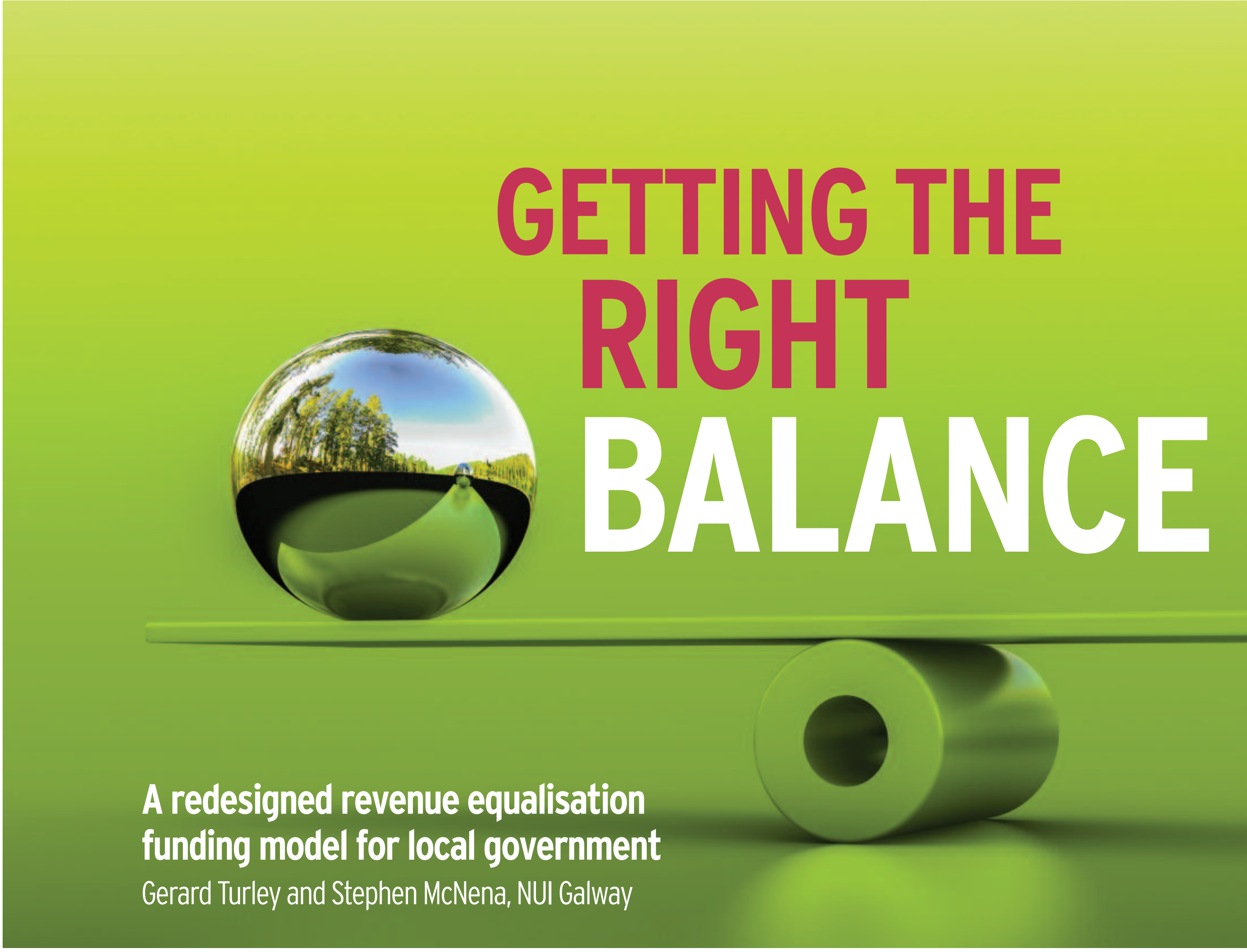


GETTING THE RIGHT BALANCE

A redesigned revenue equalisation funding model for local government

Gerard Turley and Stephen McNena, NUI Galway

Researchers at the Whitaker Institute in NUI Galway have designed a new model for estimating top-up or so called equalisation grants for local councils with inadequate revenue bases. Undertaken by economics lecturers Dr. Gerard Turley and Stephen McNena at the J.E. Cairnes School of Business and Economics, the research was published in the Spring 2021 issue of the *Economic and Social Review*, Ireland's leading journal for economics and applied social science. Here, the authors present a summary of the methodology and their findings.

