordination with higher-level authorities. Their main problems are difficulties with administration and political acceptability, although the admittedly limited experience in Singapore indicates that congestion charges are feasible and effective. User charges for urban services are the most important source of urban revenues whose collection can help improve, not worsen, the efficiency of resource allocation.

E2.4 User Fees And Development Charges

There can be little doubt about the usefulness and desirability of developing broadly based charging systems for urban public services. The application of properly designed service charges, or more generally the recovery of urban service cost from beneficiaries, can contribute to an improvement of resource allocation within and between urban areas. Such charges serve to limit the demand for urban services to efficient levels and to make actual and would be urban dwellers aware of the social cost of urbanization. As experience has shown service charges or cost recovery can generate substantial amounts of revenue for urban movements. Because, service charges are directly linked to

the provision and extension of much needed services, they are an important element in urban investment policy.

Service charges can also contribute to equitable growth. Recouping the costs of public services from beneficiaries is a fairway to finance a service and windfall gains are often appropriated by high income groups in the form of increased property values or increased yields from investments that benefit those groups most directly. Therefore user charges also serve to increase the vertical equity of the urban fiscal system.

User charges are not only a tool for ensuring efficient use and equitable financing of public services; they also serve as an investment guide, because consumers willingness to pay for services is in many instances the only way in which the benefits of a service can be ascertained and compared with the cost of providing the service.

The most common rule suggested by economists for guiding decisions on the pricing of public services is to set price equal to marginal cost. A review of the applicability of the simple marginal cost pricing rule indicates that at least two precautions are in order. First, various dimensions of service, including use, access, and location, should be captured in pricing if the rule is to serve the goal of efficient resource application. Second, the rule needs to be amended to take into account externalities, market distortions, and imperfect consumer information; other important objectives, in addition to efficiency, such as financial and fiscal viability, fairness and equity and distortion and political constraints (BAHL, R.W., 1992).

Despite these caveats and amendments to the use of the simple marginal cost pricing, it provides a good starting point for the analysis of charging systems; refinements can then be made on a service by service application.

Once an efficient pricing structure is determined, its financial and equity implications and the extent to which it runs counter to established institutional norms can be explored. Often the various policy objectives stand less in conflict than appears initially, particularly where multi-part tariffs can be employed. However the common practice of starting the analysis of user charges with objectives other than efficiency in mind almost invariably means that considerations of efficiency are neglected altogether. The result is a greater loss of efficiency than need to be the case a result that developing countries, given their low levels of income, can ill afford.

Also, development charges are a special form of cost recovery for urban infrastructural projects. Often termed "special assessments", "Contributions for betterment", "land readjustment", or "valorization contributions" they serve different purposes and involve different practices in various countries and cities. However in general they feature lumpsum charges, phased over a payment period of months or years, which are designed to recoup the public costs of infrastructural development from beneficiaries. They may cover limited projects for a particular service such as a neighborhood road-paving scheme or the construction of a sewerage line, or the full development of new areas of a city or even entire new towns. Property owners, rather than occupants of property or users of a particular service, usually incur such charges in the areas improved by public action.

E3. INTERGOVERNMENTAL TRANSFERS

Subnational governments account for only about 15 percents of all government expenditures, and this proportion has not been increasing. Urban local governments must become more of a partner in the revenue raising mobilization process. But, even with theoretic advances in the importance of local taxes and user charges, most developing countries will continue to operate with a very centralized fiscal structure. It is essential therefore, that central governments define a set of fiscal relationships with their local governments, especially those of their rapidly growing cities, that enable them to find the right balance between their needs for decentralization of governance and control over resource allocation. From those explanations, there is often mismatch between urban governments responsibility for public service provision, on the one hand, and their revenue raising authority, on the other. The gap is filled with some form of intergovernmental transfers: a grant, a shared tax, or a subsidy. Certainly, there is justification for intergovernmental transfers as part of the urban local financing structure. Transfers from higher-level governments are an appropriate way to finance those local government functions which have regional or national spillover benefits. Moreover, central governments often justify grant financing of local services as part of a policy of regional equalization of standards of living. Typically, big cities are much less dependent on such transfers than are smaller municipalities or rural local governments. The smaller share may be justified on a number of grounds in particular, that the cities have a greater fiscal capacity and more revenue-raising authority (BAHL, R.W., 1992).

Higher-level governments often treat transfers as a residual in their own budgeting process, even where elaborate allocation systems have been devised to distribute grants to local governments. The local share of central

revenue can be one of the first causalities in a budget crisis. The commonly severe constraint on national public finances in developing countries partly explains why intergovernmental transfers generally contribute a relatively small share of local government finances. Only a few countries does the intergovernmental financing system give the local governments an iron guarantee.

