

Intergovernmental Fiscal Cooperation

International Experiences and Possible Lessons
for Brazil

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Abstract*

To a large extent, policy outcomes are shaped by governance, including institutional arrangements and forums for cooperation among and within different layers of government. In turn, the effectiveness of intergovernmental fiscal cooperation (IFC) is affected by economic, sociopolitical, and institutional factors, including constitutional provisions and power balances among different levels of government. On the basis of a review of large federations, the authors propose options to strengthen IFC in Brazil. In particular, the effectiveness of IFC could be enhanced in Brazil by establishing forums for vertical cooperation between the states and the federal government, and for horizontal cooperation among states.

JEL Codes: H11, H77

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1. INTRODUCTION

In recent decades, there has been increasing focus on the importance of multilevel governance in policymaking.¹ This trend reflects growing recognition that coordination failures among stakeholders undermine policy design and implementation, leading to suboptimal outcomes. It also reflects the fact that increasing decentralization of spending and revenue responsibilities has strengthened the role of subnational governments (SNGs) in designing and implementing fiscal policy. Intergovernmental fiscal cooperation (IFC), which is a particularly relevant aspect of multilevel governance, is the subject of this paper, which focuses on the case for, and main obstacles to, IFC, drawing on a range of international experiences. The paper concludes by identifying some possible lessons for reform in Brazil.

The paper is organized as follows. Section 2 provides an overview of the benefits of and impediments to IFC, as well as of its different forms on the basis of international experience. The section also discusses institutional and other factors that influence the forms that IFC takes in various countries. Section 3 focuses on the role of IFC in macro-fiscal management, whereas section 4 discusses IFC's roles in designing and reforming intergovernmental fiscal systems.

Section 5 presents a brief overview of the main features of the intergovernmental fiscal relations system in Brazil, and the authors' initial reflections on how to strengthen IFC in the country. Section 6 provides some conclusions. The appendix includes brief summaries of key features of intergovernmental fiscal relations systems and cooperation mechanisms in a number of large federations and quasi-federations.

2. THE CASE FOR, AND POSSIBLE FORMS OF, INTERGOVERNMENTAL FISCAL COOPERATION

Cooperation across and within levels of government may require participant governments to pursue policies that are different from those that would have been selected in the absence of cooperation (Bakvis and Brown, 2010). Therefore, to choose to participate in cooperation arrangements, governments must believe that the benefits of such arrangements outweigh the costs associated with the corresponding loss of decision-making autonomy.

Potential gains from cooperation include reducing adverse externalities and spillovers, and more fully exploiting positive externalities and synergies from participants' actions and

¹ A multilevel governance framework has been formulated by the OECD and has been used in several related areas of work, including public investment, regional development, urban development, local finances, water governance, regulatory policy, and environmental issues such as climate change. See <http://www.oecd.org/gov/regional-policy/multi-levelgovernance.htm> for details.

policies, as well as of economies of scale. As discussed in detail in the subsequent sections, IFC can be beneficial in different aspects of policy, such as:

- Macro-fiscal management;
- Designing and reforming IFC;
- Sectoral policies, including service delivery; and
- Subnational revenue and expenditure management.

A further benefit of IFC is that it facilitates exchanging relevant information among participant governments, leading to a better understanding of respective objectives and constraints. It also helps identify viable policy synergies and trade-offs that can be taken into account in designing and implementing reform packages. Such exchange of information and experiences also leads to identifying good and bad practices from peers who have similar policy challenges.

Despite its potential benefits, IFC typically faces significant political economy obstacles. An important one is fragmentation of subnational levels of government (especially at the local level), which makes it difficult to effectively manage multilevel cooperation. Another obstacle is the heterogeneity of SNGs as regards size, level of socioeconomic development, and production structure, among other factors, which can make it difficult to identify win–win policy options. Also, differences in the political affiliations of SNGs may hinder cooperation among them.

These obstacles can nevertheless be attenuated by using horizontal cooperation to facilitate coordination within each subnational level of government and represent it in forums for vertical cooperation. The disincentives to cooperation stemming from economic, social, or political differences may be alleviated in some cases by agreement to delegate redistributive decisions and recommendations (e.g., on the size and distribution of intergovernmental transfers) to independent institutions (e.g., Indian Finance Commission or Australian Commonwealth Grants Commission, which are discussed further below). IFC can take different forms, such as the following:

- **Vertical**, meaning among levels of government; **horizontal**, meaning within each level, aiming to resolve issues of common interest and intra-level disputes, and to strengthen the influencing power of the level (advocacy); or **both**.
- **Multilateral**, meaning between the central government and individual SNGs, or **bilateral**, meaning between specific SNGs.
- **Broad**, encompassing the whole range of intergovernmental issues, or **narrow**, encompassing only a subset of them.

- **Harder**, meaning the decisions of the IFC forum are binding on its members, or that one level of government has veto power over certain decisions of the others; or **softer**, meaning policy adjustments are discussed and recommended, but not required.
- At the **executive level** or in the **legislature**.

As evidenced by country examples in the appendix, the choice of forms of IFC reflects a variety of economic, social, institutional, political, and cultural factors, including the following:

- **The diversity of the SNGs.** Typically, countries with more pronounced territorial disparities tend to prefer softer forms of cooperation, especially if the influence of the central government is relatively weak.
- **The main characteristics of the intergovernmental fiscal system.** IFC is typically more extensive in countries characterized by a less clear definition, or broader overlap, of spending responsibilities among the different levels of government. The same tends to happen when a level of government has statutory influence over the revenue-raising decisions of the other(s). As discussed in the appendix, Germany is a good example of this type of cooperative federalism.
- **The power balances among and within the different levels of government.** In countries characterized by large vertical imbalances (i.e., SNGs depend on transfers from higher levels of government), the central (or intermediate) government can put pressure on SNGs (or local governments) to participate in cooperation forums and to accept the agenda (e.g., Australia). In these countries, the dominant level of government may also have greater power in enforcing decisions reached through multilateral or bilateral cooperation agreements. In contrast, countries where SNGs have substantial revenue autonomy (e.g., Canada, Switzerland, and the United States) tend to rely less on multilateral vertical cooperation and more on multilateral horizontal cooperation, and/or on bilateral vertical or horizontal cooperation agreements.
- **The presidential or parliamentary form of government.** In executive federalism, intergovernmental cooperation centers on the executive branch of the national government and the SNGs. This form of federalism is more frequently found in parliamentary regimes, where the executive typically commands a majority in parliament and can thus effectively drive the cooperation agenda. By contrast, executive federalism tends to be less prevalent in presidential regimes characterized by strong separation of powers.

- **The nature of representation of SNGs in the national legislature.** In many countries, SNGs elect or appoint the members of the upper house of Parliament. However, the prerogatives of this house vary significantly, ranging from veto power on all legislation (e.g., the United States) or on all legislation affecting SNGs (e.g., Germany), to a merely advisory role. A strong role of the upper house can promote horizontal cooperation among SNGs to facilitate agreement on issues to be discussed in this house of Parliament.

3. IFC IN MACRO-FISCAL MANAGEMENT

Unilateral action by various levels of government can have important spillovers on other levels. For example, a cyclically inappropriate or unsustainable fiscal policy implemented by the central government could aggravate an economic boom or bust and possibly eventually lead to a fiscal crisis, with adverse effects on regional and local economies and their governments' finances. There are many examples of such spillovers, especially in emerging-market economies, such as Mexico in the aftermath of the tequila crisis of 1995, Russia after the 1998 default, and Argentina in the wake of the exit from convertibility in 2001. In all of these cases, the fiscal turmoil at the national level was reflected in a spate of subnational debt crises. There is also evidence of significant fiscal stress in many SNGs in advanced countries in the wake of the global financial and Euro crises in recent years (Ahmad and Brosio, 2015; Ter-Minassian and Fedelino, 2010; Vammalle, Allain-Dupre, and Gaillard, 2012).

Moreover, a central government's tax policies can adversely affect subnational finances. For example, a central government may choose to cut a national tax to stimulate the economy during a recession. However, if the revenue from that tax is shared with the SNGs and they are not compensated, allowed by fiscal rules to compensate with own-source revenue, or constrained by financing to offset the deterioration in their budget balance, the SNGs will be forced to cut spending. This, in turn, could blunt the intended fiscal stimulus and may adversely affect important public services provided by the SNGs. Conversely, a central government could choose to increase a national tax to cool excess demand or to improve its budget. If that revenue is shared with the SNGs, room for additional subnational spending may be created, thus reducing the effectiveness of the national fiscal contraction.

The expenditure policies of a central government can also adversely affect the finances of SNGs. For example, a central government's wage and benefits policies for its civil servants, changes in rules for public employment or public pension systems, or investment location

decisions frequently put pressure on the SNGs. Central government expenditure policies can also cause subnational deficits by imposing unfunded spending mandates on SNGs. For instance, a central government could set minimum standards for public services in healthcare, education, or housing without ensuring that the SNGs have adequate resources to meet the standards at an average level of efficiency.

Finally, nonfiscal policy instruments used by a central government could also have a bearing on subnational finances. For example, income policies set at the national level, in particular changes in nationwide minimum wages, administered prices policies, monetary and exchange rate policies, and regulatory policies can all have significant implications for the finances of SNGs.

On the other hand, an SNG's unsustainable fiscal policies could also have adverse spillover effects on other jurisdictions, and ultimately on national finances. Such policies include excessive tax competition, which leads to the erosion of tax bases; inadequate exploitation of assigned tax bases through excessive use of tax expenditures or weak enforcement; inappropriate employment and compensation arrangements, which bloat the government payroll; and serious inefficiencies and rigidities in current spending and investment. All these policies can lead to the accumulation of substantial deficits and ultimately to difficulties servicing debt.

Subnational debt crises typically entail serious consequences, including disruptions in public goods and services for the population of the SNG in crisis, as well as adverse spillovers on other SNGs, and possibly the whole nation. Such spillovers are generally financial, such as increased market perception of financing risks, reflected in rising borrowing costs, and, in some cases, propagation of difficulties rolling over debt. They may also include social and political costs, especially for other SNGs (or even the central government) that are politically aligned with the jurisdiction in crisis.

The threat of such consequences frequently leads to higher-level governments bailing out SNGs in distress, often by gap-filling transfers or assuming and restructuring of the debt. Such bailouts are costly. Not only do they entail additional financial burdens for the rescuer government, but they also give rise to moral hazard, and thus further soften the subnational budget constraint. Additionally, when a bailout is large, it can jeopardize the latter's creditworthiness and medium-term fiscal sustainability.