Rationale

One of the roles of local government is the provision of public goods and services. In delivering these local services, fiscal decentralisation allows local authorities to reflect the preferences and circumstances of their citizens. However, variations in the economic base of regions and localities will result in fiscal disparities across local authorities, and in turn, differences in the ability to provide given levels of public goods and services. To offset this so that individuals are not disadvantaged in their access to local public services by their place of residency, a system of fiscal equalisation is needed that will reduce these horizontal fiscal imbalances.[1]

Fiscal equalisation addresses local authority differences in the levels of expenditure on public services relative to tax rates. Indeed, fiscal decentralisation and fiscal equalisation are natural complements. In the Irish case the introduction of the Local Property Tax (LPT), where local councils have rate-setting powers, meant a need for a well-defined equalisation system to offset the larger revenues accruing to local

authorities with the greatest taxable capacities i.e. large, urban councils with the greater and more valuable number of residential properties.

While there are different models of fiscal equalisation (for example, horizontal versus vertical, partial versus full, revenue versus expenditure), what matters most is the design of the fiscal equalisation programme, and in particular, the size of the distributable pool – that is, the equalisation fund - and the formula used to allocate these unconditional equalisation grants.

Current system

Ireland's fiscal equalisation model is tied to the LPT, and the central government General Purpose Grants (GPG) that councils received in 2014 when those payments were discontinued and replaced with the LPT. With the central government deciding that no local council would be worse off from LPT receipts than what they received in GPG in 2014, a decision on the determination of the equalisation pool and the allocation method was effectively made.

Gerard Turley, NUI Galway

Stephen McNena, NUI Galway

With a predetermined share (namely 20%) of the estimated LPT yield pooled to fund the equalisation pot, equalisation transfers are based on the difference between the LPT retained locally (=0.8*LPT) and the 2014 GPG payment, with the latter set as the LPT baseline i.e. the minimum level of funding available to every local authority.[2] Where the locally retained LPT is less than the baseline, a local authority receives an equalisation grant equal to this shortfall. In this model, funding is from the well-off local councils (mainly the four Dublin local authorities and other urban areas) to the less well-off local councils, of which most are small, rural local authorities in the west, north and midlands of the country.

The result of this model is that 20 local authorities receive equalisation payments, totalling €133m in 2021. Four local authorities receive just over 40% of the total. They are Tipperary County Council (€16.3m), Donegal County Council (€16.2m), Mayo County Council (€11.5m), and Waterford City and County Council (€10.8m). Per capita, Leitrim, Longford and Monaghan County Councils receive the largest payments, with these central government equalisation grants accounting for 12-17 per cent of their revenues.

New model

We set out to design a more equitable, consistent, transparent, and evidence-based fiscal equalisation model, not tied to historical baseline supports or the LPT. In doing so, we examined local government equalisation systems in other countries (unitary and federal, decentralised and centralised, high-income and medium-income, large and small). Elsewhere, equalisation models and these intergovernmental fiscal transfers are often based on estimates of fiscal capacity and/or expenditure needs.

[1] The principle of fiscal equalisation is enshrined in Article 9.5 of the Council of Europe's European Charter of Local Self-Government. See https://rm.coe.int/168007a088

[2] The Pension Related Deductions (PRD) amount was later added to the baseline.

Given the abortive experience of the earlier (pre 2008) needs and resources model, the difficulty in assessing spending needs, and the relatively homogenous nature of local authorities in Ireland (with respect to socio-economic, demographic and geographical factors, and the subsequent cost of providing a similar level of local public services), a revenue equalisation model based on estimates of fiscal capacity was selected as the most appropriate methodology.[3] Regarded as the most sophisticated technique for assessing interjurisdictional differences and designing an equalisation transfers system, revenue-raising or fiscal capacity is commonly defined as the potential ability of local authorities to raise own-source revenues. In Ireland, own-source or local revenues are commercial rates, the LPT, and fees and charges for goods and services.

