United Nations Development Fund for Women
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Intergovernmental fiscal relations and gender-responsive budgeting

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The guidance sheet series is produced by UNIFEM's Gender Responsive Budgeting Program to assist government officials and gender equality advocates in their efforts to make gender responsive budgeting a reality in their countries.

Issues in this series will explore Gender Responsive Budgeting concepts, tools and experiences and highlight good practices adopted by ministries of finance, sectoral ministries, local governments, parliamentarians, and civil society around the world.

Introduction

Why should we know about intergovernmental fiscal relations?

Over recent decades many countries have experienced devolution of administrative, political and fiscal responsibilities to lower levels of government. Many gender-responsive budget (GRB) initiatives have followed this trend and engaged in activities at sub-national levels of government.

The local level is attractive to GRB advocates for several reasons. Firstly, in many countries some of the services considered most important from a gender perspective, including social services and economic development, are primarily the responsibility of sub-national government. In these countries focusing only on the national level will have limited impact on the daily lives of ordinary women and men, girls and boys. Secondly, many people argue that the local level is ‘closer’ to ordinary people, and thus an easier place than national level to determine and address needs, and to hear local voices. Thirdly, in several countries there are quotas for political representation at local levels of government. Some GRB initiatives therefore focus on this level to build the capacity and voice of elected women representatives.

This pamphlet is intended to assist GRB advocates in thinking about what budget experts term ‘intergovernmental fiscal relations’ and what this means for GRB activities. Understanding this issue can strengthen advocacy around ensuring that adequate resources are available for allocation towards gender-responsive priorities for which local government is responsible.

Intergovernmental fiscal relations concerns how money is transferred between different levels of government and thus how much money is available to sub-national governments for delivery of services. These transfers are necessary because many countries have decentralized functions by saying, for example, that delivery of services such as basic health, basic education, electricity and water should be delivered by the district or province/state level of government rather than national level. Generally governments have not decentralized the ability to raise revenue to the same extent as they have decentralized delivery functions. As a result, the relative abilities of different levels of government to raise revenue do not match the relative size and cost of the functions allocated to them.

Intergovernmental fiscal relations are important for local-level GRB initiatives because we need to know whether the amount of money allocated to the municipality, province or state we are working in is adequate and the available resources equitably distributed. If we don’t have this information, we might end up arguing about the distribution of a small slice of the national pie when part of our struggle should be about increasing the slice of the pie coming to our municipality, province or state.

Basic concepts

Government bodies at all levels need revenue in order to deliver services and carry out their functions. The amount of money available for a local government's budget is determined on the one hand by its revenue raising powers and capacity and on the other hand by the size and the nature of the inter-governmental transfers it receives. This pamphlet focuses on the intergovernmental transfers.

One of the important aims of intergovernmental transfers is to correct vertical and horizontal imbalances.

Vertical imbalances refer to the mismatch between the revenue-raising capacity of different levels of government and the size and cost of the functions assigned to them. Ideally the vertical division should result in a better match between the relative cost of carrying out the functions of each level and the relative slice of the pie for that level. In practice, there is rarely a good match. The most common pattern is for the higher levels of government to be relatively over-funded, while lower levels are left with 'unfunded mandates'. This mismatch can be partly explained by the greater power usually enjoyed by higher levels of government, as well as by the fact that decentralization has generally happened relatively recently, making the previous distribution between national and sub-national levels inappropriate.

The imbalance also occurs because national government is better suited to raising many types of revenue than local government. This is the case, for example, with import and export taxes such as customs and excise. It is also the case with most company and personal taxes, as a central bureaucracy will be more efficient. Centralizing collection also makes it more difficult for people to avoid paying tax by moving from one place to another.

National-level taxation can also assist with equity. Firstly, it means that all individuals and companies with similar levels of wealth are taxed in the same way. Secondly, it allows for revenue raised in wealthier areas (which are usually the urban areas) to subsidize poorer areas (often the rural areas).

