The Congress
of Local and Regional Authorities

Chamber of Regions

15th PLENARY SESSION
CPR(15)3REP
6 May 2008

Regional public finance policies

Karsten Behr, Germany (R, EPP/CD)

Explanatory Memorandum
Institutional Committee

Summary:

This report examines public finance policies in Europe with particular emphasis on their relevance for regional self-government. It analyses the state of regional fiscal autonomy in Council of Europe member States on the basis of the existing international *acquis* in the field of regional finance. Legal guarantees of fiscal autonomy, procedures for coordination between the central and regional level in fiscal matters as well as the necessary balance between the delegation of powers and the distribution of funds are addressed. The report concludes by recommending that the Congress should consider aspects of regional finance in its monitoring reports where appropriate as well as through its Working Group on "Regions with Legislative Power".

R : Chamber of Regions / L : Chamber of Local Authorities
ILDG : Independent and Liberal Democrat Group of the Congress
EPP/CD : Group European People's Party – Christian Democrats of the Congress
SOC : Socialist Group of the Congress
NR : Member not belonging to a Political Group of the Congress

Recent developments and important issues

1. Terms of reference and aim of the report

1. Organising the State financial system and determining the allocation of funds and funding sources to the various levels of government or administration – together with assigning powers and responsibilities for the various specialised policy areas – are two of the most complex matters which modern democracies have to regulate. The distribution of resources ultimately determines the scope for autonomy or dependency in the policy-making process and also the extent to which policies are actually implemented. It also serves to stimulate welfare and growth and influences the regions' socio-economic development.

2. This makes the distribution of financial resources an important element in competition between political parties, and between central government and sub-central government, as well as among local and regional authorities. It is thus the subject of more or less permanent political, legal and fiscal disputes between the various government levels. Particularly controversial areas include the distribution of powers and the practical criteria for and procedural rules on allocation of funds.

3. In 2005 the Regional Chamber of the Institutional Committee of the Congress deemed it necessary to link up its activities in the field of improvement of regional democracy with an in-depth analysis of the financial implications of regional public finances in Council of Europe member States.

4. The aim of this report is therefore threefold:

a. to detect some of the major financial issues for regions today in Council of Europe member States,
b. to help the regions to improve their financial capacity in technical and legal terms and enhance the funding of their operations by improving nationwide information about relevant financial topics, and
c. to help increase or at least stabilise the regional share in the distribution of the total financial yield of State revenues.

2. Main results of the work of Council of Europe bodies in the field of regional public finance

5. The *Congress'* drive to place regional finance on a sounder footing and increase the regions' financial capacity is based mainly on two instruments: horizontal recommendations[1] as well as *Congress* monitoring reports on local and regional democracy in the member States. These reports normally include sections dealing with local (or regional) public finance policy. The reports and recommendations are based on fact-finding missions carried out by *Congress* members, and reflect legal or practical shortcomings in local (or regional) public finance policies as measured by European standards.

6. Financial realities at the regional level have so far been insufficiently dealt with in the work of the Congress. Most of the reports focus on local authority finance. This reflects the current legal situation: the Council of Europe adopted a "European Charter of Local Self-Government (ECLS)" in 1985, Article 9 of which deals with local finance. When the monitoring reports discuss regional finance, they take that article as a reference point, although the rules on regional finance differ greatly from those on local finance. Articles 14 and 15 of the 1997 draft "European Charter of Regional Self-government" may outline the main features of legislation on regional finance, but the Council of Europe has still no binding legal instrument on regional self-government.

7. Another horizontal approach favoured by the *Congress* is reflected in the *Committee of Ministers'* preliminary draft recommendation on financial and budgetary management at local and regional Level (Congress Opinion 20 (2003) 8).

