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Cluster: Performance Management

Theme: Public Sector Innovation and Reform

Further Reading:

Turley, Gerard and Stephen McNena, Local Fiscal Capacity and Equalisation Transfers: A New Methodology for Ireland, 2020, mimeo

Turley, Gerard and Stephen McNena, Local Government Funding in Ireland: Contemporary Issues and Future Challenges, *Administration*, 67 (4), 2019.

Turley, Gerard, Darragh Flannery and Stephen McNena, A Needs and Resources Assessment of Fiscal Equalisation in the Irish Local Government System, *The Economic and Social Review*, 46 (3), 2015.

www.localauthorityfinances.com

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Fiscal Equalisation in the Irish Local Government System

Fiscal equalisation is a key element of a country's intergovernmental fiscal arrangements where functions and funding are decentralised to subnational government. Equalisation transfers are used to reduce horizontal fiscal imbalances between local authorities, so that fiscal equity can be achieved whereby citizens are not disadvantaged in their access to public services by their place or region of residency. A well-designed system of equalisation transfers depends on the size and the allocation of the distributional pool. Currently, the equalisation fund is financed from a pre-determined share of the local property tax (LPT) and a contribution from the central Exchequer. The distribution of the fund is determined by the shortfall between the LPT retained locally and the general purpose grant baseline. In 2020, the equalisation fund was €135m, with 20 local authorities in receipt of an equalisation payment, and with just four local councils accounting for over 40% of the total. In the case of small rural councils with limited economic activity and revenue bases, the equalisation grant accounts for 10-15% of council income.

Research Findings

Equalisation can be funded from central government or from the wealthier local authorities. Whichever of these mechanisms is used, a formula-based methodology to determine the size and distribution of the equalisation transfers is preferred, on the grounds of transparency and objectivity. This study constructs a model of fiscal equalisation that is consistent with international best practice but tailored to the specific circumstances of the home country. As the objective of the model is revenue equalisation, the concept of fiscal capacity is used which is defined as the potential ability of local authorities to raise own-source revenues. The Representative Revenue System framework is then used to measure this local revenue-raising potential, and in turn, equalisation transfers. Using typical revenue categories, the fiscal capacity estimate is compared to a common standard, defined here as the national average capacity level. Councils with below average fiscal capacity receive an equalisation grant, equal to the euro difference between the individual fiscal capacity estimate and the national standard. The sum of these formula-determined equalisation amounts equals the total equalisation pool. In our simulations the equalisation fund is €210m, which is larger than the existing pool but smaller than equalisation funds in many other OECD countries. As for the individual council allocations, although it is roughly the same local authorities than receive equalisation transfers under the two models, the actual euro amounts differ.

Policy Implications

Given the redistributive nature of fiscal equalisation, undoubtedly there will be winners and losers. Aside from central government which is the big 'loser' as it funds this new equalisation scheme, in absolute euro amounts the big winners are Galway, Meath, Wexford and Laois County Councils. As for the sensitive issue of the losers, different policy responses will be required to ensure fiscally prudent balanced budgets at the local level. This may include higher local property taxes levied by individual councils or, in the case of councils with the smallest economic bases and/or in a difficult financial position, temporary compensation payments from central government during the transition to this new and improved model of fiscal equalisation.