Intergovernmental fiscal cooperation can improve both national and subnational macroeconomic management in a number of ways. In countries characterized by a well-established culture of fiscal responsibility and transparency, IFC can help governments agree

on an appropriate distribution of fiscal targets and increase the chances of effective enforcement of such targets through peer pressure. A good example was the Australian Loan Council during the 1990s to 2000s.²

More generally, however, the effectiveness of IFC in deciding the allocation of fiscal targets, and in enforcing them, has been relatively weak. For example, as discussed further in the European Union (EU) country profiles in the appendix, the record of effectiveness of their Domestic Stability Pacts has been spotty. In the wake of the Euro crisis, several countries moved to translate the rules specified in the strengthened EU fiscal framework (the Fiscal Compact) for the general government as a whole into specific fiscal rules for each level of government.

The limited effectiveness of negotiated fiscal targets is not surprising, since such negotiations are often dominated by short-term political objectives. It is increasingly recognized, in both theory and international practice, that pre-commitment devices, such as fiscal rules, are superior instruments to promote national and subnational fiscal discipline and sustainability. However, it is also clear that, to be effective, fiscal rules need to be:

- carefully adapted to the economic, social and institutional context of each country, and adjusted periodically to reflect structural changes in such context;
- sufficiently flexible to accommodate unforeseeable exogenous shocks and to avoid procyclicality; and
- supported by appropriate monitoring, enforcement, and correction mechanisms, including adequate public financial management and fiscal transparency systems at all levels of government.

Intergovernmental fiscal cooperation can contribute to the effectiveness of a rules-based fiscal responsibility framework by facilitating agreements about sound design or needed reforms of the rules, by stimulating their enforcement through peer pressure, and by fostering progress on reforms of the intergovernmental fiscal system needed to improve subnational fiscal sustainability (see section 4).

Intergovernmental fiscal cooperation can also facilitate information exchange regarding global, national, and regional macroeconomic developments and prospects, and fiscal and other policy variables (e.g., central government transfers to SNGs and interest rates) needed to prepare realistic subnational budgets and medium-term fiscal frameworks. For example, Germany has an intergovernmental Working Party on tax revenue that is responsible for

² In more recent years, however, the Council has focused primarily on improving fiscal transparency to facilitate effective financial market discipline for subnational borrowing (see the appendix for details).

forecasting and distributing revenue shared between the federal government and the states. IFC forums in Austria, Belgium, and Mexico, among others, have proven to be effective vehicles for exchanging relevant macroeconomic and fiscal information among and within different government levels. In Italy, the national annual budget framework law is discussed within the Unified Conference before being submitted to the national Parliament.

Finally, and importantly, IFC forums can provide needed venues for the central government and the SNGs to present, assess, and discuss the repercussions of proposed policy actions at one level of government on the others, such as the following:

- The scope for the central government to support SNGs during cyclical downturns by increasing transfers or financing subnational investments, as was done by a number of advanced and emerging-market economies in the wake of the global financial crisis. Conversely, the need to and ways for SNGs to support countercyclical fiscal contractions by the central government when demand is overheating.
- The effects of changes in tax policies by the higher levels of government on revenue shared with the lower levels.
- The repercussions of national spending policies (e.g., pensions, subsidies, or civil service) and SNG spending mandates on subnational budgets.
- The implications of income policies (e.g., changes in the minimum wage) decided by the central government for the payroll spending of SNGs. The effects of the central government's administered price policies and proposed regulatory changes on subnational finances.
- The implications of policy changes proposed by one or more SNG for other SNGs and/or the central government.

4. IFC AND DESIGNING AND REFORMING INTERGOVERNMENTAL FISCAL SYSTEMS

This section explores the potential of IFC in facilitating good design or reforms in the main aspects of intergovernmental fiscal systems—expenditure and revenue assignments and intergovernmental transfers.

4.1. Coordinating and Reforming Expenditure Responsibilities

Clarity in assigning spending to different levels of government is crucial for efficiency and accountability, but it is difficult to fully achieve in practice. International experience shows that the most important spending functions (e.g., education, healthcare, social assistance, and

infrastructure) are frequently concurrent rather than exclusive (see the appendix for country examples). A degree of clarity can be achieved by unbundling these broad functions, not only those related to service delivery, but also those related to setting standards and regulations into narrower areas assigned to different levels of government.

Moreover, expenditure assignments are more often shaped by history and motivated by political and social dynamics than by efficiency (i.e., the principle of subsidiarity). As a result, asymmetric assignments, reflecting different capacities of individual jurisdictions within each level of government to carry them out, would be preferable but may not be politically feasible.³ Finally, expenditure assignments may also need to be reviewed periodically to reflect evolving economic and sociopolitical circumstances, as well as subnational capacities.

Vertical IFC can be useful to clarify and reform expenditure assignments, and to ensure effective management of concurrent spending responsibilities in specific sectors. The dialogue and analyses in such forums may also facilitate adoption of asymmetric assignments, when appropriate.

The importance of effective cooperation across levels of government in countries characterized by a high degree of overlap in spending responsibilities is highlighted by a number of country examples. As discussed in more detail in the appendix, vertical IFC arrangements in Australia, Austria, Germany, and India provide good examples of such cooperative federalism.

Vertical IFC can also take the form of bilateral arrangements between the central government and individual SNGs to define respective responsibilities in concurrent spending functions. These arrangements are often embodied in performance contracts that specify expectations of both parties regarding financing and results of the spending programs covered by the agreement. For instance, France has *Contrats de Plan Etat-Régions* between the central government and its deconcentrated regions. These agreements (which are made with each region separately) have a duration of seven years and aim to ensure that evolving broad national priorities are appropriately reflected in regional investment plans, taking into account relevant regional specificities.⁴ Since 2012, Colombia has introduced *Contratos Plan* with some of its departments to coordinate public investment policies, with a view to promoting more

³ Some countries (e.g., Colombia) have introduced a degree of asymmetry in spending assignments by requiring that SNGs wishing to take on given spending responsibilities show evidence of capacity (according to pre-specified criteria) to carry them out. Chile is also planning a gradual and probably asymmetric decentralization of spending responsibilities to its regions (which are currently de-concentrated units of the central government).

⁴ For example, for the 2014–20 period, the priority areas for the contracts are investments in environment, energy, multimodal transport, and support for technological research and innovation.

balanced regional development. The Chilean central government also uses *Contratos-Region* to agree on investment plans with its regions.

Horizontal IFC tends to play a greater role in countries with lower degrees of spending overlap among government levels. For example, Canada has the interprovincial Council of the Federation and the Federation of Canadian Municipalities; Switzerland has the intercantonal Presidents' Conference; and the United States has various associations of state governors, state legislatures, and local governments (see the appendix for details).

4.2. Reforming Revenue Assignments and Preventing Predatory Tax Competition

It is a well-known tenet of the literature on fiscal federalism that SNGs need meaningful own-source revenue (i.e., revenue for which they control at least the rate structure). A significant degree of revenue autonomy is necessary to promote subnational fiscal responsibility, avoid soft budget constraints, foster the accountability of SNGs to their electorates, and improve the linkage between taxation with local preferences.

It is also well known, however, that there are significant obstacles to such autonomy, from economic (e.g., greater mobility of subnational tax bases, which facilitates tax competition among SNGs) to social (e.g., unequal territorial distribution of tax bases), administrative (e.g., economies of scale in tax administration and increased compliance costs), and, most importantly, political economy (e.g., the unwillingness of central government to relinquish control of major revenue sources, and of the SNGs to sustain the political costs of taxing their citizens).⁵ Therefore, the choice, design, and reform of subnational revenue sources has to balance the benefits and costs of each potential revenue handle, taking into account the relevant economic, institutional, and sociopolitical circumstances of each country.

Intergovernmental fiscal cooperation can facilitate a dialogue among the different levels of government on respective revenue assignments, and their reform over time as circumstances evolve. For example, as the capacity of SNGs to administer their own taxes improves, or in conjunction with reforms of intergovernmental transfers, such as introducing or strengthening equalization transfers to compensate for the unequal distribution of tax bases over the national territory. Australia's Council of Australian Governments (COAG) is a good example of a vertical cooperation forum to build consensus for a major tax reform—the introduction of a value-added tax (VAT) shared between the Commonwealth and the states. In Germany, proposed reforms to shared taxes are discussed in various cooperation forums to minimize the risk of that they get blocked by the upper house of Parliament (the *Bundesrat*), whose members are designated by

⁵ See Bird (2010) and Fretes Cibils and Ter-Minassian (2015) for further discussions of the benefits and obstacles to revenue decentralization.

the states and which has veto power over reforms affecting the states. In Belgium, IFC was instrumental in ensuring agreement on a substantial subnational tax reform in 2001 (the Lambermont Agreement). In Mexico, the 2013 proposed tax reform package was discussed in the various IFC forums (the *Reunión Nacional de Funcionarios Fiscales* and the *Comisión Permanente de Funcionarios Fiscales*) to secure the needed political consensus for its approval by the Congress.

Horizontal (or possibly vertical) IFC can also help prevent excessive tax competition among SNGs. Second-generation theories of fiscal federalism emphasize that a degree of tax competition among SNGs can be promote efficiency, as individuals and, especially, companies move to locations that offer the best value in terms of infrastructure and services for their tax money. However, predatory tax competition can sharply impair the capacity of jurisdictions (particularly poorer ones) to deliver adequate goods and services or lead to unsustainable fiscal deficits. For IFC to work effectively to prevent predatory tax competition, it is essential that participants agree to abide by clear rules—particularly limits on tax expenditures granted—supported by full transparency and sanctions for noncompliance. The central government can also play an effective role in preventing excessive subnational tax competition by basing its equalization transfers on revenue capacity rather than revenue performance, thus penalizing low revenue efforts (e.g., Australia and Canada).

4.3. Reforming Intergovernmental Transfer Systems

In most countries, intergovernmental transfers constitute the backbone of subnational finances, accounting for the bulk of subnational revenue, especially at the intermediate (state or region) level of government.⁶ Transfers fulfill different objectives: filling the gap between subnational own-source revenues and spending responsibilities (vertical imbalances), equalizing revenue capacities and spending needs among SNGs, and funding subnational spending programs regarded as national priorities or as having positive externalities. Different types of transfers support different objectives. Revenue sharing is the most commonly used instrument to fill vertical imbalances, whereas equalization transfers aim to reduce horizontal imbalances, and block and special purpose transfers seek to finance subnational spending in priority sectors and programs.