[1] Eg Recommendation 90 (2001) "on financial relations between state, regional and local authorities in federal States" – Conclusions of the Moscow International Conference (5-7 October 2000)

8. The Congress' monitoring reports also highlight some of the main results, defects and challenges of regional public finance policy, which are summarised below:

a. distribution of funds between levels of government is characterised by a low degree of financial autonomy and tax-raising capacity at regional level
b. link between powers and funding
c. importance of regional financial capacity for investments on regional and local level
d. distribution of powers to regulate the integrated fiscal architecture of the State, normally vested in the central (or federal) State level
e. structure and criteria of tax distribution between the levels of government
f. importance of central State grants and subsidies, the criteria of distribution
g. fiscal equalisation schemes in member states
h. importance of administrative rules and procedures
i. rules concerning regional debt and property

9. The implementation of public finance policies in CoE member States has highlighted numerous problems of increasing financial and political importance.The following are some of the key questions which nearly all member States are facing:

a. what are the chief benefits of decentralised spending? Some people would argue that decentralisation gives a bigger say to those who know local preferences best, and that fiscal decisions taken at sub-national level reflect regional diversity more accurately.
b. how are financial resources distributed between the various levels of government?
How important is the regional level in terms of spending capacity?
c. are State financial systems and procedures for the distribution of revenue between levels, dynamic or static? Is adjustment automatic? How difficult is it, in terms of parliamentary procedure, to change key aspects of the system?
d. do regions have the financial resources they need to discharge their responsibilities? Does the connectivity principle work?
e. how are national and regional State budget deficits dealt with - who is responsible? On what level should spending be cut or State indebtedness increased, or taxes and levies be increased – or a mixture of all these approaches be tried out? What type of expenditure - cyclical or anti-cyclical – helps to reduce the regional and national debt?
f. how can the regions' political weight be turned to financial advantage at national level? When national policy is being co-ordinated, can they "sell" their vote in return for financial concessions? To what extent does implementation of national political priorities at regional level depend on gerrymandering at national level?
g. must national support programmes be "redesigned" to cater for their different effects at regional level? How can beneficial and detrimental effects be reconciled?

10. These challenges can be grouped under four main headings:
a. the link between powers and financial capacity, ie the development of criteria making it possible to distribute national revenue between the various levels of government in a manner which matches the powers assigned to them. This is particularly important for all the CoE states which are also members of the EU. To prevent financial and territorial imbalance, the EU member States need to develop and consolidate a clear framework for multi-level governance, extending to the EU institutions
b. action by central government to influence and enhance the cost-effectiveness of public spending at regional level, in the context of globalisation
c. equalisation of the regions' financial capacities to meet their requirements
d. instruments to limit regional debt, in accordance with European or national deficit regulations. In member States where the regions have power to regulate local authorities, links between regional and local finance are also particularly important for local authorities.

11. The link between the regions' powers and their financial capacities directly affects the scope of their autonomy, which largely depends on their ability to exercise as many powers as possible – a substantial share of public responsibility - in the general interest of their populations. In other words, conflict over finance starts with the distribution of powers between the national and regional levels.

12 Even when powers are clearly distributed, regional autonomy may be limited by 1) inadequate *legal* protection of their financial autonomy, and 2) a discrepancy between the powers assigned to them and their financial capacity. The first issue at stake here is legal protection of the regions' financial status. The second is their financial capacity, which has important effects on their accountability: if they have specific powers but cannot find the funds to exercise them, they cannot simply blame central government – they are the ones the public will hold responsible.

13.There are at least three reasons why the regions must seek sufficient funding from central government and pass it on to their sub-units:

1. First of all, they have to finance the regional institutions (representative bodies, public authorities, courts and their staff) which manage public affairs. If they are also responsible for enforcing national laws, then judicious distribution of the funds received from the State is vital to their doing so effectively.
2. They also need funds to cover special investment or consumer projects, ie to meet individual or collective targets specified in (national or regional) law.
3. Regional (and local) authorities provide most of the infrastructure and facilities needed by the public and by industry, and thus play a leading role in the daily lives of Europeans. For example, public spending by these authorities in the 25 EU countries came to some 170 billion Euros in 2005.

