



# **Intergovernmental fiscal cooperation (IFC) in the digital era**

Presentation by Teresa Ter-Minassian at the FIBE forum on the future of fiscal governance

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# Outline



- **Some initial considerations**
  - The case for intergovernmental fiscal cooperation (IFC)
  - Main obstacles to effective IFC
  - Political and institutional factors influencing IFC
- **Areas in which IFC can be beneficial**
  - Macro-fiscal management
  - Design and reform of intergovernmental fiscal arrangements
  - Capacity building
  - Sectoral policies
- **How IFC can help governments face key current challenges**
  - Digitalization
  - Dealing with climate change



# **Some initial considerations**



# The case for intergovernmental fiscal cooperation (IFC)

- Effective cooperation across and within levels of government may require the participants to **pursue policies different from those that they would have chosen in its absence**
- Therefore, for cooperative arrangements to work, participant governments must **believe that their benefits outweigh the losses of unilateral decision-making entailed by them**
- **Potential gains from cooperation** involve a reduction of adverse externalities/spillovers, and a fuller exploitation of positive externalities and synergies from participants' actions and policies



# Main obstacles to IFC

- **Fragmentation of sub-national levels of government**
  - Especially relevant at the local level but also at the intermediate one, when federations include many states/regions
  - May be alleviated by horizontal cooperation forums, facilitating coordination within sub-national government levels, and representing them in vertical coordination forums
- **Heterogeneity of sub-national jurisdictions** (in size, levels of development, production structure, incidence of poverty, etc.) which makes it more difficult to identify win-win options



# Some factors shaping IFC

- **IFC can take many forms:**

- Across levels of government (vertical) or among governments of the same level (horizontal)
- Primarily at the Executive level or at the Parliamentary one
- Harder or softer
- Broader or narrower coverage

- **Political and institutional factors play an important role in shaping IFC**

- Power balances between the different levels of government
- The nature of representation of sub-national governments (SNGs) in the national Parliament
- The extent of overlap in spending responsibilities among levels of government



# **Main functions of IFC**



# Benefits of IFC in macro-fiscal management

- Well functioning forums for IFC can contribute to improved macro-fiscal management by:
  - Promoting agreement on effective mechanisms of **control of subnational borrowing**, especially the design and implementation of sound **fiscal rules**, and their enforcement through peer pressure
  - Facilitating consensus on appropriate **approaches to the resolution of subnational debt crises**
  - Facilitating the **intergovernmental exchange of information** needed for the preparation of sound subnational budgets; and
  - Promoting **analysis and intergovernmental debate on policy initiatives of one level of government with potential (positive or negative) spillovers on the other(s)**



# IFC can help strengthen subnational revenue autonomy (SRA)

- SRA has several potential benefits but also many obstacles of an economic, institutional and political nature
- IFC can help strengthen SRA by:
  - Identifying the most significant obstacles in individual countries' circumstances
  - Facilitating the search for **packages of policy reforms acceptable to all participants**
  - **Limiting predatory tax competition;** and
  - Promoting an **exchange of good practices in tax administration** among and within levels of government



# IFC can also help improve expenditure policies and management

- **IFC can facilitate:**

- **Reforms to improve the distribution of spending responsibilities among government levels**

- Better reflecting societal preferences for decentralization
    - Minimizing duplication of functions
    - Asymmetric decentralization: adjusting the pace of devolution of spending responsibilities to evolving differences in sub-national capacities

- **Improved subnational expenditure management**

- Exchanging know-how and good practices in budgetary and public debt management, and in the preparation and execution of sound investment projects
    - Promoting the implementation of common accounting standards



# Potential benefits of IFC in sectoral policies

- **Some spending areas in which subnational governments have substantial responsibilities and can benefit from IFC:**
  - **Education**
    - Citizens' mobility implies diffusion of education's benefits (or shortcomings) throughout the national territory
    - IFC can facilitate the adoption of common minimum standards, the sharing of good practices, common responses to common problems
  - **Health care**
    - Prevention and care of contagious diseases
    - Diffusion of good practices in the design of efficient and effective health programs
  - **Infrastructures**
    - Water management, especially to avoid inter-jurisdictional conflicts
    - Road and rail to enhance connectivity
    - Ports and airports
  - **Regional development**