The relative weights of the objectives vary from country to country, reflecting a range of economic, institutional, and sociopolitical factors. Thus, intergovernmental transfer systems

⁶ Central government transfers to SNGs (excluding shared revenues, which in the national accounts are treated as taxes) on average account for about 37 percent of subnational revenue in OECD countries (31 percent in OECD countries with federal systems).

differ significantly across countries, as evidenced in the appendix of this paper. For example, shared revenues are very important in Argentina, Australia, Austria, Belgium, Colombia, Germany, Mexico, and Spain, countries characterized by large vertical imbalances. In other countries (e.g., Canada, India, and the United States), block or special purpose transfers play more important roles. Moreover, the degree of conditionality attached to such transfers varies widely across countries, types of programs, and over time. Many countries have explicit equalization transfers, although the criteria for their distribution vary significantly,⁷ whereas others (e.g., Argentina, Mexico, and the United States) do not. Despite such diversity, sound systems of intergovernmental transfers should ideally display the following characteristics:

- Adequacy to avoid unfunded mandates for SNGs.
- Minimization of discretionality to avoid soft budget constraints.
- Flexibility to help SNGs avoid procyclicality and cope with exogenous shocks.
- Reflection of social preferences for redistribution.
- Creation of appropriate incentives for recipient governments to exploit own-source revenue potential and to efficiently deliver public services they are responsible for.
- Transparency in design and implementation.
- Simplicity to avoid excessive complexity.⁸

In practice, transfer systems generally fall short of meeting one or more of these criteria, not least because their design or implementation is often shaped more by political economy than by economic principles and fiscal soundness. Moreover, transfer systems tend to be the object of reforms, and thus change over time, even more so than other aspects of intergovernmental fiscal systems.

Intergovernmental fiscal cooperation can facilitate sound reforms of intergovernmental transfer systems by helping search for win–win solutions to common challenges. For example, in 2001, the Belgian central government was able to pass an initially very contentious intergovernmental fiscal reform by combining increased regional tax autonomy (which was advocated by the Flemish region) with increased transfers for education (which were important to the Walloon region).

Such win–win outcomes are more likely to materialize when the central government is the driving force of the reforms, as was the case with the Lambermont Agreement in Belgium

⁷ For instance, the Canadian equalization transfer system only equalizes revenue capacities, while the Australian one aims to equalize both revenue capacities and spending needs. Equalization systems also vary widely in terms of the complexity of formulas and indicators used, reflecting countries' preferences for transparency and popular acceptability of the systems and the availability of relevant data.

⁸ The vast literature on the desirable characteristics of intergovernmental transfer systems includes Ahmad and Brosio (2006) and Boadway and Shah (2007).

and the above-mentioned VAT reform in Australia. The likelihood of success increases if the central government has some fiscal room to increase the overall envelope of transfers or to benefit the SNGs in some other ways. For example, in both Austria and Switzerland, the central government secured consensus among the states and cantons to proposed changes in equalization transfers by shouldering the cost of transitional arrangements designed to ensure that no SNG would see its nominal transfers reduced by the reform.⁹ Likewise, Australia introduced financial incentives for the states as part of a redesign of special purpose transfers to make them more performance-oriented. These changes were agreed to under the aegis of the top intergovernmental forum, the COAG, and implementation is monitored by the independent Reform Council established by the COAG in 2006.

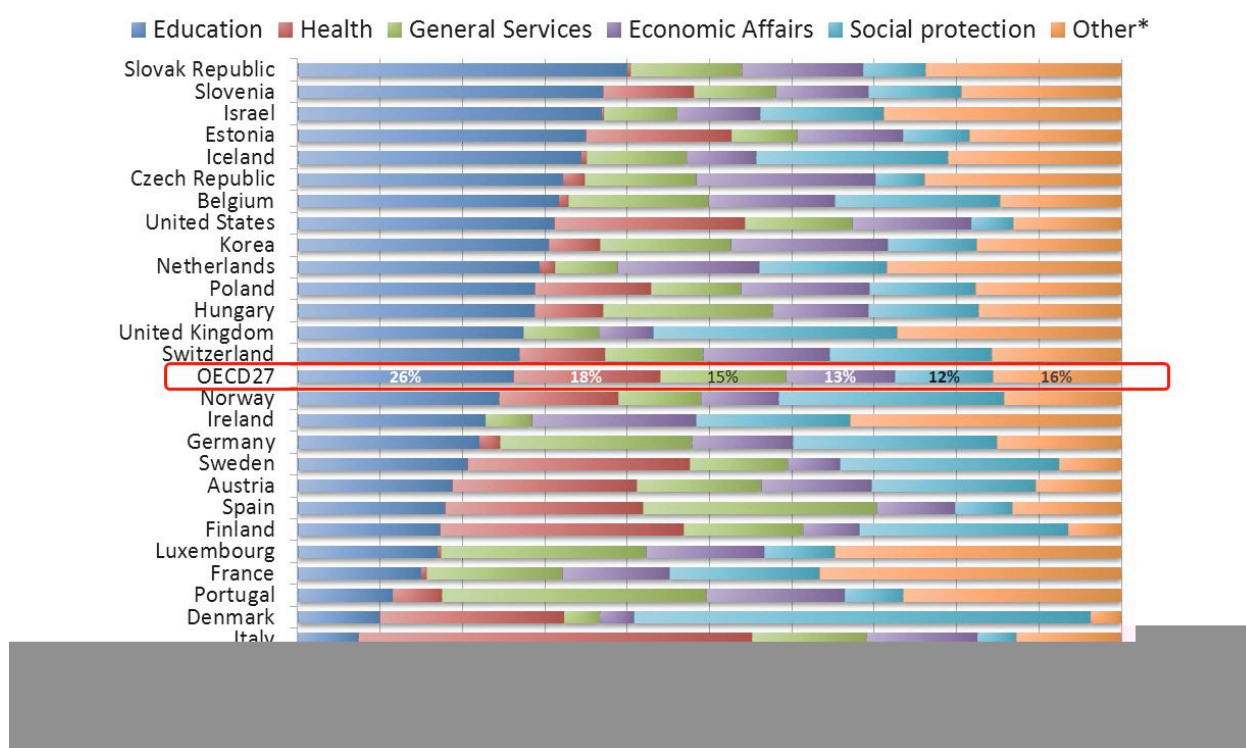
4.4. IFC in Sectoral Policies

The greatest potential payoffs of IFC are probably in specific sectoral areas, especially those characterized by extensive concurrent spending responsibilities and/or by significant negative or positive externalities. Horizontal cooperation can help minimize conflict (e.g., over scarce resources); reduce adverse spillovers from one jurisdiction to others, especially neighboring ones; exploit potential economies of scale; and promote favorable demonstration effects and learning from relevant diverse experiences. Vertical cooperation, in addition to facilitating all the above-mentioned outcomes, can help avoid cost shifting as a result of higher-level governments establishing inappropriate standards and regulations for lower-level counterparts. Most countries have a variety of intergovernmental sectoral cooperation forums; however, the potential for such cooperation is still far from being fully exploited.

Specifically, IFC can be very beneficial in a number of public expenditure areas where SNGs are responsible for relatively large, and frequently rising, shares in many countries (as evidenced by OECD countries in Figure 1).

⁹ Financial incentives have also been used by central governments to promote consensus on other types of intergovernmental reforms. For instance, Denmark and Finland used incentives to encourage mergers of small municipalities, and Canada used them to promote harmonization of provincial VATs.

Figure 1: Functional Composition of Subnational Expenditures in OECD Countries, 2013



Source: OECD.

The case for IFC is quite strong in education, which on average accounts for over a quarter of subnational spending among OECD countries. Due to citizen mobility across a nation's territory, there is potential for significant spillover of the benefits of good education provided by one SNG onto the labor market and productivity in other SNGs. Similarly, shortcomings in education quality in one jurisdiction can subsequently adversely affect labor productivity in other jurisdictions, and ultimately nationwide. Therefore, a strong case can be made for the adoption of common national minimum standards, supported as needed by well-designed equalization transfers.

Specific IFC forums for education can provide useful venues to discuss and agree on standards that should be well adapted to economic and social realities. These forums could also promote sharing good practices and lessons from failures among subnational education officials and facilitate agreement on needed reforms. Many of the countries reviewed in the appendix have intergovernmental forums on education.

Arrangements for intergovernmental cooperation are also quite frequent in healthcare, especially in countries in which SNGs have concurrent spending responsibilities with the central government in delivering services. Such arrangements can be especially useful in preventing

contagious diseases and caring for those who contract them. By their nature, contagious diseases can have spillover effects across local and regional borders. Cooperation is also useful for disseminating good practices in designing and implementing healthcare programs. Examples include the intergovernmental health forums at the ministerial level in Argentina and Australia, and the health and social issues commission of the National Governors' Association in the United States.

Intergovernmental cooperation forums can also have beneficial effects in various elements of infrastructure, for example in the following areas:

- Water resource management, to facilitate agreement on building waterways from water-rich regions to more arid ones, on efficiently using scarce water resources among different users, and on avoiding upstream pollution. Notable examples are the Australian Intergovernmental Agreement of 2004 on the National Water Initiative and the initiative to manage the Murray-Darling Basin from 2013. Both were concluded under the auspices of the COAG mentioned above.¹⁰ Brazil's Pact for the Management of Water Resources, which includes the central government, the states, and water basin councils, is another case in point.¹¹
- Environmental management and conservation, given the substantial potential for regional and even national spillovers of local activities.
- Energy management, distribution, and conservation. Again, Australia offers a good example with a National Partnership Agreement on Energy Efficiency, sponsored by the COAG in 2009.
- Interregional and intermodal transport infrastructures to maximize synergies between transport projects undertaken at the local and regional levels, with a view to improving connectivity.

Intergovernmental cooperation in infrastructure is especially important among the municipalities that comprise large metropolitan areas. Indeed, in most cases metropolitan areas have created joint institutions (including jointly owned enterprises in some cases) to manage public transport, water and sanitation, and other major utilities (Bahl, Linn, and Wetzel, 2013; de Mello and Lagos-Peñas, 2013). In New Zealand, the nine municipalities in the Auckland area have formed a joint council that decides on all matters of common interest and is a powerful intermediary with the central government.

¹⁰ Details of these agreements can be found on the COAG's website: www.coag.gov.au.