14. Regional autonomy can suffer from not only by a lack of financial capacity, but also the extensive transfer of central State powers and responsibilities to the regions. Even when they are adequately funded by the State, the additional workload may overtax their structures. This is why they must always assess State proposals on transferring powers to them with special attention, not only to funding, but also to the administrative disruption which may result from their having to exercise them.

15.The regions must at least have the financial leeway they need in order to meet new challenges arising from adapting their structures to European or global developments. In recent years, regional authorities have had to shoulder new responsibilities:

a. promoting regional and national economic growth, particularly to cover the social costs of industrial change and help remedy the effects of lagging economic and social development, eg unemployment at local and regional level.
b. finding the additional funds needed to promote education, research and development and to meet environmental requirements.
c. counteracting the effects of globalisation on their socio-economic fabric.
d. funding follow-up policies in response to demographic change.

16. On the whole, there are good reasons for advocating an increase in the regional share of national revenue, but any action taken must respect the overall limits on the State's capacity to generate revenue: its fiscal potential and the political limits on increasing State revenue. In general, tax-payers are certain to oppose any increase in fiscal pressure, while growing tax competition - vertical or horizontal - at international or domestic level reduces the ability of States or sub-state entities to fix taxes without taking account of the international tax picture. The same is generally true of fees, which are normally used to fund public services, but the public's acceptance of fee increases is limited by their purchasing power. Consequently, total State revenue usually falls short of the necessary expenditure. The result is a constant battle for funding between the various levels of government and permanent pressure to cover regional expenditure by increasing public debt, with all the negative effects that entails.

3. Main statistics on regional public finance

17. We have no recent survey to providing the key statistics – either absolute or comparative figures between periods or regions – on regional finance in the CoE countries. Total State income, the effects of sharing tax revenue between the various government levels, the financial capacity of regions, expenditure, and the effects of equalisation - figures for all of these are obviously available at national level. However, comparisons between member States are difficult and do not allow any accurate assessment of the regions' level of financial

autonomy. Nevertheless, there are some pointers to differing views on the importance of regional finance in the member States.

18. Available statistics show that the division of financial resources between the various levels of government differs widely in CoE member States. In some countries, the regions' share of national revenue is negligible, while in others it tops 50%. It is also worth considering the division of revenue between different types of regional government (regions, departments, provinces, local authority groupings), since their combined percentage share of national revenue may well be higher.

19. Statistics on OECD member States suggest that there might be an increasing gap between the transfer of powers to sub-national levels and the transfer of funding, to the detriment of the latter.

20. Statistics can also highlight the key resources available to the regions, making it possible to calculate the yield of taxes which are of real importance to them financially. Political disputes over internal distribution naturally focus on resources of special financial importance. Normally, there are only three or four taxes with a fairly significant yield (income tax, capital gains tax, turnover tax, corporate tax), but it may also be worth looking at other minor taxes which produce a regional yield, if these give the regions a hold on political issues which are important to them.

21. Statistics also reveal the special importance of fees and allowances for regional and local budgets – which is why regional and local representatives must also secure autonomy vis-à-vis these particular resources.

4. Legal instruments

22. This report uses the definitions given in the *Committee of Ministers* Recommendation Rec(2005)1, which defines various terms, e.g. "own resources", "transferred resources", "ear-marked or non-earmarked resources", "proportional or non-proportional resources", "grants", "exclusive and shared resources", and also "financial and tax capacity", "spending need", "delegated tasks" and "fiscal pressure". The Recommendation also defines other principles, such as the connectivity principle (part I, section 2, para. 12) and the principle of financial autonomy (part I, section 3, para. 13).

23. For the purposes of this report, the scope of "regional public finance policy" is defined by the sum of all those legal and administrative regulations which influence the regions' financial autonomy, and determine, implement and control regional public revenue and expenditure. Rules and procedures relating to interconnection of regional and national public finance policies and rules on the settling of disputes over finance between levels of government are also included.

