



GOVERNANCE AND PUBLIC POLICY REPUBLIC OF IRELAND

Diploma stage examination

8 June 2006

From 2.00pm to 5.00pm
plus ten minutes reading time from 1.50pm to 2.00pm

Instructions to candidates

Answer **four** questions in total.

One compulsory question from **Section A**

One compulsory question from **Section B**

Two out of the three questions from **Section C**

The question in Section A carries, in total, 50 marks.

The question in Section B carries, in total, 20 marks.

The questions in Section C each carry a total of 15 marks.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.



PRE-SEEN MATERIAL

2005 Indecon Report of Local Government Financing

Executive Summary

Introduction

This report represents an independent review of local government financing in Ireland focussing on local authority current expenditure. The report was commissioned by the Minister for the Environment, Heritage and Local Government and was completed by Indecon International Economic Consultants.

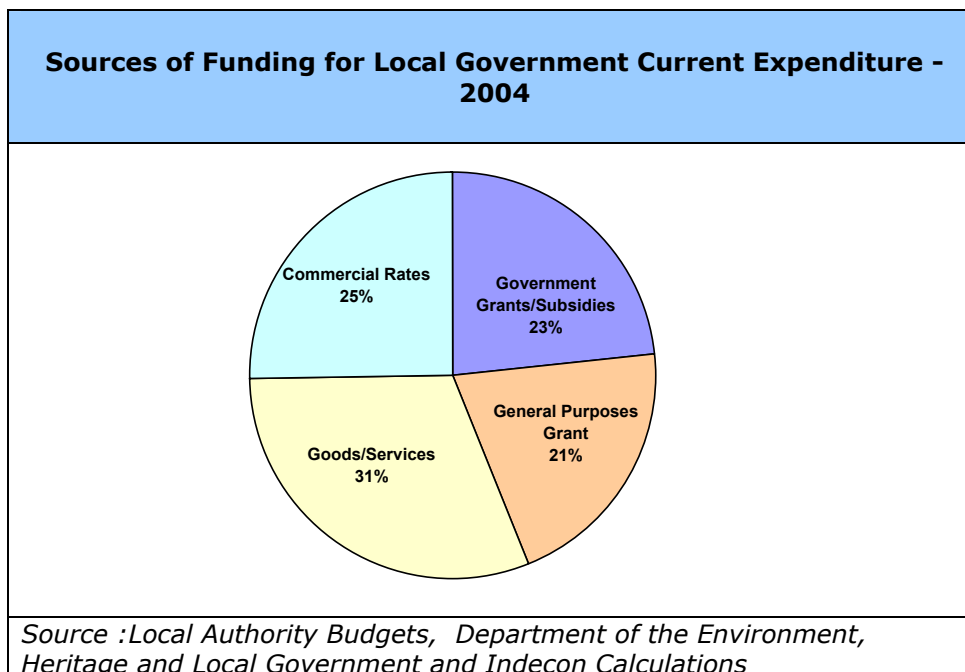
The Importance and Approach to the Financing of Local Government

Local government has a critical impact on the provision of numerous essential services required by individuals and businesses, and on the quality of life of the community. An important economic rationale for the provision of local government services concerns the provision of public goods of a local nature. Given agreement on which government functions are to be allocated to which level of government, a key question for public policy is how to provide adequate sources of finance to enable local government to carry out its functions efficiently and effectively. One approach is to assign revenue generation powers to local government commensurate with expenditure responsibilities. This is called the principle of fiscal equivalence. When locally raised finance is adequate to meet local expenditure responsibilities there is said to be 'vertical fiscal balance'.

An important issue associated with vertical fiscal balance arises where services to local residents are paid for by individuals outside the local authority areas through a transfer from central government resources. Centrally based funding can lead to a misalignment between the costs and benefits for services and lead to inefficiencies. However, a benefit of central transfers is as a means of addressing the problem of horizontal fiscal imbalance between local authorities. Horizontal fiscal balance is concerned with ensuring equity between local authorities having regard to needs and resources. These issues are important in considering how local government should be funded and have fundamental implications for accountability and for ensuring an alignment between the demand for services and the cost of providing these services.