¹¹ See OECD (2015a) for more information about the Brazilian experience. The Delta Program in the Netherlands is another interesting case, given the status of the Dutch Water Boards as a separate level of administration.

In several European countries, local governments have set up specific vehicles to deliver local services, ranging from transport to waste water management and solid waste disposal.¹² France and the United Kingdom are good examples of interjurisdictional cooperation in metropolitan areas.¹³ There is, however, significant scope for further progress. In general, local governments have yet to extend these cooperative arrangements beyond service delivery to include policy coordination, which is particularly challenging at the local level given the diversity and fragmentation of local governments.

Finally, there can be significant benefits from intergovernmental cooperation in regional economic development. It is increasingly evident from international experience that sustainable and territorially balanced development requires the emergence of development poles or hubs in less developed areas. These hubs could help lagging regions catch up to their more developed counterparts based on their respective advantages (e.g., natural resources, agricultural potential, tourism, or manufacturing).

The creation of such hubs requires extensive physical and social infrastructure to attract both private investments and skilled labor. For both, a coordinated approach between the central government and the regional and local authorities is essential to maximize synergies and avoid duplications of spending and work at cross-purposes. It is also important to cooperate with the governments of other localities in the region but outside the hub to maximize the connectivity that would allow such localities to benefit from the hub. The existence of permanent forums for dialogue among SNGs could also help prevent excessive competition among them in the form of, ultimately self-defeating, attempts to influence investment location decisions through fiscal or financial subsidies, and/or through overly accommodating regulatory regimes.

4.5. IFC in Strengthening Fiscal Management

Subnational governments frequently suffer from significant shortcomings in their capacity to manage both revenues and expenditures. The main weaknesses in revenue administration include limited audit capacities, delays in enforcing overdue tax payments, and, especially at the local level, incomplete and outdated property cadasters.

The list is even longer for weaknesses in subnational public expenditure management, though we recognize that there are examples of sound public financial management systems in many states and cities, especially in advanced countries. Weaknesses in expenditure management include the following:

¹² De Mello (2010) provides various examples.

¹³ See OECD (2015b) for various examples of intergovernmental cooperation in metropolitan areas.

- Frequently unrealistic budget projections, inadequately developed budget classifications, and little or no analysis of fiscal risks.
- Lack of medium-term frameworks and transparency of future spending obligations (e.g., pensions for subnational civil servants).
- Limited or nonexistent systems of budgeting for results, with adverse effects on the quality of the goods and services provided by most SNGs.
- Inadequate systems to select and execute public investments.
- Lack of single treasury accounts and modern financial management information systems, as well as inadequate monitoring of execution of the budget.
- Lack of uniform accounting and reporting standards.
- Weak internal and external control and auditing systems.

Intergovernmental fiscal cooperation can be useful in addressing these shortcomings. Piggybacking mechanisms (i.e., levying subnational surcharges on national taxes) provide one important example of vertical cooperation in tax administration. In these cases, SNGs use the same bases as national taxes and may delegate to the national tax administration collection of the surcharges. For example, in Canada this is the case with the provinces that have adopted the Harmonized Sales Tax. This is also the case for the VAT in Australia, which is collected by the central government on behalf of the states, whereas in Chile, the national tax administration is responsible for collecting and enforcing the municipal property tax.

Even when SNGs collect their own taxes, there is generally significant scope to strengthen both national and subnational tax administrations through the following:

- Systematically exchanging taxpayer information (e.g., by sharing taxpayer registries), a common taxpayer ID number, and sharing income tax returns and/or electronic VAT invoices, when available.
- Joint audit and enforcement efforts.
- Sharing experience, good practices and know-how, including in particular designing and maintaining modern property cadasters

Intergovernmental fiscal cooperation can also contribute importantly to strengthening SNGs' capacities to effectively and efficiently fulfill the spending responsibilities assigned to them. Central governments can help SNGs strengthen their systems and procedures for budget preparation and execution, as well as monitoring and improving the efficiency and effectiveness of spending programs, and especially of public investments. In particular, central governments

can support, including financially when necessary, the adoption by SNGs of improved financial management information systems.¹⁴

The central government should, whenever legally feasible, require or otherwise encourage SNGs to adopt common accounting norms consistent with the relevant international standards and high standards of fiscal transparency.¹⁵ In the aftermath of the Euro crisis, the increasing emphasis EU institutions have placed on adopting common accounting standards for all entities in the general government underscores the importance of this point. In Mexico, the *Comisión Permanente de Funcionarios Fiscales* monitors the conformity of the states' fiscal accounting and reporting practices with the standards mandated by the recently passed fiscal responsibility legislation.

Finally, IFC forums, both vertical and horizontal, can prove to be very useful vehicles to disseminate good practices in both tax administration and public financial management, highlighting the costs of bad practices and promoting positive demonstration effects. Most of the forums discussed in the appendix include organizational structures specifically devoted to this function.

5. TENTATIVE LESSONS FOR BRAZIL

5.1. Salient Features of the Brazilian Federation from an International Perspective

The Brazilian federation is characterized by a degree of political and fiscal decentralization that is relatively high by international comparison, although the balance of power among the different levels of government has changed over time, with ebbs and flows of centralization.

On the political level, not only the states but also the municipalities have constitutional status as members of the federation, implying no hierarchical subordination of one level of government to another. The 1988 Constitution marked a shift of power and resources to the municipal level, at the expense of the states and, especially, the federal government. Moreover, the federal government has increased its direct interactions with local governments in recent decades, especially in service delivery.

Brazil has a presidential form of government, with clear separation of functions among the three branches of government (executive, legislative, and judiciary), although the balance of power among the three has varied over time. The federal Parliament, the Congress, is

¹⁴ Some SNGs, especially smaller or poorer ones, may find it less costly to execute their budgets through the national financial management information systems. It should be noted that such a choice need not involve any loss of budget autonomy by the SNGs in question.

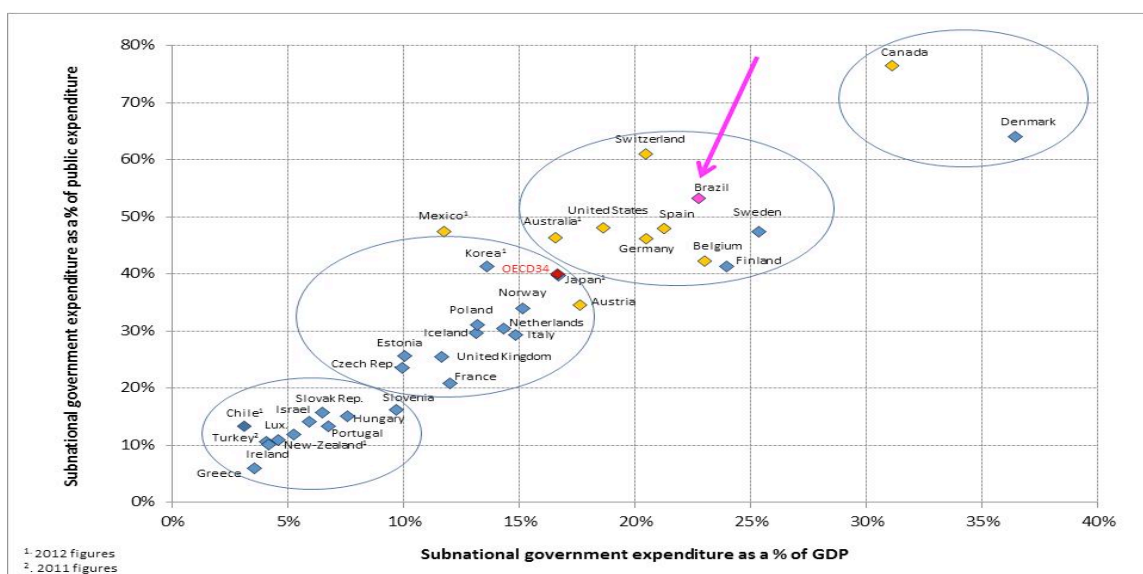
¹⁵ The central government can set a useful example by undertaking a fiscal transparency assessment based on the newer methodology of the IMF (IMF, 2014).

bicameral. The states have equal representation in the Senate, regardless of their geographical, social, or economic characteristics. Both chambers of Congress have equal powers on most issues of concern to SNGs; however, the Senate sets the limits on subnational debt.

The federation is characterized by large disparities among the subnational jurisdictions, regarding geography, population size and density, and level of economic development. Nevertheless, Brazilian federalism is largely symmetric, applying the same approaches to assigning spending responsibilities and revenues to all SNGs, regardless of level of government, while lacking a comprehensive equalization transfer system. Arguably, this exacerbates the federative conflicts that tend to characterize relatively heterogeneous countries.

Although in principle expenditure assignments follow subsidiarity criteria, in practice there is substantial overlap of spending responsibilities in the main functions of government (e.g., education, healthcare, social assistance, and law and order). Moreover, the federal level of government exercises significant regulatory power in a number of areas of state and local responsibility, and in doing so imparts substantial rigidities on subnational spending. For example, federal laws regarding the minimum wage and the indexation mechanisms for social assistance benefits have a significant impact on subnational spending, as do constitutional minimum spending requirements on education and healthcare. Notwithstanding this caveat, SNGs in Brazil carry out relatively large shares of spending compared with most OECD countries (Figure 2).

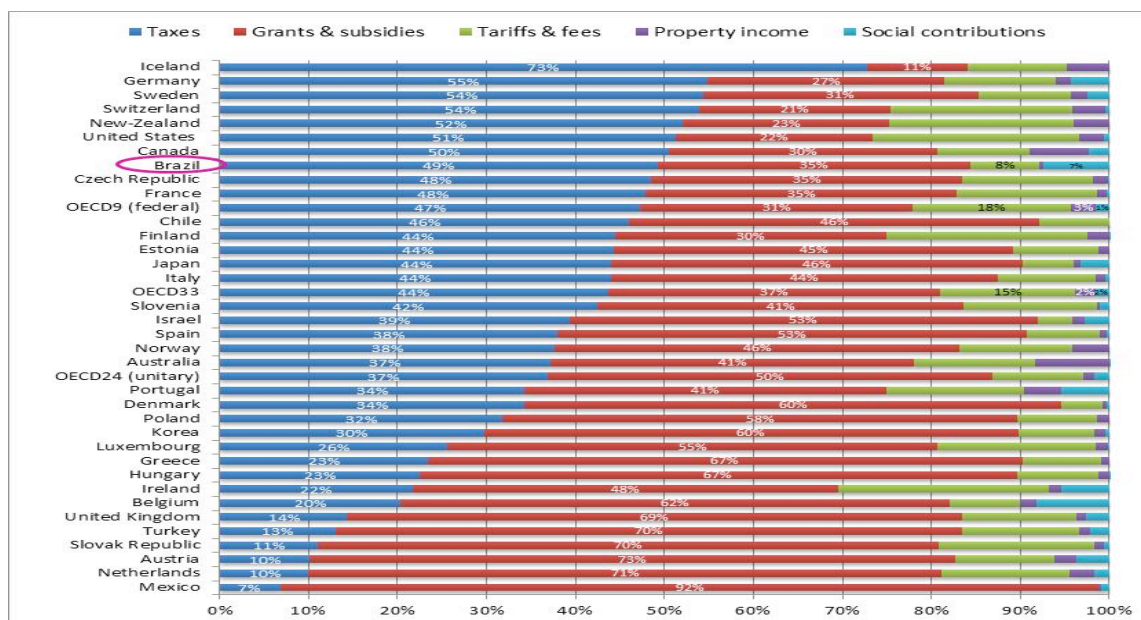
Figure 2: International Comparison of Spending Decentralization



Source: OECD.