24. Drawing on these standards, an analysis of the CoE member States' financial architecture should give the *Congress* some indication at least of the key elements which determine the regions' financial autonomy. So we need to consider some of the key questions which influence the regions' financial capacity in terms of revenue, expenditure and equalisation:

a. which level of government has powers to regulate and raise taxes? If power is shared, who determines the tax structure, key elements of the tax base, and the tax rate? Is there optimum financial decentralisation and is an optimum balance struck between the financial powers assigned to the various levels of government and their economic and political dynamism and development? Does the State intervene in regional taxation, eg by granting certain kinds of households or businesses tax exemptions, and then making financial transfers to offset them?

b. what allocation systems and criteria are applied in distributing financial resources between the various levels of government? Is the system demand-orientated or linked to financial capacity? This covers transfer mechanisms for the distribution of financial resources between the national and regional levels, including tax distribution schemes, and the impact of national policy on the financial situation of sub-national levels of government.

c. are there national or regional constitutional or legal provisions which influence regional expenditure? The financial ability of the regions to cover all or part of the cost of exercising their powers and responsibilities depends on the level of expenditure they may incur in practice. What level of solidarity between levels should the regulations require? What are the financial effects of vertical and horizontal fiscal equalisation systems?

d. what instruments are used to guarantee fiscal discipline on all levels of government, and particularly compliance with EMU regulations in the EU countries?

e. if the regions have power to determine the local authorities' financial system, what are the main rules which determine their own resource system, and what equalisation system applies between regions and local authorities, and between local authorities themselves?

25. The report further comprises a survey of legal standards at the level of the member States, based on key principles in some federated or centralised member States. In particular the principles of budget autonomy and of connectivity influence the degree of autonomy in regional public finance.

5. Aspects of the theory of regional federalism

26. Economic theory may provide guidance on assigning powers and revenue to various levels of government. The "Fiscal Federalism" approach, devised in the United States, which divides financial powers and responsibilities evenly between the various levels of government, is particularly interesting here. Convincing in its theory, it is well suited to the needs of a federal, yet unitary State, with one legal system and a single market. In Europe, on the other hand, where the powers of central (federal) and regional government interlock in accordance with a complex, vertical pattern in most EU and CoE countries - the multi-level governance effect – it is not realistic. The division of responsibilities, powers and resources (revenue and expenditure) is likely to remain highly complex in most CoE member States.

6. Technical aspects of regional public finance: Taxes, grants, equalisation, debt

27. The range of instruments relevant to public finance and to funding for sub-national authorities is enormous. Own resources (own sub-national taxes) or transferred resources, national grants, fees and allowances for the provision of public services by sub-national authorities, and also credits, are the main elements in the funding mix.

28. The volume of a sub-national authority's own resources is directly related to the degree of control which central government exercises over its use of funds. It is also an indicator of its political and financial autonomy. The experience of highly centralised western countries, like France or the United Kingdom, shows that a policy of delegating powers and funds on a long-term basis produces sound results. In France, the decentralisation process started in 1961 and was taken further in 2003, when the regions were given the right to dispose freely of approximately 5% of national tax revenue, transferred to them in the form of non-earmarked central grants. These are supplemented by earmarked grants from central government, based on 5-year programmes negotiated between the two levels. In the UK, an asymmetrical approach to devolution has given Scotland and Wales greater powers, including tax-raising powers, and a number of substantial non-earmarked grants.

29. This manner of proceeding has several advantages. The scope of the powers transferred can be restricted and adjusted asymmetrically to match differing geographical and economic requirements and administrative capacities, and the same can be done for financial transfers, while central government retains a large measure of control, reflecting its responsibility for development of the country as a whole. Numerous ways of monitoring the efficiency of the sub-national authorities' handling of public affairs can also be tried out. Linking the process to a timetable may encourage those authorities to invest in building up the institutions, giving public staff the skills, and devising the effective sub-national procedures needed to complete the State programmes on time.

