The Theory and Practice of Local Government Reform

Edited by

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Andrew Sancton, a native of Montreal, received his doctoral degree in Politics from Oxford University in 1978. Most of his academic career has been spent at the University of Western Ontario in London, where he is a Professor in the Department of Political Science. He is now director of the Department's Local Government Program, which offers undergraduate and graduate education in public administration for municipal managers. From 1998 until 2000 he was the president of the Canadian Association of Programs in Public Administration and a board member of the Institute of Public Administration of Canada. Professor Sancton is the author of many publications relating to Canadian local government. His work on the relationship between municipal amalgamations and cost savings won the 1996 J.E. Hodgetts award for the best English-language article in the journal

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Preface

As a highly developed engine for the systematic analysis of human behaviour, economics has achieved great success in explaining the operation of the market system at both the individual microeconomic level and the aggregate macroeconomic level. It has also generated significant insights into the workings of other social institutions intimately involved with resource allocation, such as the legal system, the family and the political process, especially in the post-World War II era with the pioneering work of Ronald Coase (1937, 1960, 1992), Gary Becker (1957, 1968, 1981), James Buchanan (1986) and many others.

The economics of government has made possible major advances in our understanding of the modern state, notably through public choice theory, with its origins in Anthony Downs's (1957) *An Economic Theory of Democracy*, and the theory of fiscal federalism initiated by Wallace Oates (1972). Despite all these achievements, major obstacles still need to be overcome. In particular a satisfactory theory of the state has yet to be developed and this omission has hampered appreciation of the complexities of policymaking in contemporary advanced democratic polities.

The problems inherent in understanding modern government thus remain formidable. Moreover they are amplified when we consider local government, since the local sector has attracted far less scholarly attention than central and provincial government. Dollery and Wallis (2001) have suggested two 'institutional' reasons for this state of affairs. First, local government is often not only smaller than its national and state counterparts, but also typically enjoys less autonomy in its operations, and may therefore be regarded less worthy of study. Second, most specialist local government journals tend to cater for both academic and practitioner audiences, thereby introducing a bias towards topical policy issues rather than sustained theoretical inquiry.

Notwithstanding the comparative paucity of scholarly investment in the analysis of local government, a great deal has still been accomplished. Building on the seminal work of Oates (1972), considerable conceptual progress was made with Wildasin's (1986) classic text *Urban Public Finance*, David King's (1984) *Fiscal Tiers: The Economics of Multi-level Government* and Bahl and Linn's (1992) *Urban Public Finance in Developing Countries.* More recent literature, like George Boyne's (1998)

Public Choice and Local Government and Stewart Bailey's (1999) *Local Government Economics*, has also contributed to our understanding of local government, although it tends to focus on the institutional characteristics of specific systems of local governance, especially Britain and the United States, with the partial exception of Dollery and Wallis's (2001) *Political Economy of Local Government.*

Similar progress has been made in the analysis of local government reform. For example several recent books deal with the entire spectrum of local government reform in specific nations, like Garcea and LeSage's (2005) *Municipal Reform in Canada*, or the whole gamut of municipal reform across selected countries, such as Coulson's (1995) *Local Government in Eastern Europe*, John's (2001) *Local Governance in Western Europe* and Denters and Rose's (2005) edited volume *Comparing Local Governance: Trends and Developments*.

In addition, texts that specifically examine structural reform in local government – such as *Merger Mania* by Andrew Sancton (2000) and *The Economics of Australian Local Government* by Dollery, Crase and Johnson (2006a) – invariably focus on a single country and consider international experience only in broad, descriptive terms as it relates to that country. In contrast, the forthcoming *Local Government Reform: A Comparative Analysis of Advanced Anglo-American Countries*, edited by Dollery, Garcea and LeSage, and published by Edward Elgar Publishing, will provide the first detailed, systematic and comparative analysis of all recent municipal reforms in Australia, Britain, Canada, Ireland, New Zealand and the United States, and not structural reform *per se.*

But no existing text presents the theoretical foundations for the analysis of local government structural reforms and alternative models of local government, and then assesses this theory specifically in the light of comparative international developments in a cross-section of advanced countries. This task represents the aim of the present book.

This volume is the outcome of a process that began in 2004 when Professor Lorenzo Robotti of the Università Politecnica delle Marche, Ancona, Italy, visited the Centre for Local Government at the University of New England in Armidale, New South Wales, Australia and held discussions with members of the Centre, including Professor Brian Dollery. Subsequent discussions between Professor Robotti and Professor Dollery led to the conclusion that there was an urgent need to address the problem of structural reform in local government from both theoretical and empirical angles, taking a comparative perspective.

As a consequence, Professor Dollery visited Italy to attend a specialist seminar organized by Professor Lorenzo Robotti, held at the Università Politecnica delle Marche on 11 May 2006, for the specific purpose of

bringing together those scholars who would write the theoretical chapters of the book. A detailed analysis of the proposed book was undertaken to decide on the optimal structure of the text and the best method of approaching the material. Professors Robotti and Dollery also held intensive discussions for the better part of a week to decide on an appropriate *modus operandi* for chapter authors. They also carefully selected chapter writers for the countries used as part of the comparative component of the volume.

Brian Dollery would like to express his personal appreciation to Lorenzo Robotti, not only for an invigorating and productive research partnership, but also for the friendship and kindness shown by Lorenzo on his visits to Italy. He would also like to thank Professor Euan Fleming, (then) Head of the School of Economics at the University of New England, and Professor Roley Piggott, (then) Dean of the Faculty of Economics, Business and Law at the University of New England, for their encouragement and the congenial research environment they provided at that time. Brian would also like to thank the Australian Research Council for providing financial assistance for the project through Discovery Grant DP 0558-400. In addition, Brian expresses his sincere appreciation to the Faculty of Economics at Yokohama National University for providing most welcoming research arrangements during his stay as a Visiting Foreign Professor over the period October 2006 to March 2007. In particular, he would like to thank Professor Daisuke Arie, Mrs Kazuko Eguchi and Professor Craig Parsons of the Master's Program in English for making his stay so enjoyable. Most of all, Brian would like to thank his wife Therese Burton for all her love and support during the preparation of this book.

