



CEU SUMMER UNIVERSITY

Nádor u. 9., Budapest, Hungary 1051
Tel.: (36 1) 327 3069, 327 3811
Fax: (36-1) 328-3698 or (36-1) 327-3124
E-mail: summeru@ceu.hu
Website: <http://www.sun.ceu.hu>
Skype name: ceu-sun

Public Policy

INTERGOVERNMENTAL FISCAL RELATIONS AND LOCAL FINANCIAL MANAGEMENT

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(with distance learning module starting on January 15)

In co-operation with the Local Government and Public Service Reform Initiative of the Open Society Institute, Budapest

Course directors: **József Hegedüs**, Metropolitan Research Institute, Budapest
Adrian Ionescu, Local Government and Public Service Reform Initiative of the Open Society Institute, Budapest

Core Faculty: **Ken Davey**, School of Public Policy at the University of Birmingham
Anthony Levitas, Development Alternatives, Inc.
Nicolas Levrat, University of Geneva

József Hegedüs is Head of the Metropolitan Research Institute. He was trained as an economist and holds a Ph.D. in sociology. He has ten years experience in Hungarian local government reforms, especially financial issues such as grant allocation, budgeting process, designing equalisation grants, analysing effects of local tax, local government capital budgeting, etc. As a project manager he has been lately involved in research on local government finance in Budapest, and in the preparation of the Budapest Program for 1996-2000. He led a team at MRI in co-operation with the Urban Institute, Washington to develop a training course for local government financial experts on program budgeting and related financial issues, and took part in the SNDP (Sub-National Development Program of World Bank, USAID and Know How Fund in Hungary). He was co-author of the study "Local Management in Hungary: Fiscal and Structural Adjustment at the Local Level in the Context of Economic Transition."

Adrian Ionescu is the Program Director for the Local Government and Public Service Reform Initiative (LGI) at the Open Society Institute in Budapest, Hungary. In addition to managing LGI, he is responsible for the "Subnational Governmental Finance, Fiscal Decentralization and Budgeting" program to generate and disseminate knowledge and best practices in CEE and FSU. Before joining the program in Budapest, Adrian worked as Project Manager for the Soros Foundation, and previously as a Research Officer for the Ministry of Public Works and Regional Planning in Romania. He holds a certificate from Harvard University, a MBA from Université du Québec à Montréal and a M.Sc. in Engineering from the Polytechnic University of Bucharest.

Course level, target audience

The course has been designed for the practitioners, researchers/academics and trainers in the area of public finance related to local government issues and intergovernmental fiscal relations. Applicants are expected to have a basic knowledge of computer and software usage, e.g. Ms Excel. During the course one day will be dedicated to simple simulations using Ms Excel.

Course Description, Objectives and Format

Fiscal decentralization is closely related to the "restructuring of the public economy" and involves rethinking the role of the state in different sectors, such as social policy, education, housing, communal services, etc. The process of restructuring took much more time than it was originally planned. Furthermore, the process involved little if no

coordination at all among the sectors, and therefore has not taken into consideration the effect this may have on fiscal decentralization. In fact sectoral reform has often not organized itself along the lines of fiscal decentralization principles at all.

The course deals with the process of decentralization in three different groups of countries (EU 8 countries, South East Europe, Russia and Central Asia), with a special focus on the possible roles of the central government and the different levels of sub-national governments. The same core issues are discussed (depending on their relevance) and punctuated with practical exercises on alternative assignment of responsibilities, designing the grant structure, possible application of performance measurement, capital investments, etc. Experiences and solutions in developed countries are provided for comparison.

The course will be comprised of two phases: the distance learning phase and the summer course.

A. Distance Learning Course

The main objectives of the distance learning phase is

- ❑ to provide participants with the analytical framework for understanding intergovernmental fiscal economics and to present various models of central-subnational relationship;
- ❑ to introduce the main terms that will be used during the summer course;
- ❑ to help to apply the new terms in describing the decentralization process and its elements;
- ❑ to facilitate, encourage and motivate the participants' learning process by giving continuous feedback.

The Distance Learning course will be offered as a series of eight modules over a 24-week long period (three weeks for each module). The modules can be studied separately, one after the other. Each module is about 10-12 hours of learning.

The Distance Learning phase will cover the following modules:

(i) *Issues of fiscal decentralization in a comparative framework*

Overview of the fiscal decentralization problem. Key questions in decentralization. Another distinction: unitary versus federal states. Fiscal and other forms of decentralization. Critical question of decentralization. Musgrave's definition of state functions. Traditional approach of decentralization. Why or why not decentralize. Benefits and risks of decentralization. Does decentralization destabilise? A new approach of decentralization in a transitional economy.

(ii) *Legal background of decentralization (Charter of Self-Government)*

Application of the decentralization theorem of Oates. Goals and structure of ECLSG. The subsidiary principle. Autonomy in expenditure decisions. Legal independence and protection. Financial autonomy according to ECLSG. Minimal requirements. Draft European Charter of Regional Self-Government.

(iii) *Expenditure Assignment*

Fiscal roles and responsibilities and the operations of a multi-tier government. Finance follows function, an axiom. The assignment of expenditures--the theory and practice. First division: Public versus private goods. Second division: principles to guide expenditure assignment. Externalities of local expenditures: the spill-over effects. The capacity of local governments. Economies of scale problem. Invention at local level. Operating vs. capital spending. An appropriate regulatory framework of local expenditures. The role of privatization of public services.