Horizontal imbalances are about the differences in need and capacity of different units at a particular level of government, for example between different municipalities. These differences are usually especially noticeable between rural and urban local government units. So, for example, the urban units have a wealthier population which can thus contribute more in local taxes and charges, while the population is also more dense and thus easier and less costly to serve.

The structure of the intergovernmental fiscal relations system in a country needs to take both vertical and horizontal imbalances into account. In many countries the intergovernmental transfer system is also used to promote particular policy objectives of the national government. If, for example, the national government is keen to roll out a new policy in respect of HIV/AIDS, it may give special grants to lower levels of government to take this forward, at least in the first years of the policy.

There are several ways in which money can be transferred from one level of government to another. The main categories are (a) general purpose transfers and (b) specific purpose transfers.

General purpose transfers usually consist of a lump sum which the national government transfers to lower-level government, leaving the lower-level government to decide how to distribute the money between different purposes.

Many governments use a formula to determine the horizontal distribution of total lump sum amount i.e. to calculate how much money goes to each of the different local government units. The variables in the formula vary from one country to another. They commonly include variables such as population size, geographical area, and the relative level of development or wealth. The case studies below give examples of the possible variations. The advantage of a formula is that the method of calculation is more transparent and should also be more objective. Without a formula it is easy for politics to interfere with equitable distribution.

However, a formula can also have problems. Firstly, the degree of objectivity will depend on the quality of the data used in calculating the formula. Secondly, the degree of equity of the resulting distribution will depend on which variables make up the formula and the relative weight attached to each variable. Thirdly, if the formula is very complicated, it is more difficult for non-technical people to engage in debate about it.

Specific purpose transfers are given for a specified purpose, which is determined by the higher level of government. The local government must spend the money on this purpose. They are thus often referred to as ‘conditional’ grants, because they can only be utilized on condition that they are spent on the specified purpose. These transfers often reflect particular policy objectives of national government.

The diversity of intergovernmental fiscal relations system

Every country has its own way of organizing money flows between levels of government. The next section of this pamphlet briefly describes the system in five countries, namely India, Mexico, Morocco, Philippines and South Africa. Four of these countries are classified by the United Nations Development Programme (UNDP) as medium human development countries. One, Mexico, is classified as a high human development country. As shown in the table below, all of the countries are relatively large in terms of population, thus necessitating some form of decentralized government. However, the five countries differ in the number of levels of government, in the functions assigned to each level, in revenue-raising powers of the different levels, and in how money is transferred between levels.

Human development index (HDI) and other key indicators, 2003

	Population	HDI value	HDI rank	GDP per capita
India	1,070.8m	0.602	127	2,892
Mexico	104.3m	0.814	53	9,168
Morocco	30.6m	0.631	124	4,004
Philippines	80.2m	0.758	84	4,321
South Africa	46.9m	0.658	120	10,346

Source: Human Development Report 2005

The country descriptions are intended to give an idea of the different ways that countries can organise intergovernmental flows, as well as some of the common themes. The third section then suggest some questions that GRB advocates may want to consider when thinking what this means for their activities.

Intergovernmental fiscal relations in five countries

India

India has a population of over a billion people. The first level of sub-national government is made up of 28 states and seven centrally administered territories. The 73rd and 74th amendments to the Constitution in 1992 created a third level of government, the panchayati raj institutions (PRIs) and urban local bodies. There are more than 250 000 local governments, of which 3 000 are in urban areas. Urban local governments consist of municipal corporations in large cities, municipalities in smaller ones, and towns and notified area committees in smaller towns. Rural local government consists of the district, block and village.

As in other countries, local government in India is not able to raise itself all the revenue it needs. Overall, local government raises only a little over quarter of the amount it spends. Rural local government raises much less than this.

The method for distributing nationally raised revenue between the different levels of government is decided every five years by a Central Finance Commission appointed by the President. In 2005, there were five criteria for distributing funds for PRIs and urban local bodies, namely population (weight of 40%), geographical area (10%), deviation from highest per capita income (20%), index of deprivation (10%), and revenue effort (20%). Four of these criteria thus reflect relative need.