Lorenzo Robotti would like to acknowledge the kind assistance he has received from many people over the past two years. The list of those to whom he is indebted is a long one, but special mention must be made of his colleagues and collaborators from OPERA (the Regional Economics Observatory Center at the Department of Economics of the Università Politecnica delle Marche – the team which carried out much of the research – to whom he is particularly grateful for helpful comments and advice on earlier drafts of the manuscript of this book, and colleagues who attended the conference on local government amalgamation held at the Department of Economics of the Università Politecnica delle Marche on 23-24 September 2005. He is especially indebted to the Italian Comuni National Association (ANCI) and to Professor Enzo Pesciarelli, Dean of the Faculty of Economics, Università Politecnica delle Marche, for financial support for this conference.

His indebtedness to his wife Loredana Amadio is much more than that customarily owed to a spouse for her support and patience; indeed, her insights into bureaucratic behaviour have been instrumental in shaping his own views on the subject.

Brian and Lorenzo would like to express their sincere gratitude to the various scholars who contributed chapters to the book. It has been a privilege to work with these academics. Special thanks are due to the amazingly efficient Galia Akimova for transforming the manuscript into ‘camera-ready’ format and to Alison Basden for her sterling work editing the final manuscript. Finally, thanks to the staff of Edward Elgar Publishing for their highly professional assistance in making the book a reality.

1. Introduction

Brian Dollery and Lorenzo Robotti

INTRODUCTION

The past few decades have witnessed a period of intensive reform across many local government jurisdictions in the developed world. While the pace and content of this reform has been uneven, both within particular local government systems in a given country and between municipal jurisdictions in different nations, very few local government jurisdictions have remained untouched. It is thus vital to examine the causes and consequences of local government reform.

Various conceptual frameworks have been developed to facilitate our understanding of local government reform. For example, Shah (2006, p. 15) has argued that three 'basic principles' are prerequisites to successful local government reform: 'responsive governance' whereby reform should aim at delivering services that best meet local preferences; 'responsible governance' that focuses on the prudent use of scarce resources; and 'accountable governance' in which government must be made accountable to its electorate. Based on these fundamental principles, Andrews and Shah (2005) have advanced the notion of 'citizen-centred governance' that contains three 'distinguishing features': 'citizen empowerment' founded on a 'rights approach'; 'bottom-up accountability' that emphasizes outcomes; and performance evaluation.

In contrast to overtly normative conceptual schema for local government reform, such as those of Shah (2006) and Andrews and Shah (2005), other writers have proposed descriptive typologies to characterize the nature of local government reform processes in specific municipal systems. An especially useful taxonomy of local government reform of this kind has been developed by Garcea and LeSage (2005). In their *Municipal Reform in Canada*, the authors examine the purposes, processes, policies and ultimate outcomes of local government reform programs across the various Canadian state and territory municipal systems. They constructed an analytical framework comprising five elements of local government reform processes: structural reforms; jurisdictional reforms; functional reforms; financial reforms; and internal governance and management reforms. This conceptual typology can be applied to local government reform programs in other countries, even if the nature and structure of local government differs from the Canadian case.

'Jurisdictional reform' refers to revision of the 'authority and autonomy' of municipal government relative to other tiers of government. An important ingredient of this type of reform is its impact on inter-governmental relations. 'Functional reform' deals with the 'formal and informal' roles and responsibilities of municipal entities; that is, it concerns changes in the functions performed by local councils. 'Financial reform' tackles the expenditure and revenue dimensions of local government operations. In particular, reform processes often seek to modify the revenue base of local authorities by broadening the taxation base, introducing tax-sharing arrangements, and other measures to improve income. Reform of the 'internal organization, administrative and managerial apparatus', the fourth element of local government reform, consists of revising the 'structure and functions' of elected chambers, 'council-committee systems', the organization of administrative units, and asset and resource management.

'Structural reform' embraces the reconfiguration of local government in terms of the 'number, types, and size of municipalities, quasi-municipalities, and municipal special-purpose bodies' (Garcea and LeSage 2005, p. 5). A central assumption underlying this type of reform is the notion that changes to the structure of local government can affect the operational efficiency of municipal governance without diminishing the efficacy of local democracy. In other words different local government structures possess different efficiency characteristics, which inescapably implies that some 'optimal' structural form has superior policy outcomes. In other words, in a decentralized system of municipal government, it is conceptually possible to identify an optimum size for local government. Structural reform programs should thus strive to modify the number and size of local councils to approximate this optimum size.

This claim is controversial in both theoretical and empirical terms (see, for example, Boyne 1998; Oakerson 1999; Bish 2000; Sancton 2000; Allan 2001; Dollery and Crase 2004; Dollery, Crase and Johnson 2006a). It has given rise to an acrimonious longstanding and ongoing debate between advocates of structural reform aimed at increasing the size of local government entities by reducing the number of such entities, and opponents of this view. In essence, exponents of this kind of structural reform implicitly contend that 'bigger is better' whereas their detractors proclaim that 'small is beautiful' in local governance. More recently, the debate surrounding municipal 'consolidation' has been complicated by the rise of alternative models of local government which seek to reap any advantages contingent upon size through various partnership and other arrangements between small municipalities.

Curiously, despite the voluminous literature that it has generated, the debate on the virtues of structural reform has largely lacked interplay between theoretical conjecture and empirical refutation that forms the bedrock of scientific discourse. In the policy domain, no one seems to have asked to what extent the theoretical foundations for structural reform play a role in real-world structural reform programs. Put differently, can extant and new economic theory on optimality in local government structure explain the observed incidence of structural reform in actual local government jurisdictions?

These questions form the central theme of this book. In this volume, we present several new economic models on optimal structural design in local government, and then consider the degree to which these models can account for observed trends in local government structural reform in Australia, Canada, France, Germany, Italy, New Zealand and Spain. After reviewing the relevant economic literature on the structure of local government in urban public finance, and surveying scholarly work on alternative models of local governance, three new theoretical models on the structure of local government are presented. These models, together with the broader literature on municipal structural reform, are applied to the seven 'case study' countries in order to determine *inter alia* whether they can shed any explanatory light on the structural reform policy regimes implemented in these countries.

The choice of theoretical material requires elucidation. The genesis of the modern economic approach to decentralization in local government and the associated question of the optimum size of local councils can be found in the pioneering work of Wallace Oates (1972), which has been extended by various scholars, most recently by King (1996) and King and Ma (2000a). In effect, this body of work sets out the economic rationale for decentralized local authorities and tries to establish an optimal size for a local government entity. However, it does not explain the economic basis for deciding between amalgamating small councils into a larger entity instead of instituting a partnership arrangement between these councils, nor does it consider the related issue of the stability of consolidated local municipalities as opposed to ongoing partnerships between these councils.

While a small literature has already been established to investigate these latter questions from a theoretical perspective, perhaps most notably by King and Ma (2000b), much remains to be done. Fortunately, an extraordinarily talented and dedicated group of economic model builders, centred in a research group at the Università Politecnica delle Marche in Italy, have devoted considerable attention to the problem. Accordingly, we have included three new theoretical models of optimal local government structure and stability developed by these scholars in this book. Quite apart from the usefulness of these models in assessing observed real-world municipal structural reform programs, the presentation of this material in this volume serves to advance our conceptual understanding of the optimal nature of local government structural arrangements.

The selection of the ‘case study’ countries also deserves explanation. Various factors prompted the final choice of local government systems. In the first place, while structural reform is widespread in both advanced and developing nations, we hoped to draw more useful comparisons by restricting our focus to developed nations with high income economies and democratic polities. Second, within this group, we excluded countries with little or no recent structural reform, such Japan (Mochida 2006) and the United States (Sancton 2000). Third, we deliberately included established scholars with expertise on nations in which structural reform had taken place. Finally, size constraints limited the discussion to only seven countries.

In this book, the terms ‘council’, ‘municipality’, ‘local authority’ and ‘local government’ are employed synonymously to describe the basic democratically elected governmental unit involved in the delivery of local services, regardless of the size of this entity or the range of services it provides. The sole exception is ‘special-purpose’ local governmental organizations that focus on a single service. In accordance with the traditional approach that locates local government within the larger hierarchy of multi-tiered governance, which we adopt in this book, the terms ‘provincial’, ‘regional’ and ‘state’ government refer to the intermediate level of government, whereas ‘central’ and ‘national’ government both indicate the highest tier of government.

The remainder of this chapter is divided into two main parts. The first section considers the meaning of structural reform in local government, while the second provides a brief synoptic outline of the book.

MEANING OF STRUCTURAL REFORM

In all multi-tiered systems of government, whether they are fully fledged constitutional federations, such as Australia, Canada and Germany, or more centralized systems like France and New Zealand, a fundamental distinction can be drawn between vertical and horizontal decentralization. Horizontal decentralization refers to the spatial disaggregation of governmental functions at the same level, with several governments providing a similar range of services to citizens, whereas vertical decentralization describes a hierarchy wherein different levels of government serve different functions.

This volume is chiefly concerned with how best to improve horizontal decentralization through the reorganization of government at a given level in a multi-tiered system of government. It examines whether efforts to reform local government through horizontal structural change should concentrate on decentralizing local councils by creating new smaller entities, centralize local authorities by merging them into larger municipalities, or retain the existing size of local councils but modify service with 'partnership' arrangements for specific types of service delivery. Put simply, should reform programs seek to fragment local government, concentrate municipalities into larger public bodies, or encourage existing local councils to collaborate in service provision?

Some writers have tried to develop conceptual taxonomies of different institutional models that could be adopted by policymakers intent on municipal structural reform. For example, the Local Government Association of Queensland (2005) has identified four relevant models: 'merger/amalgamation', where two or more councils are consolidated into a single larger local authority; 'significant boundary change', where the spatial area of municipal jurisdictions is altered but existing government structures are left intact; 'resource sharing through service agreements', in which one local authority undertakes specific functions for other councils, such as waste management; and 'resource sharing through joint enterprise', in which municipalities combine their activities in a given service function in order to accrue scale economies, such as record keeping and storage.

In the context of this book, these four options represent different methods of approaching structural reform that vary in the degree to which they change the nature of existing local councils. They all meet the definition of structural reform advanced by Garcea and LeSage (2005, p. 5) since they all change the 'number, types, and size of municipalities, quasi-municipalities, and municipal special-purpose bodies'. However 'merger/amalgamation' – involving the horizontal concentration of local government through consolidation by merger – is the most intrusive type of structural reform because this form of structural change fundamentally alters the character of the local councils involved. Both 'resource sharing through service agreements' and 'resource sharing through joint enterprise' are less decisive forms of structural reform, since pre-existing local councils retain their democratic autonomy and essentially the same service responsibilities. Similarly, 'significant boundary change' also leaves untouched the key democratic and functional elements of local government and thus is less destructive of existing institutional structures. In other words, this book draws a critical conceptual distinction between structural change that destroys existing local government entities and structural change that retains existing local councils, albeit in modified form.

OUTLINE OF THE BOOK

The book is divided into three discrete parts. Part I deals with the theoretical issues involved in structural reform in local government. It contains five chapters: Chapter 2 places local government within the broader context of economic theory on multi-tiered government; Chapter 3 considers alternative models of local government; Chapter 4 examines the theory of local government partnerships; Chapter 5 compares the stability of partnerships between local councils with the merger of these local councils; and Chapter 6 deals with the impact of financial incentives to local government to provide joint services.

Part II provides a ‘case study’ approach of structural reform in each of seven countries in the light of the theoretical considerations presented in Part I: Australia (Chapter 7), Canada (Chapter 8), France (Chapter 9), Germany (Chapter 10), Italy (Chapter 11), New Zealand (Chapter 12) and Spain (Chapter 13).

Part III draws general lessons from the analyses in Part I and Part II. In particular, Chapter 14 identifies common themes on structural reform that emerge from the seven countries and considers the extent to which the theoretical models can explain these developments. Chapter 15 concludes the volume by deriving policy implications for structural reform in developed countrie

9: Structural Reform in France

Alain Guengant and Yvon Rocaboy

INTRODUCTION

Fiscal federalism always has to balance neutrality and incentives when shaping tax and other reforms. In the absence of any significant harmonization at the European level, the past ten years have seen many national attempts aimed at bringing increased efficiency to both institutions and tax instruments. For instance decentralization in France is an ongoing process that builds on significant institutional reforms. The assignment of prerogatives among the different levels of government is thus progressively reshaped. At the same time, the evolution of the institutional landscape is accompanied by important fiscal transfers and other amendments.

After several partly successful attempts at reform, important changes were introduced in France in the early 1980s regarding the distribution of powers, responsibilities and finance among the different tiers of government. A legislative package – *Lois de Décentralisation* and *Lois de compétences* – was approved between 1982 and 1986, which was followed, in 1992, by the ATR Law (*Loi sur l'Administration Territoriale de la République*) and continued in 2002 with the reform of the constitution. Much has been written on the consequences of this 'process of decentralization' implemented in one of the most centralist countries in Europe (Delcamp and Gilbert 1993). Whereas some authors have warned of the serious shortcomings of these new arrangements (in terms of inefficiency, waste, irresponsibility and corruption), other commentators have instead stressed their merits (in terms of greater efficiency, accountability, flexibility and innovation in local public services).

This stream of reforms was designed to transfer more powers, responsibilities and financial resources to sub-central levels of government. A key characteristic of the decentralization legislation is that it was concerned mainly with the transfer of responsibilities to lower governmental tiers. Although new fiscal resources were given to the *régions*, *départements* and *communes* to finance the additional expenditure associated with the redistribution of responsibilities, the urgently needed global reform of local taxation did not take place. However the redistribution of responsibilities was rationally designed, with each level of government receiving a specific 'block of responsibilities'. In only a few cases was a given responsibility allocated to more than one tier of government. The new arrangements applied only to 'compulsory' responsibilities (that is, those responsibilities which a given level of government must perform).

This method of allocating responsibilities has the sweet smell of 'cartesianism' in line with the long-established French administrative tradition. However it also has the merit of discreetly reducing the fiscal burden on central government in at least two major areas: education, or more precisely the construction and maintenance of school buildings (decentralized at the regional level), which the central government neglected in the 1960s and 1970s; and social services, which seem to have become excessively burdensome for central government to finance on its own (but which now falls under the responsibility of *départements*).

The aim of this chapter is to review the main stages of the decentralization process in France, and to assess their impacts on the local public sector. The chapter is divided into four main sections. Section 1 provides a synoptic summary of the French local government system. Section 2 presents the successive reforms that have been introduced since the beginning of the 1980s, as well as their effects on the local public sector. Section 3 assesses the power of theoretical models of community partnership to explain the French amalgamation policy over the last decade. The chapter ends with some concluding remarks.

1. SYNOPTIC SUMMARY OF THE FRENCH LOCAL GOVERNMENT SYSTEM

While France is not yet a regional state, decentralization is now well under way, with an increasing range of competencies assigned to local jurisdictions. Expenditures follow a similar path. However local taxation will bear less weight in future since local resources are now increasingly controlled by the central government through its grant system.

Competencies of Local Jurisdictions

There are three levels of local government in France. The upper and most recently established tier comprises the *régions*. Twenty two *régions* were created in 1986. One hundred *départements* form the intermediate tier, and the *communes* form the lowest tier. There are 36 565 *communes*, which constitute one of the most impressive specific attributes of the French local public sector. Their average population is 1600 as opposed to the European average of 5200. The French *communes* represent nearly 50 per cent of all

European communes. Due to the obvious difficulties of managing this large number of lower jurisdictions, a move towards cooperation among *communes* has been encouraged by the French central government since 1992. Currently there are 2000 inter-communal structures (*communautés de communes*), each with its own taxation powers.

The distribution of responsibilities between the three tiers of local government is clear. In essence, the *régions* are mainly responsible for economic development, high school buildings and facilities, *départements* deal with public assistance, buildings and facilities of colleges and economic development, while the *communes* are in charge of the public services related to local needs. In practice, some of these responsibilities are shared in common with economic development, producing some conflict among the different tiers of local government, even if the regions have an assigned coordination role in the matter. This fact is the consequence of a constitutional principle which provides that there must be an absence of hierarchy among sub-national governments.

Local Public Expenditures

In 2004, French GDP amounted to €1659 billion. Total public expenditures and local public expenditures represented 54 per cent and 10.7 per cent, respectively, of the GDP. Of this total around 60 per cent of the local public expenditures are made by the *communes* and their inter-communal structures, the *EPCI: etablissements publics de coopération intercommunale*, as shown in Table 9.1.

Table 9.1: Local public expenditures 2004

	Communes	***EPCI***	**Départements**	***Régions***	**Total**
In € billion	81.5	24.5	53.9	17.5	177.4
Percentage	46	14	30	10	100

Source: Direction générale des collectivités locales.

The structure of local public expenditures is similar for both *communes* and *départements*. Current expenditure accounts for two-thirds to three-quarters of total expenditures. The *régions* are different because of the large proportion of investment in regional public expenditures, as shown in Table 9.2. This is due to the competencies of *régions* in matters of equipment and buildings for high schools.

Table 9.2: Structure of local public expenditure 2004 (percentage)

	Communes	**EPCI**	**Département s**	***Régions***	**Local public sector**
Current expenditure	63	73	67	51	65
Investment	25	18	22	42	24
Annuity of the debt	12	9	11	7	11
Total	100	100	100	100	100

Source: Direction générale des collectivités locales.

Local Public Revenues

Communes and *départements* are not too dissimilar as far as the structure of local public revenues is concerned. Around 50 per cent of the local public revenues derive from taxation and 30 per cent accrue from grants. The remaining 20 per cent are composed of user fees and borrowing. The situation is somewhat different for *régions*. In particular, the proportion of grants is larger in the case of the *régions* than it is for the other two layers of government. This situation is partly due to the lack of sources of revenues other than taxation. Table 9.3 summarizes the position.

There are four important local taxes in France: the *taxe d'habitation* as an occupancy tax; the *taxe professionelle* as a local business tax; and the *taxes foncières sur les propriétés bâties et non-bâties* as developed and undeveloped property taxes, respectively. Almost 50 per cent of the revenue of the *communes* and the *départements* derives from these four taxes. In 2002 the *taxe d'habitation* was reduced for the *régions*. This decision is in line with the central government policy to lower taxation in France. From this time onwards, of the four main taxes, only three tiers of local government collect business tax and property tax. The other three local taxes, on household rubbish, property sales and motor vehicles, are less important. The

Table 9.3: Structure of the local public revenue 2004 (percentage)

	Communes	**EPCI**	***Départements***	***Régions***	**Local public sector**
Taxation	45	55	51	30	47
Grants	33	23	32	55	33
User fees	12	13	6	3	9
Borrowing	10	9	11	12	11
Total	100	100	100	100	100

Source: Direction générale des collectivités locales

rental value of housing is the tax base of the occupancy tax and property taxes, while the business tax is based mainly on the capital of firms (see Table 9.4). Local governments are comparatively free to set tax rates, with only a few restrictive rules. For instance, the tax rate of the *taxe professionnelle* in one jurisdiction must be less than twice the average tax rate of the previous year.

There are three kinds of central grants. The *Dotation globale de fonctionnement* (DGF) is a lump-sum grant, partly computed such that it reduces fiscal inequalities among local jurisdictions. It represents more than 20 per cent of the total local revenue of *communes* and 9 per cent for *départements.* The *Dotation générale de décentralisation* (DGD) is designed to compensate for the transfer of responsibilities to the sub-national governments due to decentralization (discussed below). The DGD and the DGF are not earmarked transfers. They are annually adjusted upwards. The

Table 9.4: Local Taxation in 2004

	Recipient	Base	Percentage of Local Revenue
Taxe d'habitation (Occupancy tax)	-*Communes* -*Départements*	Rental value of housing	-*Communes:* 10% -*Départements*: 10%
Taxes foncières (Property taxes)	-*Communes* -*Départements* -*Régions*	Rental value of real estate	-*Communes*: 13% -*Départements*: 11% -*Régions*: 9%
Taxe professionnelle (Business tax)	-*Communes* -*Départements* -*Régions*	Capital of firms	-*Communes*: 18% -*Départements*: 20% -*Régions*: 18%
Taxe ordures ménagères (Household rubbish tax)	-*Communes*	Rental value of real estate	-*Communes*: 4%
Droits de mutation (Tax on property sales)	-*Communes* -*Départements*	Property sale	-*Départements:* 13%
Carte grise (Tax on motor vehicles)	-*Régions*	Engine capacity	-*Régions*: 12%

Source: Direction générale des collectivités locales.

Dotation d'équipement is granted to the three tiers of local government to help them finance capital projects (see Table 9.5).

Table 9.5: Grants in 2004

	Recipient	Explicit equalizing transfer	Percentage of local revenue
Dotation globale de fonctionnement (Grant for financing current expenditures)	-*Communes* -*Départements*	partly	-*Communes:* 21% -*Départements*: 9%
Dotation générale de décentralisation (Grant for financing the transfer of responsibilities)	-*Communes* -*Départements* -*Régions*	no	-*Communes*: 0.3% -*Départements*: 4% -*Régions*: 18%
Dotation d'équipement (Grant for financing capital expenditures)	-*Communes* -*Départements* -*Régions*	no	-*Communes*: 3% -*Départements*: 2% -*Régions*: 3%

Source: Direction générale des collectivités locales.

2. DESCRIPTION AND DETERMINANTS OF STRUCTURAL REFORMS

The French local public sector has experienced important changes since the early 1980s. These changes have been made in order to provide sub-national governments with greater responsibilities, to foster inter-communality and to improve financial efficiency.

Decentralisation

The changes in the organization of the local public sector were brought about by successive waves of decentralization. The first stage, known as ‘Acte 1’ of the decentralization process, started in 1982. In 2003, it was followed by what is generally called ‘Acte II’ of the decentralization process.

Acte I of the decentralization process

The first stage of the decentralization process sought to achieve two main objectives. First, the decision-making power of the local governments was reinforced. Prior to the reform process, departmental or regional executive power was exercised by the Prefect representing the state within the respective departments and regions. Reform transferred this power to the

President of the departmental or regional assembly. In 1986 regional councils were elected by direct universal suffrage. Since that time regional and departmental assemblies were free to make their own decisions concerning their jurisdictions. In particular, the need to secure authorization to borrow was removed. Local governments can thus now freely borrow without restriction on the amount, rate or duration of the loan. In addition, the counterpart to free access to the credit market – the obligation of balancing the local budget – was strengthened. The local governments can therefore borrow only to finance investment and not current expenditure. Moreover local councils must cover both interest and capital repayment of loans from their own financial resources, largely through tax revenue. Regional audit courts were created in 1982, and are empowered to monitor all local governments within their geographic zone. In so doing, *a priori* control of local government has been replaced by an *a posteriori* review process that symbolizes new local autonomy in France.

Second, new responsibilities were transferred to the regional and departmental levels while the functional assignments of the communes were not changed. These responsibilities were transferred in 'blocks' in order to correct the previous overlapping of authority between the different layers of government and to bring public administration closer to end users. Broadly speaking, social services and buildings and facilities of the 'collèges' were assigned to the departments, while high school buildings and facilities fell to the regions. However the initial aim of organizing disjointed 'blocks' of responsibilities was not entirely achieved. Indeed none of the territorial functional assignments can be considered exclusive to any particular sphere of government, thereby maintaining competition between the regional and departmental levels, particularly in the case of economic development.

The fiscal provisions contained in the decentralization legislation rest upon a simple principle: any additional expenditure responsibility transferred to local jurisdictions must be compensated for by central government. Compensation takes two forms. First, there is a transfer of taxes. For example, a number of taxes, formerly levied at the central level, were ceded to the *régions* and the *départements* in 1984: the tax on motor vehicle sales (*Cartes grises)* to the *régions*, and the motor vehicle registration fees (*Vignette automobile)* and the tax on property sales (*Droits de mutation)* to the *départements*. Second, local jurisdictions receive a lump-sum grant – the DGD (*Dotation globale de décentralisation*) – which is equal to the difference between the expenditure attributable to the transfer of responsibility and the value of the taxes ceded. For instance, regarding the transfer of compulsory social services to the *départements*, balance was in fact achieved in 1984; had transfer of responsibility not taken place, the central government would have had to meet 32.6 billion of the total of 52 billion francs spent on welfare, and the *départements* 19.4 billion francs. After 1984 the central government burden was 12.2 billion francs and that of the *départements* was 39.8 billion francs. The additional 20.4 billion francs burden on *départements* was fully compensated by the DGD (8.8 billion francs) and by the extra revenues from motor vehicle registration fees (7.6 billion francs) and the tax on property sales (4 billion francs). The DGD was initially adjusted annually at the rate of VAT; presently the adjustment occurs at a rate equal to the sum of the inflation rate and half the rate of growth of the previous annual GDP (see Gilbert and Rocaboy 1996).

Acte 1 of the decentralization process was characterized by an increasing gap between the transferred resources and the new functional responsibilities assigned to local governments. Indeed, around 6.5 billion of the €50 billion of additional local tax revenues were required to finance the negative differential between transferred expenditures and resources. This is mostly due to the mandatory spending which covers a broad field and results from decisions over which local governments have no control, like payroll increases imposed by civil service wage accords, social service minima set by the central government, heightened pressure from 'social needs' and the automatic application of rules introduced over decades of the French welfare state. Moreover some of the transferred taxes, like the tax on property sales, did not increase at the expected rate due to the burst of the housing bubble at the beginning of the 1990s. These opposing fiscal trends generated an adverse 'scissors effect' unfavourable to local governments.

Acte II of the decentralisation process

Acte II of the decentralization process has reinforced the transfer of powers and responsibilities to the *régions* and *départements* and has thereby entailed constitutional reform. Article I of the French Constitution was changed to read '(France) guarantees the independent administration of its territorial units'. Moreover, the Constitution now provides that taxes and other own-source revenue must represent a 'determined portion of all resources'. Finally, in an analogous manner to Acte 1 of the decentralization process, transfer of responsibilities must be accompanied by an equivalent transfer of financial resources. The implementation of Acte II began in 2003 with the decentralization of the management of minimum income programs or *Revenu minimum d'Insertion (RMI*) and the independence benefit or *Allocation personnalisée d'autonomie (APA)* to *départements*. It continued in 2005 with a new wave of transfers in the fields of economic development, vocational training, infrastructure projects, health, environment, education and culture.

Transferred expenditures represented €3.1 billion for the regions and €8.7 billion for the departments. In particular, social services, solidarity and housing amounted to €6.5 billion, economic development to €1.1 billion, roads and large-scale infrastructure to €2 billion, and education and culture to €2.2 billion. These new local responsibilities are to be backed by transfers of personnel from central government agencies, including technical, operating and service staff in local education to the regions and departments (around 96 000 people) as well as technical staff from the departmental infrastructure directorates to the departments (around 33 000 people). These transfers of personnel have been carried out gradually, finishing in 2008.