(iv) *Revenue Assignment*

Narrowing the scope of inquiry: Musgrave's three-functions framework. Realizing the political benefits of tax assignment. Constraints on tax assignment. Conceptual arguments. Alternative methods of revenue assignment. Administrative considerations. Vertical imbalance and horizontal disparities. Concluding remarks: tax competition revisited.

(v) *Grant Types*

Questions of macroeconomic control by central government. The objectives of an intergovernmental grant system. Correcting or adjusting for vertical imbalance. The determination of transfer pool. Internalize spillovers. Correcting inequalities among local governments: horizontal equity. Coordinating central and subnational spending. Central goals and local incentives (tax effort, inter-governmental cooperation, structure of government).

(vi) *User charges*

Concept of user fee finance. Application of benefit principle at local level. The nature of local public goods. Residual or essential revenue. 'Price' or 'charge'. User charges in theory and in practice. A Public Finance vs. Public Choice. Determination techniques of user charges. Charging in relation to costs, marginal cost pricing. Charging in relation to benefits. Charges and collective provision of Services. Charging the poor. User fees in CEE countries.

(vii) *Local taxes*

Increased importance of the property tax in the OECD countries; Advantages of a property tax; The property tax as a local tax; Basing the property tax on market values; Taxing both land and buildings or taxing land alone; Administration of the property tax; **Exercise:** designing property tax (simulation). Implementation: metering, collection, enforcement, billing; Case study.

(viii) *Local Borrowing*

Framework for International Local Creditworthiness; General Features, and Issues Underlying the Development, of Municipal Credit Markets; "Structured" Financing in Municipal Credit Markets; Legal and Regulatory Framework; Local Government Institutional Capacity; Infrastructure Financing and Access to Private Capital Markets; Municipal Bond Markets Prospects for Developing Countries

The modules consist of Units. Units are the nucleus of learning. The Units can be completed in about 1 hour in „one sit“. Each module is based on a core text. These core course materials were developed by an international group including: Professors Roy Bahl, Jorge Martinez-Vazquez, Sally Wallace from Georgia State University, USA, Prof. Paul Bernd Spahn from Goethe University, Frankfurt am Main, Germany, Samir El Daher from the World Bank, and Robert D. Ebel from World Bank Institute.

The Distance Learning course will start in mid-January and last until the end of June.

B. The Summer Course

The objectives of the summer course are to

- ❑ enhance participants' capacity for successful implementation of public sector resource management reform by analyzing mechanisms for the transfer of resources among governments and identifying ways to address the issue of regional disparities and local resource mobilization,
- ❑ increase participants' understanding in the issues of fast restructuring public economy in countries of transition.

The workshop style course on *Intergovernmental Fiscal Relations and Local Financial Management* will include an advanced discussion and analysis of thorough exercises and case studies from the region and the three groups of countries:

- ❑ worldwide trends in fiscal decentralization and the concept and practice of the assignment of expenditure responsibilities and revenue authority
- ❑ the design of various forms of central to sub-national transfers and local own-source revenues; creditworthiness and the financial risks of local authorities

- ❑ the emerging topic of budgeting and local public management

Attuned to new teaching techniques, the workshop aims to achieve the right mix of exercises, lectures, panel discussions and interactive learning methods. This includes the dissemination of materials prior to the course presentation (paper and/or electronically). The course will use the Distance Learning phase to teach the basics, though during the summer course the group could focus more on the case studies, panel discussions and exercises.

The summer course will have the following format:

Introductory presentation. The course will start with a presentation on the general overview of the decentralization process in the countries in transition. This presentation will focus on the concept of fiscal decentralization, why decentralization is a current issue, what are the benefits and constraints of decentralization, which are the main decentralization strategies of the different countries, etc.

Case Studies for Decentralization. The case studies will present the most typical and problematic issues of the process of transition and fiscal decentralization in three selected countries that follow different models and have different decentralization strategies. One country will be selected from EU 8 countries, one from South East Europe, and one from Russia and Central Asia. The presenters of the case studies will be experts with broad personal experience from the given country/region.

Panel discussions. During the course 7 panel discussions will be organized. Each participant will have to participate in minimum one panel, and each panelist has to prepare a 20-minute contribution on the subject, which illuminate the subject from the country and comparative perspective (some critical issues related to the subject, new developments, good solutions, bad experiences, etc.). To ensure the comparative perspective and to facilitate discussion and sharing of experience between the participants, they will be divided in groups. Each group will have some preparatory time for the panel discussion. The structure of the panel discussions is the following:

- ❑ short presentation by the trainers, introducing the main issues of the given topic
- ❑ presentation of the panelists (each panelist has a short presentation)
- ❑ discussion

Participants can choose from among the following topics:

- (i) Legal background of decentralization
- (ii) Expenditure Assignment
- (iii) Revenue Assignment
- (iv) Grant Types
- (v) User charges
- (vi) Local taxes
- (vii) Local Borrowing

Exercises. During the course, the participants will have to work on three exercises (on local tax, budgeting and equalization). The exercises are simulating some decisional problems through a concrete case, forecasting and analyzing the direct and indirect consequences of the different solutions.

Non-discrimination policy statement

Central European University does not discriminate on the basis of--including, but not limited to--race, color, national and ethnic origin, religion, gender or sexual orientation in administering its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs.