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Local government funding in Ireland: Contemporary issues and future challenges

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Abstract

The years since the 2008 financial crisis and subsequent economic crash have witnessed significant changes to the funding of the local government system in Ireland. This paper outlines these developments, while, at the same time, exploring some of the most important future challenges relating to the financing of Irish local authorities. The dominant local government revenue issues of the last decade outlined here are fiscal autonomy and the balance between own-source income and central government grants, income differences between urban and rural councils, the Local Property Tax, changes in commercial rates and fiscal equalisation. In terms of fiscal dependency and equalisation, our findings show reductions in the vertical and horizontal fiscal imbalances in the Irish local government system. Likely future challenges include the need to re-examine the balance between business taxes and non-business taxes, funding the expected growth in metropolitan areas and the financing options for capital investment by local authorities, including consideration of municipal bond issuance for the Greater Dublin Area.

Keywords: Local taxation, intergovernmental grants, fiscal imbalances, fiscal equalisation, municipal bonds

Introduction

The years since the 2008 financial crisis have seen many changes in the public sector in Ireland, and most especially the public finances of the Irish state. Whereas much of the attention has been at the national level – not surprising given the relative importance of central government over local government in Ireland – far less focus has been on developments at the subnational level. Although a number of recent papers have been written on specific aspects of local government financial performance and the local public finances (see Considine & Reidy, 2015; Robbins et al., 2014; Turley & McNena, 2016), we are not aware of any published research that covers a compilation of related issues pertaining to developments in local government funding since the 2008 financial crisis. This paper addresses this gap in the literature by examining a set of related local government funding issues, both over the last decade but also topics that are likely to feature over the next ten years or so. More specifically, in terms of the vertical and horizontal fiscal imbalances in the Irish local government system, by analysing revenue shares and fiscal capacities we are able to measure the change in fiscal autonomy and the disparity-reducing effects of the fiscal equalisation transfers on Ireland's local authorities.

The paper has three main sections. The first section reviews the theory of local government funding and outlines the different sources of local government revenue income. The second section identifies the main changes and policy issues in local government funding during the ten years after the 2008 financial crisis. These are fiscal autonomy and own-source revenues versus central government grants, the rural/urban council divide with respect to sources of income, the Local Property Tax (LPT) and commercial rates, and fiscal equalisation. The third section identifies issues that are likely to dominate the topic of municipal finance over the next decade or so, including the balance between business and non-business taxes, the growth of metropolitan areas and their funding, and options to finance public investment, including access to capital markets and issuance of municipal bonds, as is common in some other jurisdictions. The paper ends with some conclusions and related policy recommendations.

Funding local government: Theory and practice

Much of this section is taken from Turley & McNena (2018) but modified to reflect the focus on Ireland, and recent developments thereof.

A society that uses its scare resources to successfully maximise total welfare must have a mix of expenditures on privately and publicly provided goods and services (Samuelson, 1954). With respect to private goods and services, the competitive market system and its pricing mechanism allocate society's scarce resources. In cases of market failure such as public goods, externalities or asymmetric information, outcomes can be improved by government intervention. Once it is decided that provision is by the public sector, the next question that arises is the appropriate level of government, whether that is central, regional or local. Unlike political scientists, who emphasise the political or democratic role of local government, economists focus on the economic perspective, namely in achieving efficiency through local public service delivery. Using the traditional three-pillars of government framework, the main economic functions of government are the allocative, distributive and stabilisation roles (Musgrave, 1959). Whereas it is argued that the income redistribution and macroeconomic stabilisation functions are best undertaken by central government, the resource allocation role should primarily be provided by subnational government, and, in cases where the benefits are localised, by local government.

Viewed through the lens of an economist, the argument in favour of local government over national government provision of uniform services is that, given the spatial considerations, local government facilitates, to the extent possible, the matching of public service outputs with local preferences and, in doing so, promotes economic efficiency. Applying the benefit taxation model, it is desirable that those who benefit from local government expenditure should pay for it and, by doing so, maintain the link between taxes paid and benefits rendered. Where benefits do not extend beyond local boundaries, allocative efficiency can be best achieved by providing public services at the lowest level of government possible, i.e. local government units. The welfare gains that accrue by moving government closer to its constituents and ensuring that citizens get what they want are the allocative efficiency case for local government and dominate the economic debate in favour of decentralised government (OECD, 2013).

Due to different preferences for the level and mix of local services and different costs in local public service delivery, there are welfare gains from fiscal decentralisation. Formalised by Oates (1972), this fiscal decentralisation theorem presents the economic case for local government. Alongside Oates's theory is the equally famous Tiebout

(1956) model of local government. According to this theoretical model of choice, if citizens are faced with areas of different type and level of public services, citizens will choose the local area that best reflects their preferences, by 'voting with their feet'. In this case, based on assumptions of perfect residential mobility, absence of spillovers and identical preferences within each area, a political solution is not required as the market is said to be efficient.

Notwithstanding the economies-of-scale argument in favour of a more centralised government, functions should be assigned to the level of government whose jurisdiction most closely approximates the geographical area of benefits provided by the function. This indicates that, for example, national defence, foreign affairs, migration and monetary policy should be provided by central government as the benefits and costs are national in scope. In contrast, fire protection, parks and recreation, planning and zoning, and street maintenance, for example, should be provided, applying the benefits rule, by local government as these are primarily local affairs.

In theory and in practice, spending is much easier to decentralise than revenue. With the limited tax base that local governments have, the inevitable outcome of expenditure and revenue assignments is that local government spending exceeds local government own revenues, resulting in vertical fiscal imbalances. In turn, given differences in expenditure needs and fiscal capacities of local governments, assigning local government taxes and revenues will result in horizontal fiscal imbalances. Both of these fiscal imbalances mean that inter-governmental grants to local governments form an important source of revenue income, to close the fiscal gap but also to narrow the fiscal disparities between local governments using equalisation transfers (Boadway & Shah, 2007).

Whereas the rationale for which government functions are decentralised to local government is clear, at least in theory, the case for which revenue sources are decentralised is much less straightforward. In terms of local government finance and revenue assignments, for local governments to be accountable to their local residents, and to ensure that local households and firms pay for the services received, at least at the margin, there are three conditions that need to be met. First, as far as possible, local government should charge for the services provided, through user charges or fees. Second, if charging is not practical, local governments should impose taxes on local residents, except to the extent that central government is willing to pay. Third, where central government does pay, local governments

should be, as much as possible, accountable to central government (Bird, 2001). When this involves the payment of intergovernmental grants or transfers, they should be designed so that local government recipients are subject to a hard budget constraint with no gap-filling or expectation of a bailout. As with user charges, the objective, subject to political and economic constraints, is to 'get the prices right' in the public sector by designing intergovernmental grants in such a way that local governments are fiscally responsible, disciplined and prudent.

A more detailed classification of revenue sources is outlined in Table 1. Revenues can be classified as current or capital, and own-source (that is, those generated directly by local authorities) or from upper tiers of government. Shared taxes are typically classified as grants as the revenue is not considered a local tax revenue.

Table 1: Local government revenue classifications

Categories	*Current revenues*	*Capital revenues*
Own-source revenues	User charges Local taxes Other	Asset sales Betterment levies Other
Revenues from higher-level governments	Shared taxes Grants	Capital grants

Source: Adapted from Freire & Garzón (2014).

As our focus in the next section of the paper is on revenue budgets, and more specifically on current or operating revenues defined as income to finance recurrent expenditures, we restrict our discussion here to user charges, local taxes and grants (the latter of which are largely of an intergovernmental nature). We now turn to the main funding changes that have taken place in the Irish local government system since the 2008 financial crisis.

A decade of local government funding changes in Ireland

As in most other countries the present local public finance system in Ireland is a product of history, politics and chance, and not necessarily shaped by sound, normative economic principles or designed based on a rational local government funding system. Like elsewhere, the sources of local government revenues are local taxes, user charges, intergovernmental grants and other minor forms of revenue. We begin

with the balance between these different sources of income and, in particular, the split between own-source funding and central government funding at the aggregate level for Ireland's thirty-one local authorities. Among other uses, this breakdown between own-source and central government funding can be employed to derive a simple measure of fiscal autonomy (and, in turn, vertical fiscal imbalances) or, expressed in an alternative way, the fiscal dependency of local governments.

Analysis of revenue shares

Table 2 shows the composition of local government revenues by means of the shares of income by source for the Irish local government system for the years 2006–16. The outturn or actual data are for revenue income only, and are taken from the local authority annual financial statements (AFS). The period under review covers pre-crisis years, the 2008 financial crisis and the subsequent period of economic and fiscal disruption, the austerity era and the initial years of recovery. The sources of income are classified as own-source, central government grants and others (with the latter not reported in Table 2 as amounts are small). Own-source income is categorised into charges and taxes, with taxes further classified into commercial rates and the LPT. Grants are divided into specific purpose and general purpose grants, both from central government. Aside from reporting annual data for selected years, we also report the ten-year change and the change from peak to trough.

From the peak in 2008 to the trough in 2015 total revenue income fell by just over 20 per cent in nominal terms, whereas over the decade 2006–16 there was a much smaller reduction in revenue income, in the order of 3 per cent. With revenues in 2015 one-fifth less than in 2008 the other significant and related finding is the reduction in government grants in the order of 40 per cent since 2006, reflecting the austere policy decisions of central government in response to the economic and fiscal crisis. This reduction in local government revenue was offset by increases in local taxes, with tax revenue increases of almost 50 per cent in the ten-year period, due in part to an increase in commercial rates but also to the introduction of the LPT. Whereas the own-source/grants ratio was 55/45 in 2006, by 2016 the own-source share had increased to 70 per cent whereas the grants share had fallen to 27 per cent, indicating a reduction in the vertical fiscal imbalances with a local government system that had become less dependent on

Table 2: Sources of local government funding, 2006–16

Source of revenue income	*Year*						*Change in shares, in ten-year period*	*Change in shares, from peak to trough*
	2006	*2008*	*2010*	*2012*	*2014*	*2016*	*2006–16*	*2008–15*
Own-source income	0.55	0.54	0.53	0.61	0.68	0.70	0.15	0.20
of which								
Charges	0.29	0.28	0.25	0.30	0.31	0.29	0.00	0.02
Taxes	0.27	0.26	0.28	0.30	0.36	0.41	0.15	0.18
of which								
Rates	0.27	0.26	0.28	0.30	0.36	0.34	0.07	0.11
LPT						0.07	0.07	0.08
Central government grants	0.45	0.42	0.41	0.34	0.30	0.27	–0.17	–0.19
of which								
Specific purpose grants	0.25	0.23	0.24	0.19	0.21	0.26	0.01	–0.01
General purpose grants	0.20	0.19	0.17	0.15	0.09	0.01	–0.18	–0.18

Source: AFS, authors' calculations.

central government funding and more reliant on own-source revenues.[1] As these aggregate figures obscure variations in local government funding, and particularly with respect to cross-council differences in fiscal autonomy and dependency, Table 4 shows the shares at a disaggregated level, by local authority.

These and other related revenue changes have had both positive and negative elements. Our summary of these is given in Table 3.

[1] This change in the balance between own-source and central government income in favour of more locally generated revenues is in line with the *Commission on Taxation Report 2009,* which concluded that, as a result of the commission's recommendations, the balance will change 'to a position where, by the end of the five-year period, local authorities would source well over 75% of their income from their own generated sources' (Commission on Taxation, 2009).

Table 3: Pros and cons of the 2006–16 changes in local government funding

Pros	*Cons*
Less dependency on grants and more reliance on local taxes reflects a greater degree of local accountability and fiscal autonomy for local authorities.	A less transparent Local Government Fund (LGF) with Exchequer and Irish Water flows in and out of the LGF, including an unnecessarily complicated system of LPT payments. A simpler set of LGF accounts was presented for 2018.[1]
With a larger share of revenue in the form of user charges and local taxes, it is closer to the 'get the prices right' principle.	Postponement of residential property revaluations, making future revaluations politically more difficult.
A broadening of the tax base by the introduction of a property tax (the LPT), with local rate-setting powers (vis-à-vis the 'local adjustment factor').	Revenue from LPT is very small, at about 1 per cent of total government tax revenue (or, when expressed as a percentage of local government revenue, about 7–8 per cent).
Designated and identifiable equalisation transfers.	The equalisation fund is small, and its model of distribution does not follow international best practice, i.e. formula based and transparent.
Commercial rates revaluations, reflecting more current valuations.	Burden on the business sector remains high, and growing, with the rates share of revenue income increasing from 0.27 in 2006 to 0.34 in 2016.

[1] The LGF is a department-managed fund financed by motor tax (up to 2017), LPT receipts and an Exchequer contribution, and is used to pay for certain local government services. In the years 2015–17 large payments were made out of the LGF to Irish Water and the central Exchequer. Since 2018 motor tax receipts are paid to the Exchequer while LPT receipts are paid directly to the LGF.

We now turn to a more disaggregated analysis, by looking at the sources of income for all thirty-one local authorities. Table 4 reports the cross-council variation in revenue income shares for 2017 using the consolidated *Local Authority Budgets* publication (Department of

Table 4: Revenue shares by local authority, 2017

	Own-source income			*Central government grants*	
	Charges	*Taxes*			
		Rates	*LPT*	*Specific purpose grants*	*Equalisation grants*
Carlow County Co	0.34	0.29	0.06	0.24	0.06
Cavan County Co	0.24	0.23	0.06	0.37	0.10
Clare County Co	0.30	0.40	0.06	0.25	
Cork City Co	0.38	0.43	0.06	0.10	0.02
Cork County Co	0.28	0.42	0.05	0.24	
Donegal County Co	0.38	0.23	0.06	0.21	0.12
Dublin City Co	0.35	0.37	0.03	0.23	
DLR County Co	0.28	0.47	0.06	0.18	
Fingal County Co	0.25	0.54	0.03	0.18	
Galway City Co	0.30	0.49	0.06	0.16	
Galway County Co	0.30	0.25	0.12	0.31	0.03
Kerry County Co	0.34	0.32	0.09	0.23	0.02
Kildare County Co	0.27	0.40	0.11	0.22	
Kilkenny County Co	0.30	0.27	0.08	0.27	0.07
Laois County Co	0.32	0.21	0.07	0.32	0.08
Leitrim County Co	0.26	0.16	0.05	0.31	0.22
Limerick City & County Co	0.26	0.15	0.04	0.53	0.01
Longford County Co	0.33	0.20	0.04	0.24	0.18
Louth County Co	0.32	0.33	0.08	0.25	0.02
Mayo County Co	0.28	0.24	0.07	0.31	0.09
Meath County Co	0.32	0.32	0.13	0.22	
Monaghan County Co	0.22	0.23	0.06	0.34	0.15
Offaly County Co	0.28	0.31	0.07	0.27	0.07
Roscommon County Co	0.29	0.22	0.06	0.30	0.13
Sligo County Co	0.22	0.21	0.07	0.41	0.11
South Dublin County Co	0.22	0.51	0.02	0.24	
Tipperary County Co	0.32	0.22	0.07	0.27	0.12
Waterford City & County Co	0.31	0.24	0.06	0.29	0.10
Westmeath County Co	0.31	0.23	0.07	0.30	0.09
Wexford County Co	0.31	0.33	0.10	0.22	0.04
Wicklow County Co	0.35	0.29	0.13	0.24	

Source: Department of Housing, Planning and Local Government (2017), authors' calculations.

Housing, Planning and Local Government, 2017). We use budgeted accounts in preference to outturn data because the former is more up-to-date and reports data at a more disaggregated level, i.e. individual local authority.

In order to best highlight differences across councils, we report by own-source income and by central government grants. As before, the own-source share is categorised by charges and local taxes, with taxes classified as commercial rates and the LPT. The grants are classified as specific purpose and equalisation grants, as the general purpose grants were replaced in 2015 by the LPT. This allows us to calculate the dependency ratio, defined as the ratio of central government grants to local tax revenue.

The table shows the considerable cross-council variation that exists in Ireland and, in particular, the difference between the rural, less populated local councils, where economic and business activity is lower, as against the more urban, densely populated local councils with a larger level of economic activity and thus a much bigger revenue and tax base. The range of own-source revenue shares is large, with, for example, the own-source income share close to only 0.5 for Leitrim, Sligo and Monaghan County Councils. In contrast, Cork City and Galway City Councils, and Dùn Laoghaire–Rathdown and Fingal County Councils all have an own-source income share in excess of 0.8 (or, expressed in terms of grants dependency, a grants share of less than 0.2). Not surprisingly, small rural councils are heavily dependent on grants as opposed to bigger urban councils that can rely on income from user charges, commercial rates and the locally retained LPT. As an example, the comparison between Leitrim County Council and Galway City Council is striking. The biggest difference between these councils is the relative size of the local tax and central government grants shares of revenue income. As with many other small rural local authorities, Leitrim County Council depends on the central government for about 50 per cent of its revenue income, in the form of government grants. In contrast, with Galway City Council as an example, many of the more urban local authorities with sizeable levels of business activity and high property prices raise about half or more of their revenue income from local taxes, from the business sector in the form of commercial rates but also from owners of residential properties with the LPT.

These differences are best captured by the dependency ratio. The dependency ratio for the local authorities in Ireland in 2017 ranged from a low of 0.3–0.6 in Cork City and Galway City Councils and the

four Dublin councils to dependency ratios four times greater, that is, to highs of 1.5–2.5, in Cavan, Roscommon, Monaghan, Longford, Sligo and Leitrim County Councils. Over time, the dependency ratios have fallen as the years of austerity witnessed reductions in central government grants to local authorities and the introduction of the new LPT. Overall, as found elsewhere in the literature, this indicates that the local government system in Ireland is now less dependent on central government funding (Considine & Reidy, 2015; Turley & McNena, 2016). While this is a positive trend, the fundamental feature of the Irish local government system remains, i.e. very limited expenditure functions, with the central government responsible for the majority of day-to-day public spending. Indeed, as shown in Turley et al. (2018), with educational support services and water services recently reassigned from local government, local authorities in Ireland have even less expenditure responsibilities now. This explains why the amount of total government tax revenue and overall current revenue that goes to local government in Ireland is very small, at about 3 and 8 per cent, respectively. This compares to averages for EU countries of about 15 and 24 per cent, respectively (OECD, 2018).

We now examine the funding of local government in Ireland vis-à-vis funding of local governments elsewhere in the EU, by reporting the different income shares. Using the IMF Government Finance Statistics data, Table 5 reports income shares for all 28 EU countries for the year 2017.[2] We report the tax and social security contributions (SSC) share (and, of that total, tax on property), government grants share, charges share and other revenues share, where other revenues include property income, fines and penalties, transfers not elsewhere classified, etc.

Table 5: Revenue shares in EU-28 countries, 2017

	Tax and SSC – share of revenue	*of which, tax on property*	*Government grants – share of revenue*	*Charges – share of revenue*	*Other revenues – share of revenue*
Austria	17	*14*	64	16	3
Belgium	36	*49*	46	13	5
Bulgaria	12	*64*	54	15	19
Croatia	38	*17*	46	11	6
Cyprus	25	*52*	36	35	4
Czech Republic	48	*4*	35	14	3

[2] See https://www.imf.org/en/Data

Table 5: Revenue shares in EU-28 countries, 2017 (Contd.)

	Tax and SSC – share of revenue	*of which, tax on property*	*Government grants – share of revenue*	*Charges – share of revenue*	*Other revenues – share of revenue*
Denmark	36	*11*	58	5	1
Estonia	4	*73*	84	10	2
Finland	47	*8*	29	21	2
France	55	*58*	21	16	8
Germany	42	*12*	36	16	6
Greece	30	*93*	54	11	4
Hungary	40	*19*	45	13	2
Ireland[1]	26	*85*	34	31	9
Italy	45	*18*	41	10	4
Latvia	64	*14*	28	7	1
Lithuania	5	*86*	86	6	3
Luxembourg	34	*4*	45	20	1
Malta	0	*n.a.*	83	8	9
Netherlands	12	*41*	71	13	3
Poland	33	*28*	53	8	6
Portugal	49	*27*	23	16	12
Romania	10	*66*	78	5	6
Slovak Republic	8	*77*	71	18	3
Slovenia	44	*15*	35	18	2
Spain	53	*44*	34	10	3
Sweden	56	*3*	32	9	3
United Kingdom	20	*92*	63	15	2

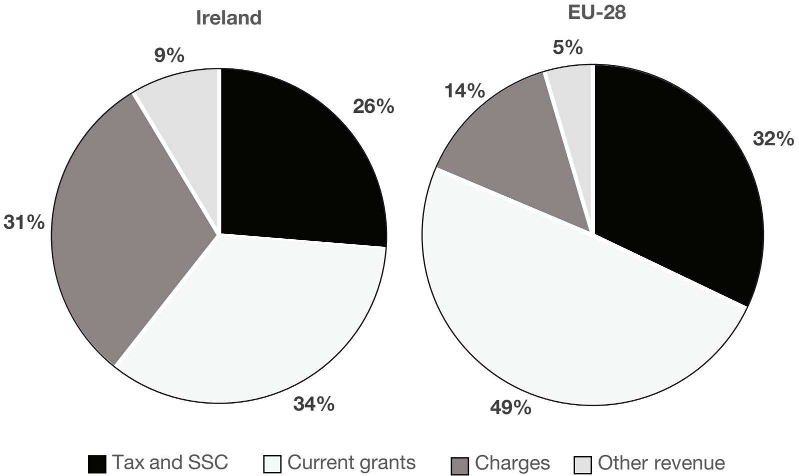
Source: IMF Government Finance Statistics, authors' calculations.

[1] The figures for Ireland are different to those in Table 2 as different definitions are used for the various revenue sources.

As expected, there is considerable cross-country variation in the local government revenue shares across the EU. This may be due to a number of factors, including the size of local government and the extent of expenditure functions, but also some country-specific conditions. Figure 1 shows the revenue shares' averages across the EU countries, and a comparison with Ireland's.

Relative to local governments in other EU countries, Ireland's local authorities rely less on central government grants and more on user fees and charges, even after the loss of income from waste charges due to privatisation. In terms of the grants/charges split, whereas it is a 3.5:1 ratio for the average of EU countries, in Ireland this ratio is

Figure 1: Revenue shares, Ireland versus EU-28 average



closer to 1:1. As alluded to earlier, one reason for the proportionately low grants share of local government revenues in Ireland is the relatively few functions for which local government in Ireland is responsible, and thus the less need for funding and especially grants from central government. Ireland's relatively heavy reliance on user charges and fees reflects the more market-based, liberal-state Anglo–Saxon type of local government system that Ireland inherited from Britain, as distinct from other administrative traditions of local government where taxes and/or intergovernmental grants are more prevalent (Schwab et al., 2017).

Local taxation

We now consider changes that have taken place in local taxation during the period under review. Since the abolition of domestic rates in 1978, commercial rates have been a very important source of revenue income for local authorities.[3] During the period 2006–16, commercial rates accounted for just over 30 per cent of operating revenues. For large urban councils, the share was closer to 50 per cent. The business sector, and particularly SMEs, often argue that the local

[3] More correctly, the transfer of the liability for paying domestic rates from the occupier to central government, via the domestic rates grant. In addition, rates on agricultural properties were abolished in 1983.

tax burden on businesses in towns and cities nationwide is very high, and disproportionate to the local council services from which they benefit, or to the burden on owners of non-business properties and land or other sources of local revenue. There have been recommendations to change the tax base from commercial and industrial properties and estimated rental values to some other tax base, such as turnover, profits or income. The consistent and valid argument used against any of these alternatives is the volatility of these bases, and the need for local government to rely on a stable tax base whose yield is insensitive to cyclical fluctuations in economic activity.

The changes that have taken place in relation to commercial rates are the recent and long overdue revaluations in many of the local authorities, combined with the rates harmonisation that arose out of the recent abolition of town and borough councils. More specifically, section 29 of the Local Government Reform Act, 2014, provided for the harmonisation of commercial rates between former town government rating authorities and the newly restructured counties forming the new rating authorities. In order to ease the transition for ratepayers to a standardised rate, while avoiding a negative impact on overall local authority revenue, the harmonisation of rates was to take place over a maximum period of ten years (Government of Ireland, 2014). Progress has been made with respect to both revaluations and rates harmonisation, with fifteen local authorities undertaking a rates revaluation by 2018 while a majority of local councils have already completed harmonisation of rates within their local authority area, with only eight county councils yet to fully finish their rates harmonisation.

In relation to the LPT, a property tax assigned to local government, it is a recurring tax on owners of residential properties where the tax is based on periodic and self-assessed property values. Compliance rates are high, at an average of over 98 per cent nationwide for the estimated 1.92 million properties, with the national tax collection agency, the Office of the Revenue Commissioners, having responsibility for its administration and collection (Revenue, 2019).[4] However, there are a number of issues with the LPT.

For one, it is not an additional source of local revenue, as was initially believed. It replaced the central government general purpose grant which was abolished in 2014/5. Two, it does not raise a large

[4] For an interesting account of the evolution of the LPT, and especially the policymaking process, see O'Leary (2018).

amount of revenue for local authorities, with both the rate and the yield modest by international standards. The total estimated LPT yield is less than €500 million, or about 1 per cent of total government tax revenue. Three, it is based on May 2013 property valuations, and the subsequent revaluation due in late 2016 (and, more recently, November 2019) was abandoned with property valuations frozen at the 2013 levels. Politically, given the increase in property prices nationwide, it will be difficult for any future national government to revalue, as it will lead to higher LPT liabilities and opposition from taxpayers and other vested interests, both locally and nationally. Four, any tax should have as few exemptions as possible, or else the tax, and especially a new tax, can be quickly undermined. Unfortunately, the number of exemptions from the LPT is not insignificant. Five, although local councils have the discretion to vary the tax rate, the experience in the first few years (to 2019) was disappointing, with a majority of local councils deciding not to exercise their taxing powers, and for those councils that have, the change in the majority of cases has been a reduction in the rate, despite the demands for more and better local public services, most especially in the area of social housing. In the four-year period 2015–18, a sum of €130 million was lost to the local authorities arising from the changes in the LPT rate. Of this total, almost €120 million was lost to the four Dublin local authorities, who cut their LPT rate by the full 15 per cent in all except one instance. While it meant that local taxpayers, or more specifically owners of residential properties, faced a reduced tax liability, it also meant that local councils had less income to spend on essential services.

Fiscal equalisation

Related to the issue of the LPT is the horizontal fiscal imbalances that exist between local authorities in Ireland and the use of equalisation transfers to reduce the fiscal disparities between the more urban and bigger councils, where business activity is most prevalent, and the smaller rural councils with weak economic bases. On the introduction of the LPT, the national government decided that 80 per cent of the tax would be retained in the locality in which it was collected, with the remaining 20 per cent pooled into an equalisation fund and thereafter distributed to qualifying councils. Rather than funding directly from central government (a form of vertical equalisation), this is a type of horizontal equalisation where funding comes from the local authorities with relatively strong revenue bases.

While the first of the two basic questions relating to fiscal equalisation and grant design, namely the size of the distributional pool, is addressed above, the second question, namely the allocation of the pool, is less than satisfactory. International best practice recommends that transfers should be transparent, adequate, stable and predictable, that they should not be negotiable or discretionary, and that they should not be for the purposes of deficit-filling, due to the problems associated with the soft budget constraint. Specifically in terms of equalisation grants, they should be formula based, using quantifiable and objective indicators that measure either expenditure needs or fiscal capacity, or both. The formula should be incentive compatible, encouraging local revenue-raising effort and local expenditure restraint. In the Irish case, currently the allocation of equalisation grants is based on that of the general purpose grants which they replaced (more specifically, the allocation was based on a decision taken by the central government that no local authority would receive less income from the LPT in 2015 than the allocated general purpose grant in 2014).

With respect to the horizontal fiscal imbalances, some local authorities, by the nature of their socio-economic profile and demographic characteristics, have greater expenditure needs or less revenue capacities, or both. As with other systems of intergovernmental fiscal relations, Ireland has an equalisation fund or pool (comprised of 20 per cent of the LPT receipts), out of which equalisation transfers are allocated in order to reduce local government fiscal inequalities. We set out in Table 6 to measure the degree of equalisation in the Irish system, by reporting pre and post LPT and equalisation amounts (OECD, 2013).

As in Turley et al. (2015), we begin by calculating the estimated revenue-raising or fiscal capacity of local councils. Fiscal capacity is defined as the potential revenue that local authorities can raise, assuming that national average tax rates are applied to the local authority tax bases. The main tax base for local councils in Ireland is commercial and industrial properties, or the Net Effective Valuation (NEV). When the individual council NEVs are multiplied by the average Annual Rate on Valuation (ARV), we get the fiscal capacity for each local authority. To get the fiscal capacities per capita, as reported in column 2 of Table 6, we simply divide these fiscal capacity amounts by the respective local authority population. Pre-equalisation, the range of this fiscal capacity per capita measure before the estimated LPT yield is a high of €544 to a low of €148, or,

Table 6: Pre and post fiscal equalisation, 2016/17

	Fiscal capacity per capita before estimated LPT yield (€)	*(ii) Fiscal capacity per capita after 80% LPT locally retained (€)*	*(iv) Fiscal capacity per capita after final LPT amount (€)*
Carlow County Co	246	301	354
Cavan County Co	204	250	328
Clare County Co	333	400	387
Cork City Co	486	556	581
Cork County Co	280	358	320
Donegal County Co	197	252	355
Dublin City Co	452	567	494
DLR County Co	450	641	500
Fingal County Co	544	647	563
Galway City Co	464	546	517
Galway County Co	148	213	238
Kerry County Co	244	321	338
Kildare County Co	258	335	330
Kilkenny County Co	233	293	340
Laois County Co	152	198	253
Leitrim County Co	179	232	459
Limerick City & County Co	215	279	313
Longford County Co	205	247	427
Louth County Co	283	342	360
Mayo County Co	222	285	378
Meath County Co	168	239	239
Monaghan County Co	236	286	420
Offaly County Co	219	269	317
Roscommon County Co	166	216	325
Sligo County Co	206	270	377
South Dublin County Co	523	613	543
Tipperary County Co	228	287	390
Waterford City & County Co	222	286	383
Westmeath County Co	219	277	346
Wexford County Co	214	279	309
Wicklow County Co	187	283	271

Source: Local authority budgets, authors' calculations.
Note: The average ARV for those councils that had not undertaken a revaluation was 68.15. For those councils that had undertaken a revaluation, the average ARV was 0.20.

expressed as the ratio of the highest to the lowest, equal to 3.7 with a coefficient of variation (CV) of 42.6. We then calculate a number of post-LPT fiscal capacity indicators to measure the extent of equalisation. In particular, we calculate (i) fiscal capacity per capita after the estimated LPT yield; (ii) fiscal capacity per capita after the 80 per cent LPT locally retained; (iii) fiscal capacity per capita after the distribution of the equalisation grant and finally (iv) fiscal capacity per capita after the final LPT amount.

The table reports the range for a selection of these fiscal capacity measures (namely (ii) and (iv) above), and we also calculate the CV in each case. After the final LPT amount (which includes the equalisation grant), the range in the fiscal capacity measure has narrowed, to a high of €581 and a low of €238, or 2.4 when expressed as a ratio, with the CV now equal to 24.4. The reduction in the range and CV is an indication of a narrowing of the fiscal disparities between the local authorities (in effect, a decrease in the horizontal fiscal imbalances), although the change is quite small. Using fiscal capacity indicators to measure before and after equalisation, the findings from Table 6 indicate that although there is some degree of equalisation, it is limited, due in large part to the small size of the equalisation fund but also, in our view, to some contentious allocations.[5]

Future challenges for the financing of local government

The challenge for Irish local authorities, as with municipalities and cities worldwide, is to provide a high level of public services while, at the same time, keeping taxes and charges sufficiently low to ensure the revenue base and, in general, economic activity continue to grow. We briefly explore three issues that are likely to feature in future debates over local government funding. They are the tax burden on businesses and non-businesses, the growth of metropolitan areas and local public

[5] For example, should Cork City Council (pre-boundary change) have been in receipt of an equalisation grant given that it has a large commercial rates base? Should Louth County Council receive an equalisation grant given that it charges a relatively low ARV on a not insignificant rates base? What explains the large difference in equalisation grants allocated to Galway County Council and Tipperary County Council? We know the technical reasons for these, as the equalisation grant allocations are based on local authorities' minimum level of funding, which, in turn, are based on their 2014 general purpose grant (and the PRD). An alternative equalisation model, however, would very likely result in different transfers to local authorities, including, we would expect, the councils listed here.

investment, and finally access to credit markets and issuance of municipal bonds.

Tax burden

As businesses and commercial activity do not have a vote in elections, weak or short-sighted local governments often see this as a reason to levy taxes on the business sector in the knowledge that they can avoid any potential backlash from other undertaxed local taxpayers. Yet, as we have alluded to earlier, there is a strong argument that the tax burden should be imposed on those who benefit from the public services that are financed by the tax payments. One such beneficiary would be the owners of residential properties as they avail of the local services provided by the council. Whereas this would suggest a tax take more from LPT and less from commercial rates, the inverse is true. As Tables 2 and 4 show, commercial rates far outweigh LPT receipts, with, on average, rates accounting for over 30 per cent of revenue income as against the LPT, which accounts for *only* 7 per cent of local authority income. Whereas we do not recommend an increase in the commercial rates (base, exemptions or collection agency, although higher collection rates are always desirable), an increase in the LPT (by means of a change in property valuations or the base rate or the number of exemptions) in order to increase property tax revenue more in line with the norm in other countries could allow some fiscal space for a reduction in commercial rates, while keeping total local taxation constant, i.e. a revenue-neutral change. Despite the political sensitivities involved, in our view the best way to introduce this would be through residential property revaluations as opposed to changing exemptions or increasing the LPT base rate. Thereafter, if councils wish to exercise their taxing powers by reducing the base rate vis-à-vis the local adjustment factor, the balanced budget rule at the local government level would require changes elsewhere, thus ensuring subnational fiscal prudence.[6]

[6] Given that, at the outset, local governments have generally less fiscal flexibility than central governments, one of the concerns with a balanced budget fiscal rule at the local level is the pro-cyclical impact that it may have, as local governments may be prevented from smoothening the budgetary impact of fluctuations in the business cycle. This is less of a problem in Ireland where the local authority is not dependent on cyclical tax revenue but instead relies on local property taxes.

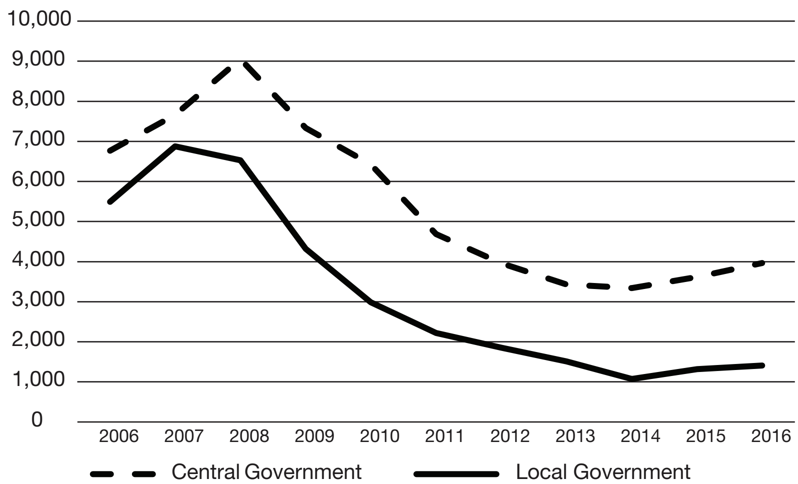
The growth of metropolitan areas and local public investment

The National Planning Framework for 2040 projects that the population of Ireland will increase by around one million people or, compared to 2016 levels, an increase of 20 per cent. Of the one million extra people, 25 per cent is planned for Dublin, 25 per cent is planned for the other four cities combined, with the remaining 50 per cent planned for the regional centres, towns, villages and rural areas to be determined by regional plans. This will require a large increase in infrastructural spending, with big annual increases in capital expenditure both by local and central government in the largest urban centres but particularly for the Dublin region where Dublin city and suburbs are expected to grow by around a quarter of a million people, to in excess of a minimum targeted population of 1.41 million people (Government of Ireland, 2018).

In Ireland, local government capital spending is largely funded by capital grants from central government, for about 70 per cent. The other sources of capital income are development levies or contributions, property and asset disposals, and non-mortgage borrowing, largely from commercial banks or state agencies. When the benefits of a capital project are enjoyed over a period of time, borrowing by local authorities to finance such public investment allows local councils to synchronise the benefits and costs of such spending, ensuring that the benefit and cost streams are balanced as the debt is paid. It also allows local authorities to avoid excessively high levies and rely less on central government for capital grants, ensuring proper pricing of large capital projects.

Figure 2 shows the levels of capital expenditure by both central and local government since 2006. For one, a very significant amount of public investment in Ireland is undertaken by local government, as is often the case elsewhere. Two, as a result of austerity, there have been years of underinvestment due to very large reductions in capital expenditure (see Turley et al., 2018). Given the recovery in the economy, combined with future population projections, much more public investment is needed, with local governments contributing to this infrastructural spending. Given their responsibility for social housing, regional and local roads, planning and environmental services, local governments will be required to invest heavily over the next decade or so. Aside from borrowing from commercial banks, state agencies or the likes of the European Investment Bank (EIB), another possibility is private external sources via the international

Figure 2: Capital expenditure by local and central government, 2006–16 (€m)



Source: Department of Finance; Department of Housing, Planning and Local Government.
Note: Capital expenditure amounts by central government are from the Revised Estimates. Capital expenditure data by local government are from the AFS. Given that the former are estimated data while the latter are outturn data, we do not show a combined total.

capital markets by means of municipal bonds, as witnessed in some other jurisdictions.[7]

Municipal bonds

For Irish local authorities, borrowing must be approved by the central government's minister responsible for local government, and is covered under the Local Government Act, 2001. More specifically, section 106 'Borrowing and Lending of Money' stipulates that 'Borrowing by a local authority … shall only be with the sanction of the appropriate Minister'. It goes on to state, 'The Minister may, after

[7] In November 2017 Limerick City and County Council announced a €85-million, 25-year loan from the EIB to fund an urban regeneration project. In December that year Fingal County Council announced a €70-million loan facility from the EIB to fund strategic investment projects as part of a larger €180-million investment in capital spending.

consultation with the Minister for Finance, make regulations in relation to borrowing by local authorities' (Government of Ireland, 2001). Subject to this permission from central government, local authorities in Ireland borrow either from financial institutions or, more likely, from state agencies such as the National Treasury Management Agency or the Housing Finance Agency. Given these restrictions, combined with the very limited spending responsibilities, it is not surprising that the level of outstanding debt of the Irish local government sector is small, relative to central government debt but also to local government debt in many other countries. At just over €5 billion at the end of 2016, it amounts to 1.7 per cent of GDP, or 2.5 per cent of GNI*.[8] This makes the issue of fiscal rules such as debt ceilings and sanctions less relevant in Ireland than in other countries where local governments have more functions and powers but also, as a result, are subject to more regulation and monitoring.