The index of deprivation is based on the percentage of households fetching water from a distance and the percentage of households without drainage. This factor is gender-sensitive to the extent that it is mainly women who collect water when it is not available nearby to the dwelling.

India also has State Finance Commissions in each state which recommend how much tax revenue should be allocated to lower-level governments, and how it should be distributed between the local bodies. Many states are reluctant to devolve revenue and expenditure powers to lower level governments. Some states have devolved functions, staff and finances, but do not give local governments the power to make decisions about how the staff and finances are used. In addition, because the salaries of the devolved staff are paid by the state, and their careers controlled at state level, the local governments do not have effective control over them.

There are significant differences between how different states organise intergovernmental flows of money. In this pamphlet we look at two states – Karnataka and West Bengal.

In the state of Karnataka the gram panchayats, the lowest level-unit of local government, receive money from three sources. Firstly, they receive a lump sum grant from the state to meet general expenditures. Secondly they receive a national revenue grant from the Central Finance Commission which is channelled through the state. Thirdly they receive specific purpose transfers for various schemes. The general purpose grant is based on population (33%), geographical area (33%), illiteracy rate (11%), persons in government hospitals (11%), and road length per square kilometre (11%). The inclusion of illiteracy rate can be considered as gender-sensitive given that there is a large disparity in India between the literacy rates of women and men.

In West Bengal, the State Finance Commission has given more autonomy to PRIs than some other states by making the grants to the PRIs unconditional. The allocations are based on two factors which are equally weighted, namely the index of backwardness and population. In addition, 2% of the total funds is set aside to reward local bodies that increase their own revenues by 5% or more in a single year.

Mexico

Mexico has 32 states and 2,440 municipalities, as befits a country with a relatively large population. Politically the Mexican system is described as ‘cooperative federalism’ because of the degree of policy coordination between the federal and state governments. One of the tools for achieving this coordination is conditional transfers. Another is close monitoring of states by federal government.

The current phase of decentralization started in Mexico in 1980 when the federal government established the Fiscal Pact. This pact, which was amended in 1993, focused in particular on decentralization of education and health services. However, the federal government still has relatively strong powers in relation to these two sectors. In addition, the federal government is responsible for general public services such as national defense, foreign affairs, monetary and fiscal policies, telecommunication, national highways and labor policies.

State governments in Mexico are responsible for construction and maintenance of state feeder roads and primary care for the rural population and urban poor, public order and safety, food assistance to the poor, water supply and sewage (together with municipal governments). Municipal governments are responsible for services such as street lighting, sanitation, slaughter houses, public markets and land use permits.

On the revenue side, the federal government raises over three-quarters of total government revenues but incurs only two-thirds of total government expenditure. Federal and state level together raise almost 95% of total revenue and incur 94% of expenditure. The main need for transfers is thus between national and state governments and nearly 88% of state expenditure is financed by transfers for federal government.

Overall, over half of the total transfer from national to state level in Mexico takes the form of conditional grants. However, the relative importance of conditional and general transfers differs between states.

Morocco

Morocco is a constitutional monarchy with a multi-layered system of government. Decentralization began in Morocco in 1960, but accelerated after the 1976 charter established communes as the lowest level of government, with further levels of provinces and prefectures before one got to national level. In 1992, a new level of ‘region’ was added between the prefectures and national level. Today there are 16 regions, 42 provinces and 28 prefectures, and 249 urban and 1,298 rural communes.

The New Communal Charter of 2001 assigned the following responsibilities, among others, to communes: land use planning; hygiene, sanitation and environment; economic and social development; local public services and community services; and socio-cultural activities.

The charter also gave communes powers to impose more than 40 types of taxes. However, responsibility for providing major social services such as health care and education remain with the national government. On the revenue side, all levels of local governments together raise less than 5% of their total budgets. But they are responsible for more than 13% of total government expenditure.

The regions' main responsibility is coordination of activities of provinces and prefectures. To perform this function they are allocated 1% of corporate and individual income tax. In addition, the provinces, prefectures and communes receive 30% of value added tax (VAT) collections. Provinces and prefectures receive 40% of this amount, urban communes receive 24% and rural communes receive 26%. Overall, the VAT transfers account for nearly 50% of local government revenue.