The financing of transferred responsibilities rests upon the proceeds of sharing of two national taxes: the domestic consumption tax on petroleum products or *Taxe Intérieure sur les Produits Pétroliers* (*TIPP)* and the special tax on motor vehicle insurance policies or *Taxe Spéciale sur les Conventions d'Assurances* (*TSCA)*. A fixed portion of these central government tax revenues is allocated to the departments, while the regions are allowed to modify the *TIPP* rate for the consumption of petroleum products within the regional territory. Consideration is being given to allowing the regions and departments to set their own rates for both taxes. There would thus be a shift away from the tendency to finance new local responsibilities through central government grants in favour of tax transfers, in accordance with the constitutional reforms of 2003.

Territorial Reform

With more than 36 500 communes for a total spatial area of 550 000 square km, France is characterized by a very high level of fragmentation in local government administration. Cooperation among municipalities has long been encouraged by the central government to tackle this fragmentation problem. In 1890 'single-purpose inter-communal associations' or *syndicats intercommunaux à vocation unique (SIVU)* were created, followed in 1959 by the creation of 'multi-purpose syndicates' or *syndicats intercommunaux à vocation multiple* (*SIVOM).* Finally, in 1966, 'urban communities' were created for communes belonging to large metropolitan areas.

This inter-communality has been largely based on the voluntary linking of communes. In practice, syndicates are governed by a council composed of representatives of the communes. Each commune contributes to the syndicate according to its population. The main goal of these groupings is to provide citizens with better access to public services through two main avenues: by taking advantage of economies of scale in the production; and by internalizing spillover effects due to the public good characteristics of these services.

This form of local government cooperation has the advantage of being flexible, but it also has distinct limits. For instance the multiplication of single-purpose inter-communal associations increases the transaction costs between cooperating municipalities. Furthermore the heterogeneity of the partners, with frequent and significant differences between syndicates comparatively common, serves to complicate program coordination. The obligation to permanently negotiate typically lengthens the lead up time for infrastructure projects. This often results in the implementation of short-term measures to the detriment of long-term policies. In recognition of these limits, the French state has undertaken to promote a more integrated form of inter-communality. The law of 12 July 1999 attempted to systemize structures which gradually appeared over the 1990s. Three structures were created: urban communities (*communauté urbaines*) covering at least 500 000 people; 'agglomeration' communities (*communautés d'agglomération*) having between 50 000 and 500 000 residents; and 'communities of communes' (*communautés de communes*) composed of small rural municipalities.

This new inter-communality is still based on voluntary cooperation between communes. But it is characterized by a single territorial area, its own taxation powers and a democratic decision-making process. A group of communes constitutes a 'public establishment for inter-communal co-operation' (*Etablissements publics de coopération intercommunale – EPCI),* which is different from a local government. At 1 January 2006, the EPCI covered 90 per cent of French communes and 53.3 million people (or 84 per cent of the French population). As a consequence, the number of syndicates (*SIVU* and *SIVOM*) fell drastically. Each type of community has its own juridical and fiscal regime. Transferred responsibilities are larger in the urban communities and the 'agglomeration' communities than they are in the 'communities of communes'. Taxation powers consist either of a supplementary levy on top of local taxes or a specialized tax. The latter is compulsory for the urban and agglomeration communities. In these instances the business tax is no longer attributed to the communes but to the grouping alone. Communities of communes can choose either of these two tax systems. In 2006 the system of imposing a single business tax on the entire community, known as '*taxe professionnelle unique*' (*TPU*), was shared by 1103 out of the 2524 communities. They collected 70 per cent of the entire business tax revenue.

The single business tax has improved risk-sharing between communes by broadening the tax base. Moreover harmonizing the business tax rates among the municipalities belonging to the same community has avoided counterproductive tax competition in attracting businesses. However the feedback effect between inter-communality establishment and economic growth of the affected communities remains ambiguous. By itself *TPU* does not modify the competitiveness of the territory under its jurisdiction and the concomitant attractiveness of the community with respect to the concurrent communities. It also seems that the transfer of responsibilities has not been accompanied by very large economies of scale. Indeed no reduction in expenditure by the affected communes has been observed. It appears that the increases in public good supply at the communal level and the two-tier management (communal and inter-communal) may have contributed to the growth in local public expenditures and local taxes.

As a consequence the organization of inter-communal councils should be reshaped. In particular, direct election of members of the inter-communal councils should be implemented to make their leaders more accountable to the citizenry. This change would involve the transformation of the community into a local government. However the coexistence of two levels of local government (communal and inter-communal) in adjacent spatial areas is not possible. The new mode of election might thus involve merging the communes within the community. This would result in the demise of communes and the launch of a new layer of government better suited to territorial planning and local economic development.

Local Government Finances

French local governments enjoy financial autonomy. However successive reforms of the tax system have led to a reduction in local tax revenue. Tax relief granted to taxpayers has been compensated more or less by global grants from the French state. These reforms have thus resulted in lower revenue autonomy due to the diminished ability of local government to resort to local taxes at the same time as devolution of expenditure has taken place.

Taxes

In 2004 taxes and user fees represented slightly less than 60 per cent of total local government revenue (see Table 9.3). Local taxes have been constantly adjusted since the late 1960s. Most of the subsequent reforms represented a way to reduce the burden of salaries and wages (Guengant 2005). From 1999 to 2003, the salary base was gradually exempted from the business tax in an attempt to reduce labour costs and thereby tackle unemployment. Around one-third of the business tax base was removed through this measure. In addition, to make firms more efficient, the rate of business tax was capped at 3.5 per cent of their added value. This measure was mainly designed for large companies in the industrial and energy sectors. As a result more than half of the business tax revenue derives from the value-added regime, which means that for a large part of the revenue, local governments are no longer free to set the business tax rate since the cap is established at the national level. At the same time, the occupancy tax was capped as a function of income to improve household purchasing power.