SNGs also enjoy greater revenue-raising autonomy in Brazil than on average in the OECD (Figure 3), although they are broadly on par with the average of other federations in the area.

Figure 3: International Comparison of the Composition of Subnational Revenues, 2013



Source: OECD.

However, the Brazilian subnational tax system is fraught with significant flaws that are widely recognized to adversely affect efficiency, equity, and competitiveness. The main problem is the heavy reliance of state finances on a mixed origin/destination-based VAT (the ICMS), with a large dispersion of effective rates across goods and services, and the national territory. This has led to predatory tax competition (the so-called fiscal war), de facto cascading, and high compliance costs for taxpayers.

To date, reform efforts have been stymied by the fact that a shift to a more neutral destination-based VAT with a uniform base across the nation would entail significant losses for the states that are net exporters to the rest of the country. However, the urgency of such a reform is becoming more apparent to the state authorities, as they see their revenues eroded by the fiscal war and as the competitiveness of Brazilian enterprises is hampered by the cumulativeness and high compliance costs of the ICMS.

At the local level, many municipalities do not appear to adequately exploit the important tax bases (services and urban properties) assigned to them. In addition to weaknesses in property cadasters, this reflects a lack of political will to tax property effectively because

transfers to municipalities are relatively large and not structured to provide incentives to raise efforts to increase own-source revenues.

The intergovernmental transfer system has significant pros and cons. On the positive side, it is largely formula-based, thereby reducing discretion and the scope for political bargaining. On the negative side, the linkage of a large share of the transfers to federal revenues that are not adjusted for the economic cycle can lead to procyclicality in subnational fiscal policies; the coefficients for horizontal distribution of shared revenues have been fixed for decades; and, even after recent reforms, the underlying formulas are not appropriately equalizing in terms of revenue capacities or spending needs.¹⁶ While the block grants for education and healthcare are redistributive, they are small in relation to the constitutionally mandated transfers, and they also fall significantly short of adequately equalizing the capacities of different SNGs to provide these important services.

As regards macro-fiscal aspects of the system, the 2001 *Fiscal Responsibility Law* stipulates uniform ceilings for state and municipal debt, but, except for a few outliers, these ceilings are nonbinding. Instead, the binding constraints on SNGs' borrowing are set in the contracts agreed to with the federal government in the context of the subnational debt restructuring of 1996–97 and related debt service requirements, which until 2009 implied the need for most SNGs to run primary fiscal surpluses. In the past few years, however, these constraints were eased through discretionary authorizations by the federal Treasury for some states to borrow.

As a result, the overall subnational primary balance has been on a deteriorating trend, currently aggravated by the recession and related downturn in own-source and shared revenues. The aggregate net debt of the states, after falling through the previous decade, has been rising and is currently equivalent to around 10 percent of GDP. Municipal debt amounts to under 2 percent of GDP. There is, however, wide variance in the size of the debt of individual SNGs relative to their revenues.

The *Fiscal Responsibility Law* instituted strict accounting, reporting, and transparency requirements for the Brazilian SNGs. In various ways, the central government supported the states' and municipalities' efforts to strengthen and modernize their financial management and information systems in order to meet such requirements. As a result, Brazil's performance in this area is largely on a par with that of the best-performing advanced countries. Considerable effort has also been put into strengthening state tax administrations, including through vertical and

¹⁶ See Ter-Minassian (2012) for a more detailed discussion of the shortcomings of Brazil's subnational revenue system.

horizontal cooperation. However, the administration of local property taxes remains quite weak, reflecting high levels of informality in housing markets and outdated cadasters in many municipalities (Bonet, Munoz, and Pineda Mannheim, 2014).

The main current vertical fiscal cooperation forum is the *Conselho Nacional de Política Fazendária* (CONFAZ) presided over by the federal Minister of Finance (or the Vice Minister) and including the finance secretaries of all the states. The main responsibilities of the CONFAZ relate to tax policy and administration. It is responsible for approving all tax concessions under the ICMS, for promoting improvements in state tax administration, and for managing an information system for state revenues (*Sistema Integrado de Informações Econômicas e Financeiras*). It is also responsible for coordinating with the National Monetary Council on state debt policies. In 2012, the states created a horizontal cooperation forum comprising their secretaries of finance (the *Conselho de Secretários de Fazenda*, or CONSEFAZ) to promote coordination of state positions on issues to be taken up by CONFAZ. Both forums are supported by a technical secretariat. There are also a number of other horizontal intergovernmental cooperation forums:

- Nineteen sectoral forums at the state level, which cover most areas of state spending.
- Several associations of municipalities, including for the state capitals and the large municipalities, which primarily function as advocates.
- Many intermunicipal consortia that aim to exploit potential synergies in selected spending areas by neighboring municipalities. This form of cooperation is particularly widespread in healthcare, especially hospital management, as well as education and culture, and environmental management. Indeed, almost half of Brazil's local governments participate in intermunicipal consortia for healthcare.

5.2. Possible Approaches to Strengthening IFC in Brazil

Compared with the other large federations mentioned in this paper, IFC appears to currently be rather limited in Brazil. Particularly notable is the absence of high-level cooperation forums, both vertical and horizontal, at the state level. There are no equivalents of the Australian COAG, the Spanish Conference of the Presidents, the Canadian Council of the Federation, or the U.S. National Association of Governors.¹⁷

¹⁷ Recent press reports suggest that an agreement may have been reached among state governors to create a high-level horizontal cooperation forum, but no details are yet available on its mandate or procedural arrangements.

While there are a number of sectoral horizontal cooperation forums among the states, they have yet to be assessed in detail, especially as to the extent that they influence policymaking and promote the dissemination of good practices among the states. It appears that they tend to act independently, failing to articulate consistent cross-sectoral strategies, including vis-à-vis the federal government. The mandate of the CONFAZ is relatively narrow in the fiscal area, focusing primarily on the ICMS.

Horizontal cooperation appears better developed at the local level, where various municipal associations carry out significant advocacy. However, there would seem to be scope for further progress in the role of these associations in analyzing policy issues of relevance to the municipalities, promoting consensus on them, and articulating them in vertical cooperation forums. Heterogeneity among the local governments, which is broader than for the states on account of the vast disparities in size and socioeconomic characteristics, poses an obstacle to effective cooperation at the local government level. The lack of effective state cooperation forums has a number of negative consequences:

- Policy decisions are often made without careful analysis and due consideration of their possible adverse spillover effects on other levels of government (or other governments within the same level). Examples are federal policies regarding shared taxes, civil servants' wages and the minimum wage, or public employment legislation. There are currently several pieces of legislation under debate in Congress that could have significant repercussions for state finances.
- The states do not have a formal and permanent venue to discuss crosscutting issues or to formulate common positions on proposed actions by other levels of government. The absence of such a venue makes it also more difficult to identify potential tradeoffs and workable compromises in areas where the interests of different states diverge, reflecting the above-mentioned heterogeneity of the Brazilian federation.
- The advocacy power of the states vis-à-vis all three branches of the federal government and the better coordinated large municipalities and state capitals is reduced, as is the effectiveness of efforts to disseminate knowledge and best practices.

In light of these considerations, it would seem important to implement more effective cooperation mechanisms for the states. Ideally, it would be best to create both a vertical and a horizontal cooperation forum (e.g., on the model of the COAG and the Council of Australian Federation, respectively).

The former would be a forum to discuss and, to the extent possible, form consensus between the chief executives of the federal and state governments (the President and the governors, respectively) on major federative issues (e.g., reforms of the intergovernmental relations systems and implications of major policy decisions of one level on another). Consideration should be given to how to include representatives of the local level (possibly the heads of the major municipal associations) in such a forum, for example, by inviting them to attend the forum meetings as observers, possibly with voting power when issues of immediate relevance to the municipalities are being deliberated.

The high-level forum could be chaired by the President, with possibly a vice president chosen on a rotating basis among the governors, and would play a broad oversight role for sectoral (ministerial-level) vertical cooperation forums in key spending areas, and for a fiscal cooperation forum.

This fiscal forum could be chaired by the federal Minister of Finance and include the secretaries of finance of the states. While the membership of the forum could mirror that of the current CONFAZ, its mandate would be substantially broader, encompassing all aspects of intergovernmental fiscal issues, including the effects of fiscal policies on other levels of government. This forum could be created by expanding the current mandate of the CONFAZ and possibly re-naming it the *Conselho de Gestão Fiscal*, along the lines envisaged in the 2001 *Fiscal Responsibility Law* but with a broader mandate. An important potential advantage of such a forum would be the scope it would create to identify packages of reforms of different aspects of intergovernmental fiscal relations that would facilitate the compensation of losses from individual reforms (e.g., offsetting losses from state tax reforms with gains from changes in the distribution of shared revenues) (Khair, 2011; Ter-Minassian, 2012).

The horizontal high-level cooperation forum among the states could focus on analyzing and deliberating on major crosscutting policy issues. It could aim to promote the formation of common positions on such issues, with a view to advocating for them in the national Congress, the Supreme Court, and within the relevant executive-level vertical cooperation forums. This governor-level forum would provide an umbrella for the existing ministerial-level forums, including the CONSEFAZ—whose mandate should be expanded in line with that of the CONFAZ—with the objective of ensuring consistency across policy areas.