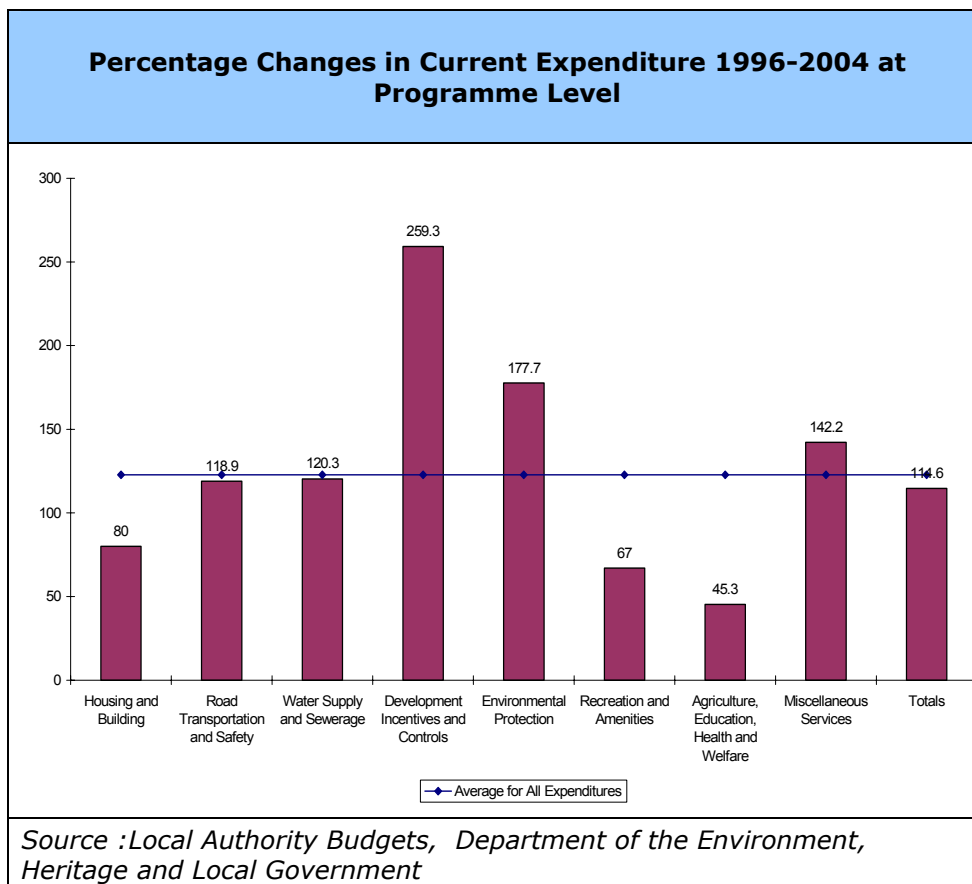
Local Government in Ireland: Structure and Recent Trends

Local government in Ireland is currently characterised by vertical imbalance, with a high degree of centralisation in funding provision. Local government is funded through a combination of commercial rates, charges for goods and services, and transfers from central government. Within transfers from central government there are grants for specific activities and a general transfer from the Local Government Fund. Charging for goods and services in 2004 now accounts for the highest share of funding, at 31%, followed by Government grants/subsidies at 23%. Commercial rates account for 25% while the general purposes grant from the Local Government Fund provides 21%. Importantly, only 56% of funding is locally based. The funding system is characterised as 'vertically imbalanced', with high levels of local expenditures being funded from general taxation.



Local authorities in Ireland undertake a range of important functions. Based on data for 2004¹, and recalling that the focus of this review is on current expenditure, the figures indicate that road transportation and safety constitutes the most significant area, accounting for 27.6% of all expenditures. The next area is environmental protection (19.2% of expenditures), followed by housing and building (14.9%), and water supply and sewerage (12.5%). Total current expenditure increased by 114.6% over the period 1996-2004, with increases evident across all key programmes. This follows a period of significant retrenchment in local authority spending reflecting the difficult public finance position in Ireland in the 1980s. The increases in expenditure over the period 1996-2004 also reflects the demands of a fast growing economy, a rising population and the implications of supporting a large scale national development infrastructure investment plan. Significant areas of expenditure growth included environmental protection (+177.7%), road transportation and safety (+118.9%), and water supply and sewerage (+120.3%). All other main areas have also experienced increases. Local government expenditures as a percentage of GNP, changed fell from 3% in 1996 to 2.6% in 2000, before increasing to 3.1% of GNP in 2004.

¹ Throughout this section we utilise budgeted expenditure data up to 2004. For the analysis of Programme expenditure, this includes expenditures on some services that are actually provided by other local authorities.