There are other reasons why central government pull back on the use of grants as a financing tool for local governments, particularly large cities. Grants may be viewed as a substitute for local tax effort, shared tax may increase the revenue disparity between the rich and the poor areas of the countries, and local government tax administration may be deficient. But these are less reasons to cut back on the transfers to local governments than they are reasons to structure transfers to better achieve national and local objectives.

A realistic view is that transfers are unlikely to resolve fully the fiscal problems of local authorities in developing countries. To the extent that grant systems are already in existence, however, subnational structural improvements can generally be made to enhance their contribution. These might include provisions to stimulate local revenue-raising efforts, to better equalize interjurisdictional revenue capacity and to build in a loan component for large cities. Rationalizing grant structures that now consist of a municipality of small ad hoc transfers and putting them on a more predictable basis could permit more effective fiscal planning, especially at the local level.

E3.1 A Typology Of Grant Programs

Grant doesn't uniform as the main source of local revenue, the share of grants in total local revenue ranges from more than 90 percent to less than 1 percent (BAHL, R.W., 1992).

Most studies of the effects of intergovernmental grants have been done in U.S because it has a relatively decentralized federal system in which grant policy is an important national concern and because a substantial amount of comparable data are available for empirical testing. Though theme methodology and results of this work are the current state of the art a taxonomy of grants based on the U.S grant system would not apply to developing countries.

A new taxonomy of grant systems; consider first the determination of the size of the total amount to be distributed in a given year, that is the divisible pool.

The current practice suggests three basic approaches; a specified share of national government tax revenues, and ad hoc decision for reimbursement of approved expenditures. Once the amount of the pool is determined, allocations among local governments are typically made in four ways; by returning shares to the jurisdiction from which the taxes were collected, that is using a desivation principle; by formula; ad hoc or by reimbursing cost.

This two-way classification gives a taxonomy of twelve grant types; the eight of these which seem more or less common in developing countries. For example the total national allocation for a type grant B is based on a share of a national tax, but the distribution among local governments is made by formula.

Type C, G, K grants are usually designated for specific purposes rather than general purpose; most grant that reimburse costs are designated for specific projects and usually must be approved by the central government. Type K grants may be open ended in that the total grant fund is determined as the sum of all reimbursable expenditures. Type Cand G grants are closed-ended the degree of reimbursement and the number of projects approved may vary from year to year according to the total funding available.

The remaining five types are all more likely to be general purpose than specified for a particular use, and are all cross-ended. Type A is shared grant in terms of both the determination of the fool and its allocation among juries diction; these funds are usually not earmarked. Type B and D are probably the most common. The pool is determined as a share of a national or state tax and is then allocated by formula or ad hoc manner for types F, Gand H the pool is determined in an ad hoc manner as part of the central government's regular budgeting process. For type the allocation is by formula, where as for type H it is purely ad hoc.

E3.1.1 The Pure Shared Taxes

The purest form of shared tax-type A grants-requires that some proportion of the amount collected in the jurisdiction of local government be returned to that local government. The higher level of government deducts a fee for collection, usually a specified percentage of total receipts. Under this system, the local government has no control over determination of rate and base. Type A is thus an inter governmental transfer and not a local tax.

E3.1.2 Formula Grants

An alternative to the pure shared tax is to distribute the grant pool among eligible local units on the basis of some formula. Formula grants may be differentiated according to whether the total grant fund is determined as a shared tax (type B) or an ad hoc basis (type F).

E3.1.3 Grants To Reimburse Costs

A third way to transfer central government resources to local government is through grants that reimburse cost (types C, G, K) under such schemes, the center agrees to reimburse the locality for all or a portion of the cost of an activity. Grant to reimburse costs are typically tied to a particular government expenditure.

E3.1.4 Ad Hoc Grants

Perhaps the extreme case of centralization in grant design is an ad hoc program (type H grants) in which the size of the divisible pool is determined annually by the center and the distribution is made on some subjective basis (BAHL, R.W., 1992):

- * Virtually all open-ended construction grants which require approval of each project.
- * That portion of any grant program allocated on a discretionary basis by the state or central government.
- * Supplementary grants allocated for special purposes during the fiscal year.

The great advantage and disadvantage of ad hoc grants is that they do not mandate a particular vertical fiscal balance between the central and local government. This gives the central government maximum flexibility to redirect resources to sectors of greatest need but it leaves local governments vulnerable and uncertain about the finances available for them. In many instances, the creation of an ad hoc grant program is motivated by a desire to limit the financial autonomy and importance of subnational governments.

E3.1.5 Capital Grants and Loans

Local capital projects are financed by a combination of capital grants, loans and short term borrowing. Loans are usually allocated to the local governments by the central government, their terms are dictated by the

central regulations, and their repayment is frequently forgiven. Such loans are in every sense a part of the system of intergovernmental transfers.

