

# **FISCAL DECENTRALIZATION AND FISCAL RISK**

**SNG BUDGET MANAGEMENT**

# Main Issues to Consider

- Is the FD model compatible with managing FR?
- Reforms necessary to bring these together
- How to Harden budget constraints at the SNG level
- Costs of controlling fiscal risk

# THE STATE OF FISCAL DECENTRALIZATION

- Most intergovernmental fiscal systems are centralized
- Expenditure and Revenue Shares of SNGs are low
- SNG Expenditures are driven by central government policies
- SNGs have limited revenue autonomy
- Soft budget constraints

# THE MANAGEMENT OF SNG BUDGETS

- Voter Driven? Central govt driven?
- Expenditure assignments: Controllable, essential, infrastructure?
- Sometimes, a weak SNG ability to deliver services or expenditure plans
- Heavy reliance on Intergovernmental transfers
- Finance does not always follow function
- Soft Budget Constraint

# SNG REVENUE CONSTRAINTS

- Limited autonomy in making tax decisions
- Few Assigned Sources
- Tax base competition
- Reliance on Intergovernmental transfers
- Limited accountability for service outcomes

# Land and Property Taxation

- Low revenue yields, but unused potential
- Central government limits and controls
- Valuation and administrative constraints
- Little use of property transfer taxes
- Unpopular with taxpayers

# INTERGOVERNMENTAL TRANSFERS

## VERTICAL SHARING

- Shared taxes
- Discretionary Shares
- “Backdoor Revenues”
- Equalization Grants
- Competing Shocks

# MANAGING FISCAL RISK IN A DECENTRALIZED FISCAL SYSTEM

- Strengthen expenditure management: MTEF
- Enhanced SNG revenue autonomy, including property tax, shared income tax base, user charges, licenses, local excises, and others.
- Fiscal rules for SNG borrowing, deficits
- Carry larger precautionary balances
- Differential fiscal powers for larger urban areas

# THE COSTS AND DANGERS OF MANAGING FISCAL RISKS

- Undesirable outcomes: central government offloading through grant reductions, SNG off-budget deficits, and reduced empowerment of local voters.
- Desirable outcomes: SNGs with a hard budget constraint, more fiscal discipline, more driven by local preferences and a better management of fiscal risks.

# REFERENCES

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