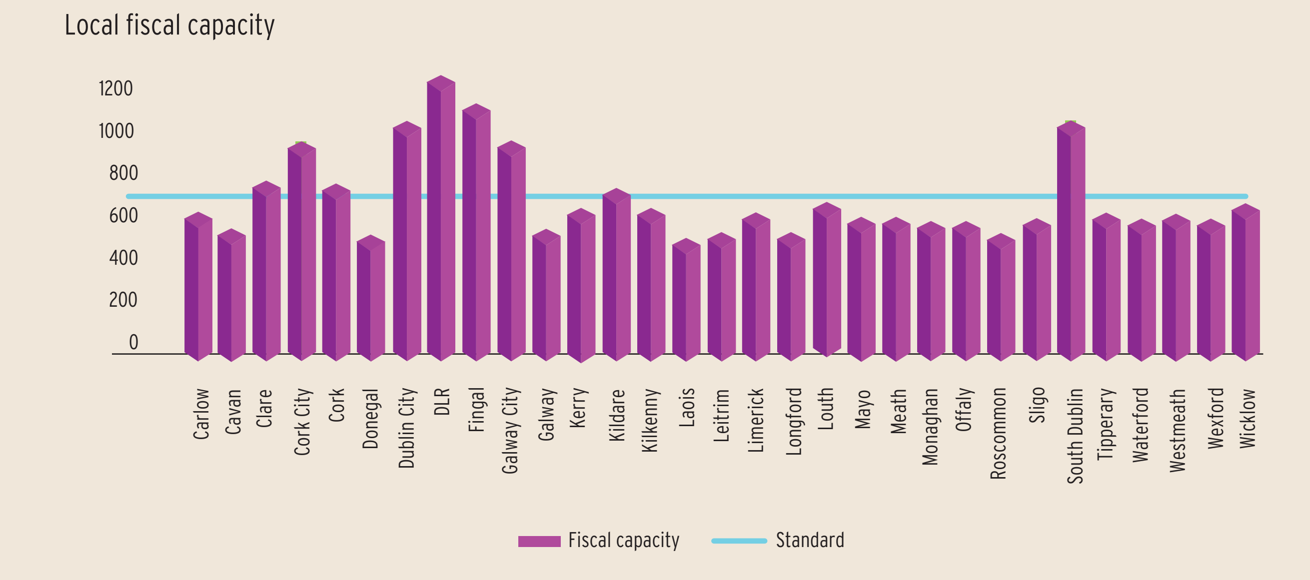
From a number of different methods to measure the underlying fiscal capacity, the Representative Revenue System (RRS) was chosen, which consists of applying national average rates to commonly used revenue bases. The advantage of using potential rather than actual revenue is that the latter may incentivise local governments to raise less revenue in anticipation of higher transfers or grant funding. As for the size and allocation of the grant pool in our model, equalisation transfers are based on the difference between the fiscal capacity of a local authority and a predetermined standard, defined as the average of the fiscal capacity estimates. Where the fiscal capacity of a local council is less than the common standard, a local council receives an equalisation payment equal to this shortfall. Based on this formula, the fiscal capacity or potential revenue estimates are displayed in Figure 1, with the national standard depicted as the horizontal line and equal to just over €620 per person.[4]

Results

In our model, the distributable pool is the sum of the equalisation amounts, equal to €210m. Although larger than the existing fund, it is still smaller than equalisation funds in many other OECD countries. As for the individual council allocations, although it is roughly the same local authorities that receive equalisation payments under the two models, the euro amounts differ. For illustrative purposes, the 2017 amounts for the existing model as against our new model are presented in Table 1.

In the new model, 22 local authorities are eligible for equalisation grants, with the funding now derived directly from central government. In our simulations, the local authorities that receive the largest grants are Donegal, Galway, Meath, Laois, and Wexford County Councils. Although rural Leitrim and Longford County Councils are eligible for less funding under this model, they still receive more than most other local authorities per head of population. As for the overall impact of equalisation, using *before* and *after* estimates to measure the equalising effect, the reduction in fiscal disparities across local authorities is greater under our new model.

Figure 1: Fiscal Capacity Estimates (€ per capita)



[3] This decision to omit a spending needs assessment from the methodology is supported by international evidence, where expenditure equalisation is regarded by many as highly complex and prone to lobbying and negotiation, but also because subnational disparities in service costs are generally smaller than in tax-raising capacities.