The tax revenue is given to the local governments in the form of a conditional grant, although the conditions are fairly general. Thus local governments must spend 8% of this money on 'public goods', 79% must be spent on operational expenditures, and the remaining 13% on investment expenditures.

Each of the three components of the conditional grant is calculated differently. The allocation of the 'public goods' money between local governments is calculated on the basis of relative expenditures on personnel. The formula for dividing the operational component of the VAT proceeds between provinces is based on two factors: (a) the size of the population gives two-thirds of the weighting while (b) geographical area gives the remaining third. The distribution of the operational component of VAT proceeds between communes is based on 'tax effort' i.e. how much money each commune raises itself. This approach is intended to benefit communes which put effort into raising their own revenue. However, it discriminates against communes where the majority of inhabitants are poor. The investment component is distributed between communes on the basis of the nature of the projects.

As noted above, communes have the power to raise more than 40 types of tax. The most important types are urban tax, business tax and supplementary urban tax. The first two of these taxes are assessed and collected by the national government and transferred to local government after deduction of a collection fee. Together these two taxes make up about 12% of the total revenue of communes. The supplementary urban tax is assessed and collected by the communes and make up about another 10% of commune revenue. Other taxes include market fees, forestry income and construction fees. The rates and levels of many of the local taxes and user fees are set by national government. This, together with very limited assignment of functions to local government, means that devolution is not nearly as extensive in Morocco as in some other countries.

Philippines

Philippines is a republic made up of around 7,000 islands. Historically, the Philippines has always had a very decentralized political structure. In the past each barangay (village) was ruled by its own chieftain and formulated its own laws based on tradition and needs. Colonization and conquest by the Spaniards, followed by the Americans and Japanese, resulted in greater centralization.

However, after independence in 1946 the country again began moving towards a more decentralized system.

The 1973 Constitution made it mandatory for the state to ‘guarantee and promote the autonomy of the local governments to ensure their fullest development as self-reliant communities’. More recently, the Local Government Code of 1991 has promoted fiscal decentralization. More than 70,000 personnel were transferred to local government units (LGUs) from national government agencies whose functions had been devolved, such as agriculture, health, social welfare, and budget and management.

Today Philippines is divided into 42,000 barangays, which fall under 115 cities and 1,492 municipalities, which in turn fall under 80 provinces. In 2004 national government raised 91.9% of total government revenue, but was responsible for only 79.5% of total government expenditure. Thus, as in other countries, some method to transfer money from national to sub-national government is necessary.

Municipalities and cities are responsible, among others, for agricultural services, community-based forestry projects, primary health care services, public works and infrastructure, school building, social welfare services, information services, solid waste disposal and environmental management systems, municipal buildings, cultural centres, public parks, sports facilities, tourism facilities and promotion. Cities are municipalities which are more developed and urbanized. In addition to the above functions, they are also responsible for communication and transportation facilities and education, police and fire services.

Sub-national governments in Philippines get their revenue from three sources:

- Internal, for example property and other local taxes, user fees and other charges
- External, for example the Internal Revenue Allotment (IRA) and grants in aid
- Other, for example loans and public-private partnerships.

The IRA is the largest transfer. It accounts for 40% of national revenue and more than two-thirds of the total resources of the LGUs. Own tax revenue from property tax and other local taxes make up only around 20% of total LGU revenue, while non-tax revenue is less than that, at about 14% in 2006.

Only national government can levy taxes such as income tax, VAT, excise and customs. Provinces collect property taxes and then pass on 40% to municipalities and 25% to barangays.

The calculation as to how much money goes to each LGU is based on the amount of revenue collected by national government three years before. Provinces and cities each receive 23% of the total revenue, while municipalities and barangays receive 34% and 20% respectively. Within each level, the available funds are then distributed on the basis of population (50%), area (25%) and equal sharing (25%).

In addition to money from taxes, the national government must allocate 40% of funds collected through royalties, forestry and fishing charges to sub-national government. National government must also give 1% of gross proceeds from the utilization of national wealth such as mines and forests to the LGU where the resource is located.