The three key drivers of increases in spend have been increases in local authority staff levels, increases in pay rates, and increases in expenditures on services provision. Employment increased by 23.3% over the period 1996-2001 and pay rates increased in nominal terms by 44.7% compared to a 54% increase in pay rates in the manufacturing sector over the period.

We also considered how each of the areas of local government expenditure is funded. It is instructive to note the changes over time in the importance of different funding sources. Over the period 1996 to 2004, growth in transfers from central government has out-paced growth in local authorities' own resources. In 1996, prior to the establishment of the Local Government Fund and the funding from motor tax receipts, government transfers amounted to €674.8 million. In 2004 this was equal to €1,586 million, an increase of 121.1% over the period. In contrast, the increase in revenue raised from goods and charges was 111.9% while for commercial rates the increase was 111% over this period.

Recent Reviews of Local Government Funding

The most recent review of local government financing in Ireland was undertaken in 1996 for the Department of the Environment, Heritage and Local Government. The report noted that Ireland had a “highly centralised system of financing of local government”. The Report examined the system of funding that existed in the mid-1980s, and its efficiency and effectiveness against a number of criteria. Some of the criticisms made in relation to local authority funding included the following:

- ❑ Limited discretion for local authorities;
- ❑ Insufficient revenue buoyancy; and
- ❑ Inequitable funding system.

On the appropriate mix between local and central funding, the 1996 review noted that previous reports suggested that substantial levels of local funding should be available to local authorities. Our analysis has shown that in percentage terms central government expenditure in the period since 1996 has increased as a share of local government expenditure thus further increasing the degree of central funding.

In terms of funding options, the 1996 Report concluded that “the commercial rates base should be extended to include all bed and breakfast accommodations and non-residential agricultural buildings”. It also stated that “there is scope to raise additional revenues from local authority charges”. In addition, it suggested the introduction of a property tax as the most feasible option for raising additional funding.

In 1985, the National Economic and Social Council (NESC) prepared a report entitled “The Financing of Local Authorities”. The report was also critical of the funding system. It noted that:

- ❑ the current system had a local tax base which has no electoral franchise;
- ❑ local authorities levy local charges in a way which is perceived as taxation (i.e. it raises revenues which exceed the actual cost of services provided); and
- ❑ the “bulk” of the revenue is supplied by central government.

The NESC report examined a number of options for changing the funding of local government and concluded that a local property tax would improve local accountability, would be administratively feasible and would widen the national tax base. The report concluded that a local property tax should be supported by a system of grants from central government. This was because an element of the local government activities constitutes national-level services (e.g. national roads). In addition, it was felt that transfers from central government would be required to achieve its equalisation role.

The Commission on Taxation also reviewed local government financing in 1985. It highlighted the importance of classifying the services provided by local authorities as either local or national. It argued that “the case for devolving administration of these services to local authorities is based on considerations of efficiency and of giving people greater access to services, thus allowing easier contact with local representatives and officials”. The Commission defined local services as those which are optional insofar as the “locality has wide discretion over what is done and the manner in which it is done” and where there is scope for local “initiative” and “variety”.

The Commission argued that such local services should be financed primarily from local taxation, and that central government support should be provided to account for local differences in either needs or resources. In terms of key recommendations, the Commission on Taxation stated that “should it be decided that a system of local taxation is desirable, a local property tax should be introduced on all residential, industrial and commercial property (excluding land)”.

Key Points from International Experience

Experience from other countries provides insights to some of the questions of relevance to the debate on local government financing in Ireland. Across the OECD countries, there are varying models of local government. In most countries, local government has responsibility for planning and infrastructure provision. This is similar to the position in Ireland. However, local government in a number of OECD countries also has responsibility for public spending in areas such as education, health and social transfers, which are central government functions in Ireland.

The international review demonstrates that local authorities in Europe vary significantly in size. While Ireland has a large number of local authorities per capita compared to the UK, our position is not unusual in an EU context, and many countries have a greater number of local authorities per capita. In relation to the extent of fiscal discretion or autonomy of local government, most countries rely on a significant amount of transfers from the centre, but not to the extent evidenced in Ireland. Recent evidence also suggests that support for fiscal autonomy is growing as policy makers attempt to improve accountability and incentives for efficiency. Ireland has a more centralised funding system than some other EU countries and that local sources of funding account for a relatively low share of local government revenue. The detailed review of countries undertaken in this review also highlighted the link between local accountability and the ability of local authorities to generate funding.