[4] This standard amount represents the revenue that would be available, on average, to the local authorities if they had a uniform tax and non-tax revenue system that they applied in a common manner.

Table 1: Equalisation grants (new versus old, €m)*

Local authorities	New	Old
Carlow County Council	3.5	3.0
Cavan County Council	9.7	6.0
Cork City Council^	--	3.1
Donegal County Council	24.1	16.4
Galway County Council	23.2	2.9
Kerry County Council	6.9	2.5
Kilkenny County Council	4.7	4.7
Laois County Council	13.9	4.6
Leitrim County Council	4.5	7.3
Limerick City & County Council	12.4	5.0
Longford County Council	5.6	7.2
Louth County Council	2.9	2.3
Mayo County Council	10.5	11.5
Meath County Council	15.2	--
Monaghan County Council	5.9	8.2
Offaly County Council	7.6	3.7
Roscommon County Council	9.4	7.0
Sligo County Council	5.6	7.0
Tipperary County Council	10.5	16.5
Waterford City & County Council	10.3	11.3
Westmeath County Council	6.1	6.1
Wexford County Council	13.3	3.8
Wicklow County Council	3.9	--
Total	**€209.9m**	**€140.3m**

Source: Department of Housing, Local Government & Heritage; Turley & McNena (2021).
* Estimates for 2017.
^ Due to the 2019 boundary extension (vis-à-vis Cork County Council), Cork City Council is no longer in receipt of equalisation transfers as it now has a bigger economic base.

Given the highly political nature of fiscal equalisation, any new redistributive scheme will inevitably result in losers and winners. The biggest 'loser' is the central government as it funds this equalisation model. Although the proposed cost is over €200m per annum (as against the €35m that the Exchequer currently contributes to the existing equalisation fund), it must be remembered that at the peak of the GPG payments in 2008, the total amount of unconditional grants to local authorities was €1bn.

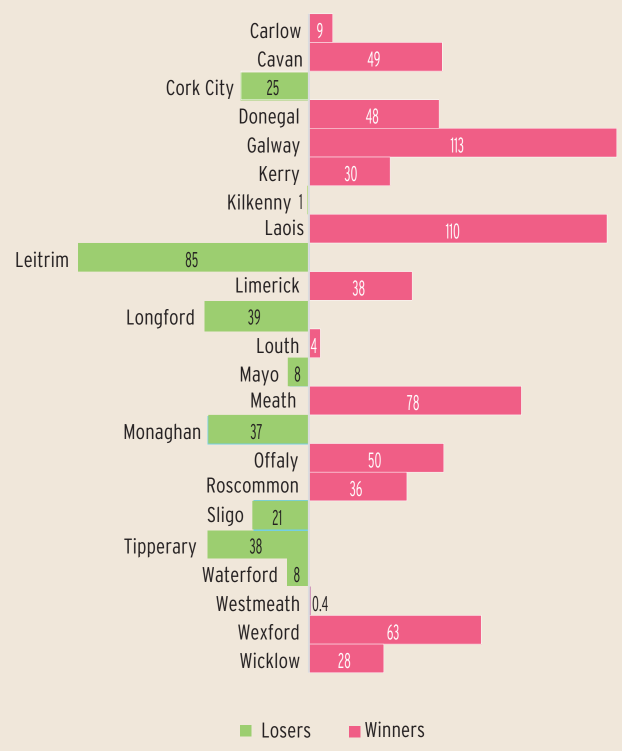
Per head of the population served, the biggest winners are Galway, Laois, Meath and Wexford County Councils. Here, we note the outcome for Galway County Council as it is often cited as a case of inadequate and unfair equalisation payments (of less than €3m per year), as against, for example, equalisation grants in excess of €11m and €16m for Mayo and Tipperary County Councils respectively, which have arguably similar socio-economic and demographic profiles. The somewhat surprising results for Meath and Wexford County Councils are largely explained by the relatively low commercial rates base in Meath (pre the 2019 revaluation) and the high rural share of the population in Wexford (at more than 60%).