6. CONCLUSIONS

The analysis in the previous sections indicates that there is a strong theoretical case for IFC in both federations and unitary states, especially in light of the trend in many countries toward decentralizing responsibilities to deliver important public goods and services to SNGs. Well-functioning IFC arrangements can help the different levels of government recognize and attenuate adverse externalities from their policies, better exploit economies of scale in providing certain public services, reduce the risk of contagious diseases spreading, improve citizen security and environmental quality, and maximize connectivity, to cite just some potential benefits.

However, as demonstrated by the country discussions in the appendix, there is no easy recipe to ensure well-functioning IFC. The effectiveness of IFC forums is strongly affected by a range of economic, sociopolitical, and institutional factors, including constitutional provisions that reflect the history of decentralization in each country, power balances among the different levels of government, the design and practice of intergovernmental fiscal relations (in particular the degree of spending and revenue autonomy of SNGs), and the extent of regional economic, ethnic, and social disparities which can, and often do, give rise to conflicting attitudes and prevent constructive dialogue among SNGs.

These considerations suggest that effective models for IFC need to be tailored to individual countries' circumstances. Further, though lessons from other countries can be useful in shedding light on the advantages and disadvantages of possible design options, they cannot be imported uncritically. Among the lessons from international experiences, the following appear worth emphasizing:

- Different IFC forums serve different purposes and require different compositions. For example, sectoral forums need to include policymakers and specialists in each specific area; forums to promote cooperation in strengthening revenue and expenditure management should include tax and treasury officials, respectively; and forums to discuss fiscal policy reforms need to include ministers or secretaries of finance responsible for the national and subnational public finances. However, it is also important that different forums do not work at cross-purposes, thus it is desirable to have an overarching forum. Such a forum should involve the chief executives of the national and intermediate levels of government and a suitably high-standing representative of the local level to promote consensus on the main intergovernmental policy issues.

- Vertical cooperation is most likely to be successful when the executive branch of the national government is relatively strong and can exercise effective policy leadership.
- Horizontal cooperation forums can usefully complement vertical forums and are especially needed at the relatively fragmented local level. Horizontal cooperation is likely to be the main form of IFC in federations characterized by substantial revenue and expenditure autonomy of the constituent states vis-à-vis the national government.
- There is also a potentially useful role for cooperation among relevant subsets of the subnational levels of government. For example, the municipalities encompassing a metropolitan area could coordinate services like public transport, roads, and water management, and minimize predatory tax or regulatory competition.
- The effectiveness of IFC forums is likely to be reduced by tensions of an ethnic nature or arising from very sharp differences in natural resource endowments, levels of development or economic structures across a national territory, or more generally by a history of perceived unfairness by the national government in the distribution of resources among SNGs. Even in such contexts, however, it can be argued that dialogue in an institutional IFC forum can be useful in searching for win-win policy reforms. IFC forums can help identify trade-offs and compensations between winners and losers from such reforms.

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APPENDIX: SELECTED COUNTRY PROFILES

As a background to the above analysis, this appendix briefly summarizes the salient features of intergovernmental fiscal relations and the main IFC channels in selected countries, mostly large federations, inside and outside the EU.

A1. NON-EU COUNTRIES

A1.1. Australia

The Australian federation comprises the federal (Commonwealth) government, six states, two self-governing territories, and over 700 local governments, which vary significantly in size, population, geography, and economy.

Spending responsibilities are defined clearly by the constitution. Subnational expenditures account for nearly half of general government spending. However, the Commonwealth's extensive powers of constitutional regulation in areas assigned to the states result in substantial de facto overlap of spending responsibilities. This blurs accountability to the Parliament and the electorate and has led to duplication and inefficiencies (COAG, 2013; Koutsogeorgopoulou and Tuske, 2015).

Most taxation powers are concentrated at the federal level, which accounts for over 80 percent of total tax revenue. The resulting large vertical imbalance has facilitated extensive use of conditional grants, reducing the states' autonomy and accountability in areas of their responsibility. There are also substantial equalization transfers, funded by VAT revenue. The system, which is administered by the independent Commonwealth Grants Commission, aims to address the differences in revenue capacities and spending needs of the states,¹⁸ but it uses formulas widely seen as excessively complex and costly to administer.

There are no statutory borrowing limits; borrowing is primarily constrained by financial market discipline, supported by strict transparency requirements. State debt, which had declined to around 3 percent of GDP in the mid-2000s, has risen again in more recent years to nearly 9 percent of GDP.

¹⁸ The states also provide equalization transfers to their municipalities.

Australia has a long and extensive tradition of intergovernmental coordination forums, concentrated at the executive level, including the following:

- Premiers' Conferences that pre-dated the federation's establishment in 1901 and were replaced in 1991 by the COAG as the highest-level instance of policy coordination between the Commonwealth and the states and territories.
- A number of intergovernmental ministerial councils in different sectoral policy areas.
- The Loan Council, which was initially created to discuss and agree on borrowing limits, but now primarily focuses on ensuring transparency of borrowing policies.
- The Commonwealth Grants Commission.
- The Council of the Australian Federation, a horizontal coordination forum among the states.

In the literature, the general assessment is that these forums have been instrumental in promoting intergovernmental consensus on important tax and spending reforms, as well in facilitating policy coordination in sectoral areas (e.g., water management and health), but they present the following shortcomings:

- They are not institutionalized, and thus have no legal basis.
- The federal level drives the timing and agendas of the COAG and the intergovernmental ministerial council meetings, and their proceedings have limited transparency.
- Their respective responsibilities are not sufficiently clear, and both the number of sectoral forums and their tendency to delegate upward have been reduced.

More generally, there is growing recognition that the system of intergovernmental fiscal relations suffers from significant shortcomings and needs comprehensive reform. The COAG has commissioned the preparation of a white paper to outline options for such a reform, which it expects to release and discuss in 2016.

A1.2. Canada

The Canadian federation is widely regarded as a model example of fiscal federalism, combining separation of functions and taxation powers with a significant degree of territorial solidarity. The federation comprises, in addition to the federal government, 10 provinces, three territories, and a multitude of local governments, which are under provincial jurisdiction. Canada also provides a significant example of asymmetric federalism, with special regimes for the territories and the Province of Quebec.

The constitution assigns a number of exclusive functions to the federal government and the rest to the provinces, which in turn choose which functions to delegate to their municipalities. Concurrent functions are quite limited (mostly immigration, agriculture, and environmental protection). Subnational expenditures account for nearly 70 percent of total government spending.

The provinces and territories have extensive revenue-raising powers, sharing income and consumption tax bases (among others) with the federal government. State and local taxes account for nearly half of total tax revenue. The provinces are also assigned revenue from nonrenewable natural resources. As a result, the aggregate vertical imbalance is relatively low compared to most other federations.

However, given substantial differences in the distribution of natural resources and other tax bases, as well as in spending needs, there are significant horizontal imbalances. These are addressed primarily through formula-based transfers intended to equalize revenue capacities, and through block grants for health and social services. Equalization is only partial, given the budgetary resource constraints of the federal government, a fact that explains continuing redistributive tensions within the federation.

There are no federally imposed restrictions on provincial borrowing, but given the long history of no bailouts from the federal government, some provinces have adopted their own borrowing constraints. Subnational debt, which had been broadly stable at less than 50 percent of GDP prior to the global financial crisis, has risen significantly, approaching 60 percent of GDP. In recent years, the Parliamentary Budget Office has been providing assessments of subnational (and federal) finances in their annual Fiscal Sustainability Reports.

Canada does not have any formal vertical cooperation forum. The main intergovernmental cooperation forums are horizontal: the Council of the Federation, which includes the Premiers of all the provinces and territories,¹⁹ and the Federation of Canadian Municipalities.

The Council of the Federation is chaired by one of the Premiers on a rotating basis, meets twice a year, and is supported by ad hoc committees of ministers, a steering committee at the deputy-ministers level, and a small secretariat. The Council's main mandates are to:

- Serve as a forum where members can exchange viewpoints, information, knowledge, and experiences;
- Promote a coordinated approach to federal–provincial relations on the basis of shared analysis and discussion; and

¹⁹ More details can be found at <http://canadaspremiers.ca>.

- Analyze actions or measures of the federal government that, in the opinion of the Council members, have a major impact on the provinces and territories.

The main areas in which the Council has promoted coordinated policies include ensuring unfettered internal trade, promoting innovation in healthcare, and managing water resources, energy, and national transportation strategies.

The Federation of Canadian Municipalities acts as a coordination forum among the local governments and as an advocacy group. Though it has no formal power, it has significant ability to influence debate and policy at the provincial and even federal levels.

A1.3. India

The Indian federation includes 29 states, seven territories, and a very large number of urban and rural governments. It is a bicameral democracy; the members of the upper house are elected by their respective states. The federation is characterized by wide disparities in ethnic, religious, and socioeconomic characteristics. This has favored a strong centralizing role of the federal level of government (the Union), which has only modestly been reduced in line with the decline of the traditionally dominating Congress party.

Expenditure assignments are exclusive or concurrent, with the latter covering major social and economic areas, including healthcare, education, energy, and environmental regulation. Although the states carry out the bulk of spending in most areas, the Union has overriding powers and can even dismiss state governments deemed not to carry out their functions in compliance with the constitution. The Union's influence is further strengthened by the provision that states indebted to it (in practice all the states) have to obtain its authorization for new borrowing.

Different levels of government are assigned different tax bases, with the most productive ones assigned to the Union. The states' main revenue source is a sales tax, traditionally fraught with substantial distortions but now being reformed. As a result, states are highly dependent on transfers from the Union.

Of these transfers, the current ones are based on criteria set every five years by an ad hoc independent finance commission. The commission has traditionally set transfers based on broad equalization objectives, but also to fill ex post resource gaps. However, these objectives promote inefficiency in spending, discourage own-source revenue efforts, and generate moral hazard. Capital transfers and loans are decided by the Union through its Planning Commission, in line with the objectives of successive National Plans.

The Union and most states have adopted fiscal rules that target the current balance, but they have relatively poor records of implementation. States and territories have been running an aggregate deficit in excess of 2 percent of GDP. The general government debt is around 65 percent of GDP. There are several forums for IFC, most notably the following:

- The Interstate Council, rooted in Article 263 of the Constitution but established in 1990, is chaired by the Union's Prime Minister and includes the chief ministers of states and territories, plus selected Union cabinet members. A standing committee and secretariat support the Interstate Council, which meets on an ad hoc basis to discuss high-level federative issues and can deliver nonbinding but influential recommendations on such issues.²⁰
- The National Development Council, created in 1952, has a composition similar to that of the Interstate Council. Its main functions relate to developing, reviewing, and monitoring implementation of the National Plan.²¹
- Six Zonal Councils, created in 1956, promote dialogue and cooperation among neighboring states and territories.
- Various sectoral interministerial councils promote vertical and horizontal cooperation in selected functional areas.