# **How IFC can help governments face some key current challenges**



# Opportunities and challenges of digitalization for SNGs

- Digitalization in its various forms (internet of things, big data analytics, AI, blockchain technologies) creates **many opportunities** for improving the activities and finances of subnational (as well as national) governments
  - Enhancing both own and shared revenues
  - Improving the effectiveness, efficiency, and transparency of public services
- But SNGs face **many challenges** in exploiting the potential of digitalization
  - Governance issues (needed legal and regulatory reforms, privacy concerns)
  - Human resource constraints
  - Lack of adequate IT infrastructures and limited fiscal space to improve them
  - Cybersecurity risks
- **Different SNGs are differently equipped to meet the challenges of digitalization.** Smaller and poorer urban and especially rural communities are more likely to suffer from skill shortages, limited connectivity, and scarcity of budgetary resources



# How national governments can help SNGs address such challenges

- In the absence of support from the national government, **the digital revolution is likely to widen spatial and income inequalities** within a national territory.
- **National governments (NGs) can assist subnational digitalization efforts in a number of ways:**
  - By ensuring that SNGs have adequate resources to fund investments in digitalization, through appropriate revenue assignments and equalization transfers
  - By giving adequate weight to the objective of digital inclusion across the national territory in national infrastructure investment decisions
  - By defining appropriate nation-wide standards to facilitate seamless interfaces among the national and subnational digital platforms; and
  - By providing technical assistance and training to subnational officials



# The role of horizontal cooperation

- Horizontal cooperation can also support effective and efficient subnational digitalization:
  - Through **dedicated forums for interregional and intermunicipal dialogue on digitalization issues**
  - Through **peer-to-peer support, including** demonstration effects, technical assistance, and cross-training of officials; and
  - By ensuring smooth **interfaces among subnational digital information systems**, especially among local governments in large metropolitan areas



# IFC in mitigation of climate change (I)

- **SNGs can play an important role in policies to mitigate climate change**
  - Through regulation and taxation in areas such as transportation and land use, on which they have major responsibilities
  - Through the infrastructure investments needed to meet decarbonization goals
- There are also reasons for a **strong involvement of NGs in mitigation**
  - Subnational polluting activities can generate significant externalities across the national territory
  - SNGs may use lax environmental standards to attract polluting industries
  - NGs have more budgetary resources and are responsible to deliver on international commitments for decarbonization



# IFC in mitigation of climate change (II)

- **The relative roles of the different levels of government vary across countries:**
  - In many, mostly unitary, countries, environmental targets and standards are set by the national government, with the SNGs mainly charged with implementing the nationally mandated policies to meet the targets in their respective jurisdictions
  - In some federations, SNGs enjoy substantial autonomy in the choice of environmental standards and of the policies to pursue them
  - In other countries, including some federations, the national government sets minimum standards, leaving to the SNGs scope to exceed them.
- **Both vertical and horizontal cooperation mechanisms are needed for the effectiveness of any of these approaches.** They include:
  - Prior consultations on proposed policy changes
  - Timely and transparent reporting on key environmental indicators, increasingly being facilitated by ongoing advances in digital technologies; and
  - NGs' support to the development of subnational capacities in the mitigation area



# IFC in adaptation to climate change

- **SNGs' main responsibilities in adaptation to climate change**
  - Land use regulations to minimize risks of flooding
  - Investing in infrastructure less vulnerable to climate change-induced disasters, and
  - Preparing contingency plans to respond to such disasters.
- **NGs have a significant role in promoting adequate subnational adaptation efforts for various reasons:**
  - To avoid common pool and moral hazard problems
  - To provide SNGs technical support to assess the climate change-related risks they face and to design the appropriate remedial actions; and
  - To supplement subnational resources devoted to adaptation through special-purpose transfers and capital grants.

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**Thank you!**