Projections of Future Expenditures and Revenues

As part of this review, we have estimated the future funding requirements of local authorities in the period to 2010. This has taken account of existing and emerging demands, but we accept that any estimates of future requirements will, in part, reflect the preferences of local communities and, in part, the willingness of local or national taxpayers to fund different levels of services. This inevitably cannot be captured within revenue and expenditure projections. This calls for a multi-faceted approach, which sets out a number of scenarios based on a realistic assessment of policy developments, and exogenous demand and cost factors. To this end, we examined existing projections, various econometric approaches, and approaches based on trends in demand and cost factors. These approaches produced a number of different scenarios, all of which indicate that the current expenditure requirements of local authorities are likely to increase further in the period 2010. A summary of estimated expenditure requirements and projections for revenue is presented in the table overleaf, which assumes local authority expenditures increase in line with GNP. Depending on the assumptions used, a range of scenarios as to the gap between projected income and expenditure arise and, depending on expenditure assumptions, these range from €415m to €1,500m. The estimated funding gap is also based on our assumptions for developments in existing revenue sources some of which (such as commercial rates) we believe will not grow as fast as in recent years. Some local authorities consulted believe that expenditures significantly in excess of GNP growth will be needed while other estimates show somewhat lower levels of spend.

| Status Quo Projected Expenditure and Revenue €m² | | | |
|--|-------------|-------------|-------------|
| | 2004 | 2006 | 2010 |
| Expenditure | 3,616 | 4,260.0 | 5,846.0 |
| | | | |
| Commercial Rates | 907.6 | 966.9 | 1,097.5 |

² A detailed discussion of the assumptions underpinning these projections is set out in chapter 7.

| | | | |
|--|----------|--------------|----------------|
| Local Government Fund (General Purpose Grants) | 747 | 796 | 903 |
| Central Government Grants/Charges ³ | 1,963.7 | 2,080.80 | 2,331.57 |
| Funding Gap | - | 416.3 | 1,513.9 |
| <i>Source: Department of the Environment, Heritage and Local Government, Local Authorities Budget 200 4 and Indecon analysis</i> | | | |

In all cases, significant increases in nominal expenditure requirements are projected. Even assuming continuing growth in charges and increases in commercial rates, motor taxation, and increases in government subsidies in line with inflation, the figures suggest a growing funding gap. These estimates are in nominal terms and the funding gap will need to be addressed by a combination of efficiencies, increases in charges, commercial rates, or motor taxation, new sources of local revenues or increases in exchequer funds, or a reduction in services.

RECOMMENDATIONS

A key contextual issue in terms of drafting recommendations is the European Charter of Local Self-government. This “recognises the vital contribution of local self-government to democracy, democratic stability, effective administration close to the citizens, the decentralisation of power aimed at rationalizing the decision making process and to giving citizens the opportunity to participate in public life”. It sees local authorities as key agents in a “democratic society as democratically constituted bodies enjoying and exercising wide ranging responsibilities and able to regulate and manage a substantial share of public affairs under their own responsibility and, which is of the utmost importance, doing so in the interest of the local population”. The Charter provides for a number of principles which must be respected by the Member States.

³ This income of €1,963.7 million is made up of €1,125.3 million in charges for goods and services and €838.4 million in specific government grants. There is also a small gap between expenditure at €3,616 million at 2004 and revenues at €3,618.3 million reflecting balances.

In framing our recommendations we also take account of the borrowing constraints imposed on members of Economic and Monetary Union by the terms of the Stability and Growth Pact. Ireland has been within the General Government Balance and General Government Debt limits set out in the Pact in recent years. We recognise the potential impact that local government can have on these criteria and support the need for appropriate expenditure borrowing control as part of control of the entire general government sector within the context of the Stability and Growth Pact. This should have regard to the requirement on local government to provide necessary infrastructure and services to the economy.

Based on our detailed analysis, we have developed a number of key recommendations covering both funding and expenditure aspects. Over time our recommendations have the potential to raise much needed finance for local government and we believe also lead to cost savings that can be used for further service improvements. This will assist local authorities to meet on-going expenditure needs.