Elsewhere, local governments raise funding for capital spending by means of bond issuance on capital markets. Municipal bonds are debt instruments whereby the local government promises to pay interest, and repay the principal on maturity. Municipal bonds have been extraordinarily successful in raising capital for infrastructure investments in US cities, in part because the federal government grants tax-free status to municipal bonds. They are less common in Europe, where the tradition has been to borrow from the central government, or from specialised (state or private) banks. However, since the recovery in Europe after the 2008/9 Great Recession and the sovereign debt crisis that followed, some countries have begun to look again at the case for municipal bonds.[9] Close to home, two such examples are Aberdeen City Council in Scotland and the UK Municipal Bonds Agency (UKMBA).

In 2016 Aberdeen City Council issued a municipal bond, raising over £370 million at a price of 111.989 per cent and a spread at

[8] GNI* is Ireland's new modified aggregate measure of national income, arising from the well-known distortions in Ireland's GDP figure due to its globalised nature, high concentration of multinationals and the practice of relocating intangible assets, such as intellectual property and R&D.

[9] Stephen Kinsella of UL (with Karl Deeter of Irish Mortgage Brokers) has written on several occasions about the case for municipal bonds for Ireland's local governments. Whereas the timing of these earlier calls was problematic as they were during a financial crisis when capital markets and public finances were under enormous pressure, the economic environment in 2018/19 is very different and more conducive to such possibilities.

G+125bps, to fund its infrastructural capital investment projects out to beyond the year 2050. Interestingly, from the perspective of the feasibility of a bond issuance for Dublin City Council (DCC), Aberdeen City and Dublin City Councils are not too dissimilar in terms of size. Although DCC has a bigger population, a greater number of elected councillors and higher net assets than Aberdeen City Council, its annual budgets in terms of total revenues and spending are about the same as Aberdeen City Council, which has more expenditure functions. To prepare for the bond issuance Aberdeen City Council had secured a 'high-grade investment' bracket Aa2 credit rating by Moody's. In advance of the launch, the council had to undertake a lot of preparatory work, including submission of detailed financial information, a debt profile and strategic plans of the council, but also information on the institutional framework of the Scottish local government system, investor presentations and roadshows, and bond documentation, including the legal and regulatory requirements, in conjunction with a whole set of advice from legal, financial and treasury bodies.

An alternative to a direct issuance of a bond by a single local authority is for local councils to pool their borrowing requirements and, by doing so, reduce their credit risk and lower the cost of borrowing. This can be done by means of an agency that pools a number of local authorities together. This is the route taken in Britain where the UKMBA was set up in 2015 as a public limited company, owned by its members – that is, the local councils and the Local Government Association. Similar municipal bond or funding agencies exist elsewhere, in, for example, France, the Nordic countries, Japan and New Zealand.[10] Most local councils in the UK borrow primarily from the Public Works Loans Board, at rates above government bonds (80–100 basis points above gilts). The challenge for the UKMBA is to be able to compete with this, and offer a cheaper cost of borrowing while, at the same time, persuading a sufficient number of local councils to come together in order for the agency to go to the market and issue bonds.

[10] Agence France Locale in France, KommuneKredit in Denmark, MuniFin in Finland, Kommuninvest in Sweden, Kommunalbanken in Norway, Japan Finance Organisation for Municipalities in Japan, and the Local Government Funding Agency in New Zealand. Although these all differ in terms of ownership and membership, structure and corporate governance, credit ratings and guarantees, etc., they all have one thing in common: namely to provide low cost funding to local authorities and municipalities.

One possibility for Ireland would be for DCC to consider following the example of Aberdeen City Council. Over the long term and given the projected increases in population for Ireland's east coast and Dublin region, we believe that it is important for Ireland's largest local government to be able to mobilise resources to fund big infrastructural investment projects into the future in a way that is not dependent on central government but is also cheaper than the current financing arrangements.

Conclusions

The years since the 2008 financial crisis have been a tumultuous and painful period, but also an opportunity for meaningful reform. The local government system has witnessed many changes in this decade, and not only funding related: for example, new functions in the area of local development and enterprise support; territorial reforms resulting in the abolition of town governments, amalgamations of some neighbouring city and county councils and new countrywide municipal districts; more oversight and scrutiny of the local government system and its performance, financial and otherwise. On the funding side, we have witnessed the introduction of the LPT and greater fiscal autonomy for local authorities, commercial rates harmonisation and revaluations, and a revamped fiscal equalisation system. Together, these changes, in theory at least, should contribute to a more coherent and improved system of fiscal decentralisation and intergovernmental finance, as outlined in the theory section of this paper. As a contribution to the empirical literature on the vertical and horizontal fiscal imbalances in the Irish local government system, this paper measures the not insignificant change in local councils' fiscal autonomy and, albeit very limited, the disparity-reducing effects of the fiscal equalisation transfers. Further academic research is required into the design of a better fiscal equalisation system for Ireland that addresses the horizontal fiscal imbalances (part of the broader debate on the rural/urban divide in society), and is more stable, objective and sustainable.

As with all other public sector reforms, more needs to change, especially in relation to the balance between business and non-business taxes, a more transparent equalisation system with a larger distributional pool, and changes to the way local public investment is financed. The latter is particularly relevant, given the legacy of the

austerity years and the underinvestment in infrastructure, and the projected increases in population, especially in the urban centres. For Ireland's largest urban area, careful consideration needs to be given to alternative ways of funding a bigger Dublin metropolitan area, depending less on capital grants from central government as is currently the case, but more on borrowing from external sources, both public and private. As the memory of austerity fades and we plan for the long term, there is an opportunity for policymakers, both at local and – given the highly centralised nature of public administration in Ireland – national level, to consider the merits of municipal bonds as a way of funding the infrastructural investment that is critically needed for Ireland's local communities, businesses and subnational authorities.

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