30. In connection with <u>taxes</u>, three elements are of particular interest:

a. the principle of giving sub-national authorities resources commensurate with their powers and responsibilities;

b. the principle of striking a balance between State-transferred and regionally determined revenue;

c. the increasing importance of tax competition between and within member States.

31. CM Rec(2005)1 defines <u>grants</u> as follows: "Grants" are non-proportional financial transfers, ie not depending directly on the amount raised locally. Decentralisation of some powers to a sub-national level must be

accompanied by an appropriate financial structure. Vertical and horizontal fiscal imbalance can never be avoided, and fiscal transfers must therefore be regulated by a special law. In general, the vertical distribution of resources between levels of government must be regulated by special laws. These must be flexible enough to reflect economic and social realities - ie disparities - throughout the State. They must make economic sense, but they must also be rigid enough to ensure that transfers are not made for purely political reasons. When national and regional governments are controlled by different parties, there are regular disputes concerning alleged misuse of national grants.

32. Solidarity, national unity and the need to enable less developed regions to prosper are among the arguments frequently used to back equalisation, but economic theory also supports it. Both revenue and cost equalisation can be either horizontal, with transfers going from sub-national authorities with low structural costs/high tax capacity to those in the opposite position, or vertical, with transfers going from central government to the less affluent sub-national authorities. Equalisation systems differ greatly between countries, and the national situation - the taxes which are decentralised, the services which are provided at sub-national level, etc. - is an important factor.

33. Tax-raising capacity, the structural cost of providing services and the need for services often differ between sub-national authorities. In these circumstances, decentralisation can lead to unequal treatment in respect of services for people in different parts of the country. If central government wants to enable sub-national authorities to provide the same, or roughly the same, range and quality of services, then it must equalise differences in their tax and service capacity.

34. Revenue is usually equalised via non-earmarked transfers, since it covers services normally funded from own tax income. In principle, costs could be equalised via earmarked transfers for each service component, but since non-earmarked grants are generally a more efficient way of financing sub-national service provision, the same approach should be followed.

35. Equalisation requires accurate statistical data in numerous areas. Data on structural variables, such as tax capacity and structural costs, should be specially compiled for this purpose. The use of existing data may create situations where sub-national authorities refrain from collecting taxes, since their lower revenue will be compensated for anyway, or let service provision costs rise, since their high expenditure will be offset by more efficient authorities. Calculating these variables is frequently difficult, but average per capita revenue (given the same tax rate) can often be used as a basis for revenue equalisation. For cost equalisation, a number of variables affecting the expenditure of various sub-national authorities need to be defined. Common examples include sparsely populated regions, mountain regions, and demography.

36. In addition to equalising grants autonomous equalising systems are fairly common in CoE member States, particularly those with federal or highly decentralised structures. Insofar as the need for regional equalisation is accepted, the systems applied in CoE states are required to do different, and sometimes contradictory, things.

a. they must strike a balance between efficiency, transparency, legal fairness and equity
b. they must be complex enough to meet different requirements
c. they must provide a clear picture of accountability, although mixed funding masks the responsibility of the various levels of government to fund fulfilment of their own tasks
d. they must achieve a compromise between the stronger regions' interest in keeping "their" tax revenue, and the weaker regions' interest in obtaining unconditional, unlimited grants
e. they must be designed to offer weaker regions the prospect of keeping pace with economic development, although their fiscal power after equalisation normally remains below the average.

37. In fact, equalisation pursues a wide range of complementary aims. These include: balanced social and economic development of all a country's regions, and consistency and transparency of the funding system. The former is necessary to sustain the country's legal, economic and social unity, and ensure that resources are effectively allocated (e.g. by avoiding inefficient migration or investment).

38. Equalisation systems differ considerably throughout Europe. The German system, for example, is based on complex arrangements, linking the two levels of government both vertically and horizontally. Other CoE States favour purely vertical mechanisms, with no horizontal equalisation between regions.