There is broad agreement in the literature that these forums have had limited effectiveness so far. The main reasons are probably the strong predominance of the federal government, large vertical imbalance, and other institutional flaws resulting in soft subnational budget constraints. Such constraints have fostered reliance by the states on bilateral dealings with the Union instead of multilateral coordination mechanisms.

There is also broad consensus that IFC needs to be strengthened to face the challenges posed by changing political landscapes, increasing horizontal imbalances among the states, and the need to remove still significant barriers to interstate commerce. However, no institutional initiative has been taken so far.

A1.4. Mexico

The Mexican federation includes the federal government, 31 states, and the Federal District, as well as 2,445 municipalities, which are subject to both federal and state laws. The decentralization of spending responsibilities is substantial. (In 2012, subnational spending accounted for nearly 50 percent of total public expenditures.) However, education has been

²⁰ See www.interstatecouncil.nic.in.

²¹ For more details, see <http://interstatecouncil.nic.in/Ndc.html>.

recentralized because of the inadequate financial control of spending by the states. Nevertheless, the federal government wields substantial influence over decentralized expenditures through regulation and conditional transfers to finance major spending categories (the so-called *aportes*).

The Mexican SNGs enjoy very limited revenue autonomy; the states' main sources of own-source revenue are a payroll tax, a vehicle tax, and some charges for services (*derechos*). The municipalities also rely on *derechos*, as well as on a poorly utilized tax on real estate. The states receive around 20 percent of federal revenue (*participaciones*) as well as the above-mentioned *aportes* and other specific discretionary federal grants. The municipalities receive state transfers.

The heavy (over 90 percent) dependence of Mexican SNGs on transfers is identified in the literature as an important source of soft budget constraint (Pineda, Ramirez, and Rasteletti, 2015), as evidenced by repeated bailouts of states in financial difficulty by the federal government. This dependence is rooted in a political system in which state governors wield substantial powers in Congress, and the federal government uses the financial dependence of the states to secure support for important legislation.

To reduce the need for such bailouts, the federal government has recently enacted new fiscal responsibility legislation, setting ceilings on the ratio of state debt to revenue and requiring that fiscal accounting and reporting standards be harmonized throughout the federation. The government is also stepping up efforts to better monitor the evolution of state finances through the *Unidad de Coordinación con las Entidades Federativas* in the Ministry of Finance. Further, it is contributing to programs to improve state and local financial information systems and capacities (in particular through the *Instituto para el Desarrollo Técnico de las Haciendas Públicas*, or INDETEC).

The legal framework for IFC in Mexico is set out in a *Law of Fiscal Coordination*, first decreed in 1978 and repeatedly amended thereafter.²² This law mandated the creation of several forums for IFC, including a high-level Meeting of Fiscal Officials (*Reunión de Funcionarios Fiscales*) and the Permanent Commission of Fiscal Officials (*Comisión Permanente de Funcionarios Fiscales*). The Meeting includes the federal Minister of Finance and the finance secretaries of the states, and meets at least once a year to discuss the main issues in intergovernmental fiscal relations. The Permanent Commission comprises eight representatives of the states (chosen on a rotating basis) that meet more frequently with the Revenue Secretary of the Ministry of Finance. The role of the Commission is to monitor

²² Details can be found at <http://snecf.gob.mx>.

implementation of the revenue sharing system, review developments in state finances, and discuss proposed reforms of the intergovernmental fiscal system. The above-mentioned INDETEC acts as a technical secretariat to the Commission. The Commission is generally considered an effective forum for promoting better dialogue across government levels, as well as among the different states, and on occasion has facilitated consensus on needed fiscal reforms.

A1.5. Switzerland

The Swiss Confederation is characterized by high degrees of both fragmentation (it comprises 26 cantons and over 2,700 municipalities in a country of under 7.5 million people) and subnational autonomy. These features reflect the wide diversity in language, religion, and level of per capita income across the cantons. The cantons are represented in the Council of States, to which the 20 largest cantons elect two representatives each, and the smaller six one each. The Council, which is modeled on the United States Senate, has full legislative powers and veto power on all federal legislation. A peculiarity of the Swiss Confederation is its heavy reliance on direct democracy (referendums) to decide on fiscal policy issues.

Exclusive spending responsibilities of the federal government are specified in the Constitution. All other functions are split between the cantons and the municipalities, which account for about 38 and 20 percent, respectively, of total general government spending. Each government level has substantial autonomy in carrying out its assigned responsibilities.

There is substantial overlap in the taxation powers of the different levels of government as regards personal and corporate income taxes. In contrast, the federal level controls most indirect taxes, and the cantons and localities the property taxes. In all, the cantons account for nearly 30 percent and the localities for about 19 percent of total tax revenue. There is significant tax competition among cantons in providing tax exemptions and setting the rates of personal and corporate income taxes.

Fiscal equalization transfers have historically been relatively small and ineffective. They were strengthened by a 2008 reform, but fiscal disparities among cantons and municipalities remain significant.

There are no federally imposed limits on cantons' borrowing. Although most subscribe to a principle of balancing their budgets over the medium term, in fact, some cantons have accumulated sizable debts. Aggregate subnational debt is equivalent to around 22 percent of GDP.

Given the characteristics of the Swiss Confederation, it is not surprising that IFC is not well developed. There is no institutionalized forum for coordination between the federal government and the cantons. The main channel of influence of the cantons on national policies is the Council of States.

The main forum for multilateral cooperation among the cantons is a Presidents' Conference, supplemented by sectoral ministerial-level forums. Horizontal coordination is frequently enshrined in intercantonal agreements on specific issues or policies, which may include all the cantons or a subset of them.

A1.6. *The United States*

The U.S. federation encompasses the federal government, 50 states, and more than 87,000 local governments. Each state has its own constitution. In cases of conflict between the national and state laws, the former prevail. The United States has a bicameral national Congress, where legislation needs to be sanctioned by both houses. Each state elects two representatives to the Senate.

The assignment of spending responsibilities broadly follows the subsidiarity principle, but many services are unbundled, leading to concurrent responsibilities in several broad spending areas. The states' share of total expenditures is just slightly lower than that of the federal government. However, the influence of the federal government on spending has been rising in the past several decades, especially since the federal government has imposed (sometimes unfunded) spending mandates on lower government levels.

The three levels of government share the income tax base, while most indirect and property taxes are levied at the subnational level. State taxes account for about 20 percent and local taxes about 15 percent of total general government taxes. States and localities engage in significant tax competition, especially in corporate income and consumption taxes, as well as excises. There are, however, constitutional limitations on subnational taxation powers: states cannot levy taxes on international trade or taxes deemed to impede interstate commerce. There are no revenue sharing and equalization transfers. Intergovernmental transfers take the form of block or special-purpose transfers, reflecting allocative, as well as distributional, purposes.

There are no controls on subnational borrowing imposed by higher levels of government, but most states have adopted constitutional rules of balanced current budgets. The adoption of such rules was largely the result of a long history of no bailouts of states by the federal government. There is a formal bankruptcy procedure (Chapter 9) for insolvent local governments.

The presidential nature of the federal government and related separation of powers have prevented the emergence of executive federalism (as in parliamentary-type federations, like Australia or Canada). The states' main formal channel of influence on federal policies is through the Senate, in which the states have more direct and equal representation.

Intergovernmental cooperation is therefore largely horizontal, including associations of state governors and of state legislatures, and various local intergovernmental associations, primarily with an advocacy function. States and local governments also enter into ad hoc agreements on issues of mutual interest.

The National Association of State Governors (NGA) plays an important advocacy role for the states, not only by lobbying the executive and the Congress on issues of particular relevance to the states, but also by representing the states' viewpoints on issues being taken up by the Supreme Court. The NGA is articulated into four permanent commissions—Economic Development, Education and Labor, Health and Social Issues, and Natural Resources—that analyze and promote the achievement of states' common position on issues in their respective areas. Over the years, the NGA has promoted agreement by the states on a set of common broad principles on federative relations and tax reform. The NGA also, especially through its Center on Best Practices, promotes the dissemination of knowledge on issues of relevance to the states.²³

A2. EU MEMBER COUNTRIES

Adoption of the Fiscal Compact in 2012 by most EU members and its translation into high-level national legislation has shaped the evolution of IFC in the EU in recent years. The following briefly summarizes the key features of the new fiscal framework.

The fiscal numerical rules included in the Stability and Growth Pact have been strengthened. The medium-term structural fiscal deficit objectives must not exceed 0.5 percent of GDP. Nominal deficits higher than 3 percent of GDP still trigger the excessive deficit procedure. The gross public debt should not exceed 60 percent of GDP. Countries in violation of these limits must adhere to pre-specified correction paths. The framework is supported by enhanced surveillance by the European Commission, and by strengthened procedures to apply sanctions for protracted violations of the rules.

The fact that all limits apply to the general government but that the central government is responsible for ensuring their observance has heightened the need for intergovernmental

²³ More details on the NGA can be found on its website (www.nga.org) and in Carvalho (2015).

cooperation in EU countries. There is significant variation in the mechanisms these countries use to promote such cooperation, but there are also similarities, which are discussed in the selected cases presented below.²⁴

A2.1. Austria

The Austrian federation includes the federal government, nine states, and over 2,100 local governments. The federal government has relatively large spending responsibilities, but in many areas it delegates their execution to the states, which account for about 16 percent of general government spending. However, since in many areas the states act as agents of the center, their spending autonomy is limited. Local governments account for about 15 percent of total spending. The federal government collects roughly 95 percent of total taxes. It shares them with the states and municipalities according to formulas defined in a federal law, which is revised every three years.

Since 1996, subnational fiscal targets have been negotiated and enshrined in Domestic Stability Pacts that cover five years, with mixed records of implementation. The compliance record, initially strong, weakened after 2002, partly reflecting lack of enforcement. Further, compliance was marred by SNGs resorting to various accounting stratagems, such as reclassification of public entities. Deviations from the Pact's targets were especially pronounced during the crisis years, leading to a downward revision of the targets in 2011.

The 2012 Stability Pact sets structural budget deficit limits for each level of government (0.35 percent of GDP for the federal government and 0.08 percent of their GDPs for the states). Local government deficits should not in aggregate exceed 0.02 percent of GDP. The distribution of the latter total among individual localities is to be decided by a state-level coordination council.