Finally, given that the LPT will no longer be used to co-fund these equalisation payments under this new model, urban councils also win out with an additional €40m revenue income available annually to the four Dublin local authorities to fund essential services for their residents.[5] Figure 2 outlines the losers and winners, with the euro amount per head of population reported.

Conclusions

Equalisation is a key element of a country's inter-governmental fiscal arrangements where functions and funding are decentralised to subnational government. Although Ireland is a highly centralised country with limited responsibilities and powers devolved to local authorities,

Figure 2: Winners and Losers (€ per capita)



[5] In the changes to the LPT announced in June 2021, local authorities will in future retain 100% of the LPT receipts collected in their administrative area. Although the shortfall will be made up by central government, no details of the new equalisation fund or the Local Government Funding (Baseline) Review Group report were publicly available at the time of writing.

horizontal fiscal imbalances exist, and persist. Ireland has a system of equalisation transfers but we believe that the current model is not fit for purpose. This study constructs a model of fiscal equalisation that is consistent with international best practice but tailored to the specific circumstances of the Irish local government system. For the model to be operational, we believe that the data requirements are relatively straightforward, and not overly burdensome.

As for the sensitive issue of the councils that lose out from this new fiscal equalisation model, alternative sources of funding include, if the fiscal space allows, higher taxes locally levied on commercial and/or residential properties, or in cases where it is deemed necessary, a temporary transition payment from the central government. Either way, this new model provides for a local government funding model that is more objective, predictable, sustainable and, most importantly from the perspective of less well-off local councils providing comparable levels of public services, equitable. Finally, while fiscal equalisation may appear an obscure and technical subject, all individuals in the Irish State are affected by it through the local authority services they receive, and the taxes and charges they pay to their local councils. Hence, as the title of this article indicates, there is a need for a redesigned funding model for Ireland's system of local government, based on the key principles of horizontal equity and revenue equalisation.

To read the full paper entitled *Equalisation transfers and local fiscal capacity: A new methodology for Ireland,* visit https://www.esr.ie/article/view/1497. Based at NUI Galway, the authors manage the local government finance website at *www.localauthorityfinances.com.*

If you require more information on fiscal equalisation, please email gerard.turley@nuigalway.ie.

Launch of special edition of *Administration* to mark the retirement of Dr Richard Boyle from the IPA

Joanna O'Riordan, IPA

In March 2021, a special edition of *Administration*, the peer reviewed journal of the Institute of Public Administration (IPA) was launched. The edition which is free to access on the journal's website is a tribute to Dr Richard Boyle who worked in the Institute's Research Division for 34 years, the final decade as Director of Research, Publications and Corporate Affairs.

The special edition includes contributions from both senior public servants and academics and is framed around key public service reform and policy challenges. The areas chosen are ones which are particularly pertinent to the future capacity of the public service and the aim was to make recommendations and suggest ways forward.

The twelve papers in the special edition are grouped into three sections. The first set of papers draw on a wealth of experience of the Irish public service – Richard's own reflections, and those of Robert Watt, Dermot McCarthy, Muiris MacCarthaigh and Peter Thomas. These papers review public service reform over the past decade and provide some valuable insights and challenges. The second group of papers look at specific aspects of the reform agenda requiring further energy – William Roche and Joanna O'Riordan look at people issues, Mary Murphy and John Hogan focus on policy analysis, Gerry McNamara and colleagues examine performance management, Aidan Horan and Michael Mulreany look at governance issues, while John Healy and Madeleine Clarke reflect on citizen engagement. The final group of papers by Mark Callanan and Paul Umfreville and Local Sirr provide overviews respectively of reform in the key sectors of local government and housing.

Richard was interested in all aspects of the public service. The breadth of his interest in, and contribution to, research on the public service is best reflected in the fact that all of the topics covered in the special edition are topics on which Richard himself actively researched and wrote about in the course of his career. In addition to his research and writing, Richard also had a long track record of supporting the public service through active involvement with a wide range of committees, most recently the *Our Public Service 2020* management board. Richard also contributed immensely to the IPA. While he was always willing to represent the Institute publicly or in the media, more typically it was behind the scenes, supporting the education, training and publishing dimensions of the Institute's work. Richard will be missed by all his IPA colleagues.

***Administration* special edition link:**
https://sciendo.com/pl/issue/ADMIN/68/4