39. It must be noted, however, that all equalisation systems must be integrated within a broader fiscal framework, since other fiscal instruments also produce equalising effects at regional level. The most important of these instruments are:

a. national budgets
b. expenditure by specialised national agencies
c. national social security schemes
d. expenditure by State-owned enterprises (postal services, telecommunications, railways, motorways)
e. expenditure by private enterprises, insofar as they distribute public resources
f. earmarked national grants and funding.

40. Borrowing at regional level has become one of the most controversial aspects of regional finance policy. The new powers increasingly assigned to the regions, often without commensurate fiscal transfers from the centre, the follow-up costs of infra structural investment and (most obviously in certain member states) slow GNP growth have driven many regions into debt. On the other hand, the degree of indebtedness differs between levels of government.

41. Three questions are important here:

a. are there legal limits on regional debt?
b. what economic or fiscal factors influence the regions' policies on indebtedness?
c. what mechanisms guide co-operation or co-ordination between the various levels of government?

42. CM Rec(2005)1 makes a number of important points on regional borrowing:

a. regional authorities must in general have the right to borrow,
b. they should not normally borrow to finance current expenditure,
c. their borrowing should be integrated within the state's borrowing policy,
d. the state should not guarantee regional borrowing.

> The Helsinki Principles place only two restrictions on regional borrowing:
> *12.4 For the purpose of borrowing for capital investment, regional authorities shall have access to the capital market within the limits of the law. Borrowing is only possible to finance capital investments. The details may be ruled by law.*

7. Legal guarantees and coordination procedures for regions

43. Legal guarantees and procedures are needed to protect the financial interests of the regions. When core aspects of the financial relationship between central and regional government are regulated by law, the regions participate in normal law-making procedures at national level. The extent of their participation may vary, but they are usually guaranteed minimum consultation. The part which they play in framing national financial legislation is an important indicator of their autonomy.

44. If these elements are not regulated by law, or further consultation is needed on details, then special co-ordination structures are required. Experience shows that there are many possibilities: "consultative commissions", "local finance committees", "national public finance conferences", "national public finance guidance councils" , "fiscal planning councils", etc. It is not just the instrument as such, but also its aims, composition, working methods and accountability, which show how far the regions are involved in determining the State's revenue structure.

45. Regional participation should not be restricted to legal issues or procedures. It may also be necessary to extend it to tax estimation, the evaluation of macro-economic data and forecasting, since these elements may have major effects on their degree of financial autonomy.

8. Conclusions and further *Congress* work on regional public finance

46. Reconciling the financial interests of the central State and the regional level is a permanent task which takes high political priority. The Congress should focus on launching a debate within its institutions, identifying the

main topics of regional finance on the basis of the different national experiences as well as the legal and technical benchmarks in the field of regional finance with an eye to strengthening their constitutional and legal position and financial capacity.

47. The debate in the *Congress* on the regions' financial autonomy and relations with central and local government may specifically cover:

1. Providing better constitutional and legal guarantees on the regions' financial autonomy – a regional financial charter is one core element of a legal instrument on regional self-government;
2. Giving the regions more powers and also the increased financial resources they need to exercise these powers in the medium term; this will give regional (and local) authorities a greater share of State resources;
3. Providing institutional guarantees concerning national grants to strengthen legal instruments, and increase planning security and transparency on other levels of government.
4. Devising a protective scheme (connectivity principle) to ensure that regional and local authorities are not assigned additional tasks and powers without the financial resources they need to exercise them;
5. Where they do not exist, devising and strengthening financial instruments to improve the State's financial cohesion.

48. The protection of the financial interests of the regional level must be completed by legally guaranteed procedures concerning the structures of interaction between the central State and the regional level: If the core elements of the financial relations between the central State and regional level are governed by law, regions participate in the normal law-making procedures set out in national legislation. The degree of participation may differ, but normally minimum consultation of the regional level is guaranteed. Nevertheless, regional participation in national public finance legislation is one important factor in evaluating regional autonomy.