South Africa

South Africa is a republic with a unitary system of governance. It has nine provinces and 284 municipalities. The national government is responsible for delivery of general public services such as defense, police and labor, as well as for national-level policy making. Provinces are responsible for delivery of the most important social services, including school education, health, and social welfare. Local government is responsible for household services such as water and electricity, as well as for local economic development.

National government in South Africa has the sole power to raise the main taxes such as personal income tax, company tax, VAT, the fuel levy, and customs and excise. Together these make up about 80% of total government revenue. Provinces can raise revenue through gambling taxes, motor car license fees and user fees for hospital services. Together these provincial sources make up only around 1% of total government revenue. Municipalities can raise revenue through property taxes and user charges on electricity and water. Together the municipal sources account for about 20% of total government revenue.

Because of the mismatch between the cost of assigned functions and revenue raising powers, provinces are able to finance only about 3% of their functions from own revenue. Overall, municipalities cover nearly 80% of their expenditure through own revenue. However, there are very big differences between municipalities and some are able to cover only a small fraction of their budgets.

South African's Constitution says that provincial and local governments are entitled to an 'equitable share' of nationally raised revenue. The equitable share is transferred as an unconditional grant to provinces and municipalities. In theory this gives the local and provincial legislatures the power to decide how to spend the money. In practice, there is usually limited leeway as a large part of the allocation must be spent on ongoing payments, such as salaries of teachers and nurses.

In addition to the unconditional equitable share, South Africa has a fairly large number of conditional grants. Government reconsiders and fine-tunes the system of provincial and local grants each year, after listening to the advice of the Financial and Fiscal Commission. Several of the elements of the system reflect the government's attempts to address the serious geographical and race inequalities that are the legacy of the discriminatory apartheid system that ended in 1994.

The formula for the provincial equitable share is made up of six components. Education and health have the heaviest weighting (51% and 26% respectively in 2006), while there are smaller weights for population size (14%), fixed institutional costs (5%), poverty levels (3%) and level of economic activity (1%). Each of these components has its own formula. For example, the education component is based on the school-going population (to reflect need) as well as enrolment (to reflect current actual 'demand').

During the 1990s the health factor was weighted by the proportion of women and young children in the province's population to reflect the fact that pregnant and lactating women and young children were entitled to free health care. This extra weighting was later dropped. The health component continues to be weighted by the percentage of the population which is not covered by health insurance and is thus most likely to use public health services. This weighting is gender-sensitive because women are less likely than men to be covered by health insurance.

In addition to the equitable share, provincial expenditures are financed through conditional transfers. In 2006 there are 17 conditional grants which are channeled through nine national departments. The three largest grants are for housing subsidies, tertiary hospitals (which often serve people from other provinces other than where they are situated), and infrastructure. In previous years there were grants for early childhood development and home- and community-based care, both of which would have been of particular benefit to women.

The formula for the local government equitable share is designed mainly to enable them to provide services to poor households. In 2006 it is made up of four components: a basic services component (covering water, sanitation, refuse, electricity, and environment); an institutional support component to fund the basic costs of administration and governance (based on population and the size of the local council); a revenue-raising correction component to compensate municipalities with poor inhabitants who cannot pay much property and other taxes; and a stabilizing component which prevents municipalities experiencing large changes from one year to the next.

Municipalities also receive conditional grants. These grants fall into two categories: (a) infrastructure and (b) capacity building and restructuring. Each of the categories is made up of several grants. Most are based on a formula, but a few depend on applications from municipalities.

Lessons

The country descriptions above give some idea of the complexity of intergovernmental fiscal transfers, and the very different ways in which they happen in different countries. What does this mean for GRB work?

The first issue is a fundamental one. GRB practitioners need to understand the allocation of functions between the different levels of government before deciding where they want to focus their energy. Thus in Philippines, for example, Women's Action Network for Development focused their attention on the health sector when doing GRB work in Sorsogon City because LGUs bear the main responsibility for health services and high maternal mortality is a key gender concern in the area. In contrast, in Mexico, where GRB work has also focused on allocations for maternal health, the focus is on provincial and state levels because these are the levels responsible for health service allocations in Mexico.