We recognise that a planned timescale will be needed to implement a number of our recommendations. For example, reforms in the area of service delivery may require the re-location of staff involving local negotiation within the context of social partnership. Recommendations in respect of charging raise issues around acceptability and phasing that need to be addressed. In addition, we recognise that the local government system will require additional funding in the short-term to deal with non-discretionary expenditure increases as outlined in chapters 6 and 7. This points to the need for on-going Exchequer funding and, where feasible, increases in locally based funding within the context of the existing system.

SECTION A – (Compulsory)

1

• **Requirement for question 1**

Local Government in Ireland has normally struggled to find alternative sources of revenue.

- (a) (i) What are the principal sources of revenue for local authorities in Ireland? 4
- (ii) Under Better Local Government, what reforms have taken place in terms of the sources of local government revenue and the accounting procedures that have taken place in local authorities? 4
- (iii) What are the consequences of there not being a system of local taxation on domestic properties in Ireland? 4

Most of the functions of Irish local government are statutorily provided for under the 2001 Local Government Act, which consolidated all previous local government legislation.

- (b) (i) What are the principal functions of local authorities in Ireland by programme group? 3
- (ii) What are the roles of City/County Development Boards and their relationship to local authorities? 2
- (iii) What role do local authorities now play in 'Community and enterprise'? 3

The National Development Plan involves an investment of over €52 billion in a range of infrastructural developments.

- (c) (i) Explain with examples the role of local authorities with respect to the National Development Plan 2000-6. 4
- (ii) Explain the role of the BMW and S&E Regional Assemblies. 4
- (d) The above report on local authority finance from Indecon argues that the relationship between central and local government in Ireland is one of 'vertical imbalance'.
 - (i) Discuss the reasons why such an imbalance has come into being. 11
 - (ii) Explain why Irish governments have traditionally been reluctant to accede to requests to devolve power to local authorities. 11

(50)

SECTION B – (Compulsory)

2

Sinéad recently joined the Corporate Services Team of Oldtown Town Council as an accountant. She has been asked, along with two other new and relatively junior finance recruits, to investigate the Council's difficulty in attracting and retaining high-quality finance staff.

The core objective of the three-person team is to recommend an improved remuneration package that should help to overcome the recruitment and retention problem. Each member of the team has been assured that their own remuneration package will be adjusted to bring it into line with any new package that is recommended by the team and then agreed by the Council.

The team, after undertaking detailed research and consultation, concludes that the Council's existing remuneration package will need to be significantly enhanced and brought more closely into line with private sector schemes, if the recruitment and retention problem is to be resolved.

Sinéad and the two other new finance recruits are therefore faced with the dilemma of proposing a remuneration package that would provide significant improvements to recipients generally and to them personally.

• **Requirement for question 2**

- (a) Outline CIPFA's six fundamental ethical principles, indicating which of them are relevant to the situation being faced by Sinéad and the two other members of the team. 9
- (b) Explain the course of action you feel that Sinéad and the two other members of the team should take in this situation. 7
- (c) Demonstrate how your recommended course of action for Sinéad and the two other members of the team fits with the relevant fundamental ethical principles that you identified in 2 (a) above. 4

(20)

SECTION C – (Answer two questions from this section)

3

The emergence of multiple agencies performing public service tasks has been a defining feature of modern Irish government. However, this process of agencification can cause problems in respect of traditional accountability relationships.

• **Requirement for question 3**

- (a) What are the main functions performed by agencies? 3
- (b) What is the role of the Board in a State agency? 6
- (c) Identify and discuss the methods by which agencies are held accountable to their parent Departments. 6

(15)

4

Pressure groups are important institutions in modern democratic societies. On the one hand they help to give people a sense of belonging and social involvement and allow them to co-operate to achieve collective goals. On the other hand, they are also one of the most important ways that citizens can express their democratic right to be heard and influence government.

- **Requirement for question 4**

- (a) What are the principal differences between political parties and pressure groups? How can we best understand the different categories of interest groups in Ireland? 6
- (b) What is social partnership? Using examples, identify how social partnership changed the manner in which pressure groups in Ireland pursue their goals. 9

(15)

5

Since the early 1990's, there has been an increased emphasis on the accountability of the political and administrative spheres in Ireland to the public. In response, several new bodies have been established alongside existing bodies to oversee activities within these spheres.

- **Requirement for question 5**

- (a) What are the functions of the Freedom of Information Commissioner and the Comptroller and Auditor-General? 8
- (b) What is the role of the Standards in Public Office Commission? Identify in your answer some of the difficulties it has experienced to date in fulfilling its remit. 7

(15)