E4. THE SCOPE AND PROSPECTS FOR REFORM

There is no simple rule for determining the appropriate allocation of responsibility to urban governments. Experience, however, suggests that urban governments do a better job of urban management when they have greater authority over their own affairs than when their powers are limited and they must continually coordinate their actions with those of autonomous national or local entities that are also involved in the provision of urban services.

Among the local revenue sources usually available to urban government, the property tax, motor vehicle taxation, and user charges are attractive. The many examples of their successful use in cities of developing countries provide a good indication that increased reliance could be placed on these sources of revenue. Those examples also show, however, the need for effective administration, political will in implementation, and support from the national government, particularly in the form of technical assistance.

In the case of the improvement of the local government fiscal structure, proposals, often major and severing, for fiscal reform as a means of alleviating serious problems of urban governments have been put forward in most, if not all, large cities of the world. Although the nature of these reforms have varied with local conditions and with each team of advisers responsible for them, very few such reforms have been accepted in their entirety. Commonly, resistance on the part of the policy makers and citizens facing the prospect of fiscal reform, however much needed, stems from doubts about the unanticipated effects of untested, large scale changes in the economic environment and about the distribution of the windfall gains and losses associated with reform. Moreover, losses usually threaten to befall urban elite to the gain of larger, broader socioeconomic groups, including the poor, who have less political clout.

Perhaps the biggest problem of all is the resistance of the central government to the increased local authority that is almost always part of these proposals. Ministries of finance are too worried about their next dollar of revenue to get very enthused about giving more money to local budgets. Ministries of public works are loath to give up control over the allocation of infrastructure funding and the direction of local investment. National legislators see fiscal decentralization as an inroad on their ability to distribute resources in return

for political points with the home constituency local governments should of course the proponents of reform, but they are hardly in a position to change national laws concerning the powers of local government, and in many cases the local officials are themselves appointed by the central government.

In most cases of major, sweeping reform in the developing world, certain conditions have prevailed: higher-level government too over important sources of revenue previously allocated to local authorities; sweeping political changes resulted in major shifts in national priorities; or fiscal problems were so unmanageable that reform was unavoidable.

Incremental reforms of local finances have found more general acceptance. Examples are the creation of special districts for capital cities, which give them specific responsibilities to expend and raise revenue; enlargement of metropolitan jurisdictions by annexation of adjacent municipalities; phased development of new sources of revenue and reform of existing sources; and ad hoc responses to fiscal pressures.

Given this state of affairs, it seems that a top down approach to far-reaching fiscal decentralization, however preferred it might be is not a starter in most developing countries. A better route might be to reform of financing systems in the largest cities, with a decided emphasis on the kinds of fiscal reforms that will make these cities more financially self sufficient and will lead to a generally higher rate of revenue mobilization.

Decentralization from the point of view of local autonomous land, a final question is whether, and by how much the grant system weakens local autonomy, that is, the participation of the local population in fiscal decisionmaking. In raising a given amount of revenue, a locally raised tax would provide more autonomy than would a grant of equal yield. This is because the burden would be placed on the community both to set the tax rate and decide on the level and composition of expenditure. A grant, however, does not necessarily weaken local autonomy severely. It depends again on the structure of the grant system. At one extreme is the pure shared tax, for which the local government does not set the tax rate but receives a return on taxes paid in the local area. In this case, there is not a complete separation of the pain of taxation and the benefits received from the expenditure of those tax moneys. Depending on the conditions placed on the disposition of the grant funds, local autonomy may be weakened least with this kind of intergovernmental transfer.

General purpose grants provide more local discretion than do conditional grants (grants designated for a specific purpose, or requiring a matching contribution). In theory, the general purpose or unconditional form does not distort local budgets and depending on the income elasticity of demand for public and private goods will result in some combination of increased spending for various public functions and tax reduction. The conditional form of grant-in-aid, conversely, is designed to stimulate spending for a particular function. For example, if local residents undervalue a government service, because full social costs or benefits are not taken into account, a conditional grant may be used to stimulate spending on that function.

As a result, such conditional grants are, all other things being equal, thought to change local budgets in favor of the aided good. Conditional grants, then, are the more effective way of imposing the national will on local governments; hence they compromise local fiscal autonomy the most.

Cost reimbursement grants are conditional, and they would seem to limit local autonomy more than any other form. If there is full reimbursement for a particular function, the local government may have little to say about the level or composition of services provided. Projects that partially reimburse costs also impinge on local autonomy (compared with general purpose grants) because the required match (price effect) induces a distortion in the local government budget.

Alternative Forms of Intergovernmental Grant Programs

Method of allocating the divisible pool among eligible units	<u>Method of determining the total divisible pool</u>		
	Specified share of national or state government tax	Ad hoc decision	Reimbursement of approved expenditures
Origin of collection of the tax	A	na	na
Formula	B	F	na
Total or partial reimbursement of costs	C	G	K

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