The second point relates to the importance of understanding how revenue allocations are determined, including the relative proportions that go to each level (the vertical division), the relative mix between conditional and unconditional grants, and the way in which the amounts of the conditional and unconditional grants are determined. GRB advocacy could focus on any of these items. It could argue, for example, that too much is being kept at national level, often to finance an over-large defense force. It could argue that the components of the formula are not gender-sensitive or pro-poor – for example that too large a proportion of the grant is used to reward local governments that raise their own revenue, thus rewarding wealthier municipalities and those that are economically well-off. It can suggest different ways of measuring performance and need that lead to a more equitable outcome and provide incentives for local governments to prioritize the needs of the disadvantaged. It can argue that the way particular components are calculated should be changed. For example, in South Africa GRB advocates could argue for re-imposition of the extra weighting of the health component for women of child-bearing age and children.

Arguments in favor of pro-poor and rural-biased allocation formulae are often at the same time gender-sensitive. This is so because women tend to predominate among the poor, and women also generally predominate in rural areas, while men are more likely to migrate to urban areas.

The suggestions above relate mainly to the formulae for unconditional grants and the formulae that are used in determining the horizontal distribution. There is potentially even more scope in relation to conditional grants, as these can more easily be focused on addressing issues that are important from a gender perspective. Above, for example, we have the examples of the South African conditional grants for early childhood education and community- and home-based care for people living with HIV and AIDS.

GRB advocates might also want to advocate around the reporting requirements in respect of conditional grants. This would be useful where a conditional grant is allocated for a purpose that affects both women and men (or girls and boys), but where women (or girls) have a special need. So for example, if there is a conditional grant in respect of school construction, a reporting requirement could be that local governments must state whether the new buildings included separate and adequate latrines for girls. This sort of requirement could also be added as a precondition for accessing money from conditional grants.

Finally, there might be possibilities of arguing for grant formulae that explicitly take gender or gender issues into account. One example of where this is already happening is India's National Programme for Education of Girls at Elementary Level (NPEGEL). The NPEGEL is a supplement to the government's mainstream Sarva Shiksha Abhiyan (SSA) programme. SSA already provides some financial provisions for girls' education, including free textbooks. NPEGEL funds are allocated to 'under privileged / disadvantaged girls' in classes I through VII in (a) areas where the level of rural female literacy is less than the national average and the gender gap is above the national average; (b) districts which have at least 5% scheduled caste/tribe population with female literacy rate below 10%; and (c) selected urban slums. 'Clusters' of schools which demonstrate good rates of enrolment for girls receive extra money to allow them to provide for things such as additional classrooms, drinking water, electrification, and toilets. NPEGEL also provides money for childcare centres to relieve older girls of this task. NPEGEL does not operate through local government units, but the same approach could be adapted for an intergovernmental fiscal system.

NPEGEL is funded by government. Vietnam's Primary Education for Disadvantaged Children project, which is co-financed by government, the World Bank and donors, has a similar combination of gender targeting and targeting of other disadvantages. Firstly, districts are selected on the basis of gender disparity. Secondly, the project addresses constraints (such as cost, age of school entry) that affect girls disproportionately. Thirdly, there are particular interventions, for example to address sibling care, in areas where gender disparities are worst. Fourthly, the calculation of the amount of bonus funds to be received by satellite schools is weighted by the number of girls who enroll. Fifthly, support and training programmes and material for staff and parents cover gender issues.

Work on intergovernmental fiscal relations presents a greater challenge than work focused on a particular local government in that one needs to engage with several levels of government, and there will be many competing interests. However, as noted above, local government work that ignores intergovernmental fiscal relations can easily end up fighting over a too-small slice of the pie while others with less need gobble up the rest.

The description of different countries draws heavily on Rao MG, Bagchi M & Chakraborty L. 2006. *Fiscal Decentralisation and Gender Budgeting*. National Institute of Public Finance and Policy, New Delhi.