49. If these elements are not ruled by law or if details need further consultation, there have to be special coordination structures within member states. Experience points to a large range of possibilities: "Consultative commissions", "Committee of local finances", "National conference on public finances", "National council for public finance orientation" , "Fiscal Planning Council", etc. Not only the instrument as such, but also the target, the composition and the functioning as well as the accountability of such a body is relevant to determining the degree of the regional contribution to designing the national state revenue structure.

50. The participation of the regional level should not centre solely on legal subjects or procedures. Participation might also be needed in the areas of tax estimation and evaluating macro-economic data and forecast, because these elements can have major effects on the scope of financial autonomy.

51 In practical terms, the *Congress* might launch a number of activities to strengthen or at least maintain the financial autonomy and performance of regions:

52. Congress reports

The *Congress* should integrate the CM Recommendation's requirements within its monitoring reports on local and regional democracy, focusing on three questions:

a. what aspects of financial policy are of most interest to regional authorities? Are those aspects inherent in national public finance policy or peculiar to the regions? Are similar aspects important in different member States?

b. has the member State concerned brought its laws into line with the requirements of Recommendation (2005)1?

c. if not, what parts of the Recommendation can contribute to the development of national law?

The economic, legal and political complexity of the whole question makes it necessary to look more closely at certain key aspects:

53 Tax distribution and tax competition

The regions' financial resources are generally limited and frequently short of those they need to exercise their powers and responsibilities. The *Congress* might analyse the following aspects in a report:

a. advantages and disadvantages of sharing taxes between the different levels of government
b. limits to increasing tax income via intensified international and national tax competition.

54. Subsidies

In most CoE member States, State subsidies are one of the chief instruments used to fund regional expenditure. The *Congress* monitoring reports have shown that the form and structure of these subsidies, and the conditions and procedures applying to them, often influence the extent of the regions' financial autonomy. The *Congress* might prepare a report on the extent to which subsidy systems in the member states follow CoE guidelines, and on ways of making them more beneficial, legally and economically, for regional authorities.

55. Financial equalisation

Vertical and horizontal equalisation is one important means of increasing the regions' financial capacity and promoting solidarity, but its economic sense and necessity, its legal basis and practical arrangements for effecting it, are very often contested. The *Congress* could prepare a report on European equalisation systems and their democratic and economic effects on member States. This report should not focus solely on federal or highly decentralised countries, but should cover all the member states. As far as the equalising effects of the EU's structural fund policy are concerned, it might be co-ordinated with the Committee of the Regions.

56. Connectivity principle

The *Congress* could prepare a report on the connectivity principle and its implementation in the member states, including technical and financial aspects. Key questions might include: how to calculate the cost of implementing delegated powers, and how to proceed when the actual cost exceeds/falls short of the estimate. This report should include both chambers of the *Congress*, since connectivity is a basic topic for local authorities too.

57. The suggested Congress activities should take into consideration the financial and operational capacities of the Congress and its Secretariat. A variety of activities could be envisaged:

58. Round table on issues raised by the funding of regional entities

During its next plenary session, the Congress might organise a Round Table of *Congress* members and regional ministers responsible for regional public finance, to identify the main political issues raised by funding of the regions. The central question might be: *What legal and policy problems relating to regional public finance are likely to arise between the various levels of government in member states in the next two years?* The Round Table's conclusions might highlight ways of streamlining the future work of the *Congress* on regional public finance.

59. Introducing regional public finance issue into the work of the ad hoc working groups of the Congress, particularly the group related to regions with legislative powers. Since financial transfers between regions demand improved consultation and coordination structures, the Congress might strengthen the work of this ad hoc working group as an adequate congress body to deal with regional public finance.

60. In the medium term, the *Congress* may be interested in

a. devising indicators for comparison of the performance, efficiency and sustainability of regional public finance. It might be useful to develop criteria making it possible to compare the cost-efficiency of regional governance in some of the main fields of activity (who is providing public services at what cost?);
b. identifying the part which State financial transfer instruments can play in increasing the regions' financial autonomy.