As mentioned above, the constitutional reforms of 2003 provided that any such relief was to be fully compensated by the French state. In 2004, due to both successive reforms and the 2003 constitutional rule, the central government financed around 50 per cent of the business tax and 30 per cent of the occupancy tax. The reduction in the local tax burden was then greater for firms than it was for households. The share of the business tax in the local public revenue dropped from 55 to 40 per cent. This reduction in the differential between taxes paid by firms and those paid by households was one of the expected results of the local tax system reforms. According to some studies, firms contribute far more to local budgets than they receive in terms of industrial public goods. The share of local public expenditures accruing to firms seems to be around 20 per cent (Guengant et al.1995).

Central government grants

In 2006 the national budget law raised financial transfers to local governments to €65 billion (around 20 per cent of all national tax revenue), two-thirds of which went to operating transfers (essentially the *dotation globale de fonctionnement (DGF))* which amounted to €38 billion), 10 per cent to capital grants, 20 per cent to offset tax exemption and relief, and the remainder to finance the new decentralized responsibilities. These financial transfers are adjusted annually at a rate depending on both the inflation rate and a fraction of the growth rate of the previous year's GDP. The *DGF* can be divided into two major parts: a lump-sum to finance local public services, mostly calculated on the basis of demographic and spatial area criteria; and an 'equalization' component to reduce purchasing power inequalities among sub-national governments in terms of local public services.

The importance attached to equalization policies in France is largely due to the existence of marked disparities in purchasing power between local governments, which in turn leads to large inequalities in terms of local public expenditures per capita, particularly at the communal level (Guengant et al. 2002). These disparities stem from some communes being far better endowed than others in terms of their business tax base (that is, in the location of firms). By way of example of these huge inequalities, the fiscal base of the richest 1 per cent of communes is 44 times higher than that of the poorest 1 per cent of communes (OCDE 2006). The central principle of the equalization system is thus to compute the equalization component of the DGF in inverse proportion to the purchasing power of sub-national governments. However, as a constitutional obligation since 2003, the equalization system does not aim at achieving absolute equality but rather at incremental movements towards greater regional equality. A recent assessment of the impact of the French equalization system (Gilbert and Guengant 2004) showed that the overall correction rate after payment of grants amounted to 40 per cent for communes in 2001 (34 per cent in 1994), 51 per cent for the departments (43 per cent in 1994) and 54 per cent for the regions (35 per cent in 1994).

3. ASSESSMENT OF THE EXPLANATORY POWER OF THE MODELS

Chapters 4, 5 and 6 in this volume present different economic models specially constructed to explain the rationality of municipal amalgamation. Are these models relevant to the French case? The Bartolini-Fiorillo model (BF) proposes a positive analysis of the optimal form of partnership among local councils. Two forms of partnership are examined: a consortium (a partnership whose goal is to produce specific services) and a union (an institutional arrangement that is more flexible and free to decide on the quantity and variety of services that it provides). In their model the authors assume that the transaction costs (that is, administrative and political costs) are higher for the unions than they are for the consortia, whatever the number of member councils. On the other hand the union is better able to match citizens' preferences in that it is designed to exploit economies of scope. As a result the optimal partnership for quasi-benevolent politicians lies in the trade-off between a better mix of public services and the loss of administrative/political power. The main proposition of the BF model is that the union model is optimal for services that have a high degree of substitutability, so that flexibility can be fully exploited, while non-amalgamated partnerships are preferable when the elasticity of substitution between services is low.

In France the type of public services that might be transferred to the union is ruled by law. Most of these services are characterized by low elasticity of substitution (such as garbage collection). According to the predictions of the BF model, under these circumstances, no councils would have chosen to create a union. Yet French amalgamation policy has still been successful, as we have seen earlier in the chapter. An explanation for this might be found in the model proposed by Fiorillo and Pola in Chapter 6. The authors argue that the best way to induce councils to amalgamate is to provide the union with a specific tax and to allocate a grant positively related to the 'tax effort' of the partnership. This is exactly what the French government did in the late 1990s. The business tax (TPU) was transferred to the union and the central grant transferred to the partnership (DGF) was positively linked to the fiscal revenue of the union. These financial incentives were mainly what enticed most French municipalities to sign a partnership agreement. Some commentators have even argued that this approach is the only rational way to explain the success of the French amalgamation policy.

In Chapter 5, Palestrini and Polidori conduct a cost and benefit analysis of municipality amalgamation relative to continued autonomy by the municipalities, as well as the stability of the union once formed. It is of particular interest to note that they establish that central government financial incentives are required to prevent the union from dissolution when the expected benefits are lower than anticipated, and that these incentives are Pareto-improving. At first glance this model might fit the French context. It is theoretically feasible for a municipality to 'de-merge' if it appears that the benefit of leaving outweighs the advantage of continued amalgamation. But this decision has to be approved by a qualified majority of the union members, which makes the 'de-merger' almost impossible in practice. According to a recent poll three-quarters of French mayors felt that there was no freedom to leave inter-communality establishments. In fact, as at 1 January 2005, 16 communes had sought to withdraw from 13 'agglomeration' communities and only four were authorized to 'de-merge'.

4. CONCLUDING REMARKS

In order to limit the growth of public expenditure, France has engaged in a series of important reforms since the early 1980s. Sub-national governments have been at the heart of this ongoing reform process. In common with many other countries, greater local government responsibility accorded to bigger local governments seems to have been the basic thrust of these changes in France. The competencies of the two upper tiers of French local government have increased while a very active policy of amalgamation at the municipal level has been implemented.

Yet other much needed reform in local taxation has not taken place over the same period. A few taxes have been abolished or reduced, and these have in any event been compensated for through central government grants. As a result sub-national governments have been provided with greater responsibilities, but simultaneously less autonomy to finance these new competencies.