Limits are also envisaged for total public debt, with distribution among government levels to be guided by their respective shares in the stock of debt. The Pact also includes a rule limiting the growth of expenditures to that of potential national GDP. Various escape clauses and a debt-brake-type correction mechanism are envisaged in this latest Pact. The Advisory Fiscal Council was created in 2013 to monitor compliance of all levels of government with the requirements of the Fiscal Compact.

The initial results of the 2012 Pact have been encouraging, with subnational deficits declining to below the targets. However, to date, little progress has been made on broader intergovernmental fiscal reforms (including increasing subnational own-source revenue

²⁴ See Tournemire (2014) for more detail.

responsibilities and eliminating expenditure overlaps) that would help harden the subnational budget constraint and ensure continued compliance with the EU objectives in the future.

Austria is a good example of executive federalism, in which the federal government, given its dominant role, largely drives IFC. The states are represented in the Senate, but the role of the Senate is limited.

Periodic conferences between the federal and the state executives, covering areas of common responsibility, represent the main forum for vertical cooperation. The periodic revisions to revenue sharing arrangements are negotiated within this forum. There is also a consultation mechanism involving the association of local governments for issues of relevance to them.

The main forums for horizontal cooperation are a Conference of State Governors, supported by a permanent Secretariat, and two associations of local governments (municipalities and towns), which are consulted by the federal government and the states on matters of local interest.

A2.2. Belgium

The Belgian federation comprises the federal government, six federated entities (three regions and three communities), 10 provinces, and nearly 600 localities. The federation has undergone successive waves of reform that have substantially strengthened the autonomy of the federated entities at the expense of the federal government. In contrast, the role of the provinces is declining.

As a result, federal spending responsibilities have been reduced over the past couple of decades, although they still account for more than 62 percent of consolidated general government spending. The share of spending by the federated entities has increased to nearly 25 percent, and that of local governments has fluctuated narrowly around 13 percent of the total.

Subnational autonomy has also been strengthened on the revenue side, as some intergovernmental transfers have been replaced by increased regional surcharges on federal taxes. Nevertheless, the federal government still collects around 90 percent of total taxes, which are shared with the lower levels of government. There is a formula-based national equalization mechanism. The main parameters of the formula are regional personal income tax collections and unemployment levels.

Until 2013, the internal stability pact framework involved an annual determination of budgetary targets for the federal and regional governments based on the recommendations of a multi-partisan High Finance Council. The council typically recommended a distribution of fiscal

adjustment efforts between the two levels of government in line with their respective expenditure shares. Ex post, however, the central government ended up contributing more.

In 2013, the Intergovernmental Cooperation Agreement between the federal and federated governments adopted the EU-required principle of a balanced structural budget for the general government. The distribution of the target among the participating governments was decided by the *Comité de Concertation*, to be effective through 2018, on the advice of the High Council of Finance, which is also responsible for monitoring compliance with the agreement. However, the agreement does not seem to have been fully implemented so far.

Intergovernmental cooperation takes place through different institutional channels, including the following:

- In the Senate, whose members are appointed by the federated entities, but which has limited legislative powers.
- At the Executive level, through the *Comité de Concertation*, which comprises the federal and federated entities' heads of government, and through 16 sectoral interministerial committees.
- Through a variety of formal and informal coordination forums between each federated entity and its own provinces and municipalities.

A2.3. Germany

The German federation includes the federal government, 16 states, and over 11,500 local governments, which are regulated by state legislations. It provides a clear example of cooperative federalism: a strong role of the federal government, as evidenced by extensive concurrent spending responsibilities, and authority to issue framing legislation in many areas assigned to the states. At the same time, through the upper chamber of Parliament (*Bundesrat*), the states collectively have veto power over federal legislation that affects them. The members of *Bundesrat* are appointed by the states.²⁵

The states have no autonomy in setting the base or rates of taxes, but they share the revenue from the major national taxes. At the same time, in the *Bundesrat*, they can block changes in shared taxes proposed by the federal government. The shared revenue is distributed partly on origin and partly on equalization criteria. Intergovernmental transfers are mainly horizontal, involving redistribution of shared revenue among states on the basis of indicators of respective needs.

²⁵ See Feld and Von Hagen (2007) for a discussion of the advantages and disadvantages of the German model of cooperative federalism.

Until 2009, the states were not subject to statutory borrowing limits. Some faced financial distress and had to be bailed out by the federal government. A constitutional amendment adopted in 2009 stipulates that the states have to run balanced structural budgets starting in 2020. However, their lack of revenue autonomy raises concerns about the feasibility of this target for some of the states.

The extent of cross-constraints among the different levels of government requires extensive intergovernmental cooperation to minimize potential conflicts and maximize the chances of mutually beneficial outcomes. Such cooperation takes place in many forums at the executive level, aiming to prevent conflicts in the *Bundesrat*. Examples of these forums are as follows:

- The Stability Council, created with the constitutional amendment of 2009, includes the federal and state ministers of finance. This council monitors developments in the states' finances. It is empowered to issue warnings to states considered at risk of fiscal crisis and to negotiate adjustment programs with them, but it has no formal enforcement powers. An independent advisory board of technical specialists supports the council.
- A Working Party on tax revenue forecasting. This party is responsible for forecasting and distributing shared revenue.

There are also various associations of local governments, which are consulted by the federal government and the states on issues of relevance to them.

A2.4. Italy

Italy is a unitary state but has features similar to those of a federation. In particular, its 20 regional governments (five with special statutes) are popularly elected and are responsible for important spending areas (especially health and infrastructure). They also have significant own-source revenue, mainly a tax on the value added of enterprises. However, in contrast to most federations, the regions do not have hierarchical oversight of the lower government levels (110 provinces and 8,100 municipalities).

Decentralization deepened during the 1990s and 2000s, but a constitutional reform aimed at greatly expanding subnational spending responsibilities was never implemented, and there has been some re-centralization during the recent crisis years. Re-centralization includes a gradual phasing out of the provinces and the planned transformation of the Senate into a body with competence limited to legislation on intergovernmental matters. In recent decades, there have been frequent changes in various features of the intergovernmental fiscal system,

including assignment of spending responsibilities, regional and local taxes, and the design of equalization transfers.

Italy has a long history of Internal Stability Pacts that included limits on subnational deficits and spending growth, but their record of implementation has been mixed. To strengthen their effectiveness, sanctions were introduced in 2003, and accounting and transparency requirements were tightened.

A constitutional amendment passed in 2012 requires, in line with EU mandates, balanced structural budget at all levels of government by 2016. However, the amendment envisages scope for the regions to compensate temporary disequilibria among the municipalities in their respective territories. This provision is expected to strengthen the coordinating role of the regions vis-à-vis their municipalities.

Italy has a number of intergovernmental cooperation forums, including the following:

- Vertical executive-level forums:
 - States-Regions-Provinces Conference.
 - States-Municipalities Conference.
 - Unified Conference. All four levels of government are represented in this forum, which is chaired by the Prime Minister. Within this broader forum, a Standing Conference has been in place since 2013 to coordinate public finances, review the national and subnational budgets for compliance with the above-mentioned fiscal rules, and promote dialogue on other aspects of intergovernmental fiscal relations.
- Parliamentary committees on intergovernmental fiscal reform.
- Horizontal cooperation forums within each level of government, primarily for advocacy.
- A special mechanism to consult with the subnational units regarding EU legislation.

A2.5. Spain

Spain is a quasi-federal unitary state that comprises 17 regional governments (*Comunidades Autónomas*, or CAs) with elected governments and substantial spending autonomy. Two of the CAs (the *País Vasco* and *Navarra*) have a special regime (*régimen foru**sl*) with even higher spending and revenue autonomy, an asymmetry which is generating tension and centrifugal pressures in the other CAs. Spain also comprises 50 provinces and over 8,100 municipalities, which are overseen by both the central government and the CAs.

The country has undergone a strong decentralization process in recent decades, more pronounced on the spending than the revenue side. The CAs have exclusive or shared competencies in major spending areas, but, with the exception of those under the *régimen foruzsl*, more limited revenue autonomy since the most important taxes are collected by the central government and then shared with the CAs. Own-source revenues are cyclically volatile, contributing to procyclical fiscal policies by the CAs. Shared revenue is partly redistributed according to equalization criteria, complementing equalization transfers from the central government to the poorer regions. The richer regions contest the extent of the redistribution, fueling separatist tendencies.

During the past decade, multi-annual fiscal targets for the different levels of government were made by successive *Budgetary Stability Acts* in 2001 and 2008. Annual targets ex ante consistent with the requirements of the acts were defined by the central government, reflecting negotiations with the CAs in a Council on Fiscal and Financial Policies that included the ministers of finance. Compliance with the acts was significantly weakened because the CAs resorted to public–private partnerships (PPPs) and accounting stratagems, thus the acts were practically abandoned during the global financial crisis.

In the wake of the Euro crisis, Spain has raised fiscal stability to a constitutional principle. Since 2012, negotiations on subnational targets have been carried out within the framework of a new *Organic Law on Budgetary Stability*. This law mandates convergence of the public debt to 44 percent of GDP for the central government, 13 percent for regional governments, and 3 percent for local governments. It also limits structural deficits of the general government to no more than 0.4 percent of GDP and expenditure growth for all governments to that of potential output. Further, it strengthens enforcement mechanisms, as well as transparency and accounting requirements, including on PPPs. Another change involved the creation of an *Autoridad Independiente de Responsabilidad Fiscal*, which is charged with monitoring fiscal developments at all levels of government and assessing their compliance with the revised fiscal responsibility framework.

There are a number of forums for IFC in Spain. At the executive level, the most influential is the Conference of the Presidents, chaired by the Prime Minister and comprising the presidents of the CAs. There are also a number of sectoral interministerial conferences, including the Fiscal and Financial Policy Council, which is responsible for coordinating economic, financial, and fiscal matters. The central government is also active in negotiating bilateral agreements with individual CAs. The Federation of Spanish Municipalities and Provinces represents the provinces and municipalities at the central government level. At the

legislative level, the main forum is the Senate, which has 58 members appointed by the CAs; however, it has fewer powers than the elected House of Representatives.

The main forums for horizontal cooperation are the Conference of Governments of the CAs, and the Federation of Provinces and Municipalities. Both help identify the scope for common positions of their respective members in negotiations with the central government, and act as forums for exchange of views on common issues and challenges.