

FEDERAL FISCAL RELATIONS IN AUSTRIA

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AUTHOR'S PREFACE

The following study was completed while the author was a Visiting Fellow in the Centre for Research on Federal Financial Relations at the Australian National University, Canberra. I express my thanks to the Director of the Centre, Professor R.L. Mathews, and Fellows in the Centre for many stimulating discussions and the exchange of information about fiscal federalism. It was the experience of comparative federalism, especially the Anglo-Saxon pragmatic view of federal fiscal relations as involving economic and political problems of allocation, distribution and stabilisation, that gave me (a scholar of constitutional law) a completely new understanding of Austrian financial relations. I attempted to apply this new understanding to the following study with the expert advice and linguistic help of Professor Mathews and his colleague Agnes M. Wilkinson. Without their efforts and help this study could not have been published.

The Austrian federal system is very little known in the Anglo-Saxon world although it is one of the most interesting working compromises between a pure centralist and a federalist system. I hope that the following study will give the reader a first impression of the system in which fiscal relations are highly centralised in constitutional and legal terms but not in terms of the practical politics of the federal system. To harmonise both parts is one of the most difficult and continuing reform tasks of Austrian federalism, major aspects of which I have tried to sketch in the last part of the study.

Innsbruck
November 1983

Peter Pernthaler

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R.L. Mathews
Director

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ABBREVIATIONS

BGBI	Bundesgesetzblatt (Federal Law Gazette)
B-VG	Bundes-Verfassungsgesetz (Federal Constitutional Law) of 1920 (as amended)
FAG	Finanzausgleichs-Gesetz (Tax Sharing and Tax Assignment Law), BGBI Nr. 673/1978, valid from 1 January 1979 to 31 December 1984
F-VG	Finanz-Verfassungs-Gesetz (Fiscal Constitutional Law), BGBI Nr. 45/1948
Para. Absatz	Paragraph (corresponds to the English Section)
S	Austrian Schilling (at November 1983, §A1 = S 17.50).

Asymmetries Between Competences and Financial Resources

Systems of financial relations in federal countries or other countries with decentralised units of government should theoretically be consistent with systems of assigning competences (tasks or responsibilities) to the different levels of government. The reason for this correspondence is obvious. There cannot be any real federalism or autonomy without adequate and independent means of financing the 'own tasks' of the decentralised political units. This seems to be a very trivial perception.

However, financial relations are usually the crucial element in arrangements for dividing competences and powers in a federal or other decentralised political system. This is partly due to the fact that financial resources provide the fundamental basis of political power and are therefore reserved or monopolised to the maximum extent possible by the most important level or unit of government in the federal system. This is usually the federal government.

There are also economic reasons leading to imbalance between competences and financial resources, to the disadvantage of lower levels of government and the benefit of the federal government. It is not only Popitz's classical concept of the power of attraction of the larger budget that encourages the flow of financial resources to the centre. In the modern economy, centralising effects result also from the federal government's planning responsibilities and institutions and the need for federal intervention in economic and social policies for the purposes of economic stabilisation and income redistribution. There is also a structural reason for disparities between tasks and financial resources in federal systems, since there are usually less-developed regions and units of government in every complex political system which require the use of central instruments of fiscal equalisation and harmonisation, and thus more discretionary powers and funds for federal governments.

All these general reasons for differences between tasks and financial resources in federal systems apply to Austria, but they are less important in explaining the Austrian brand of fiscal federalism than the historical legacy of the highly-centralised Austrian-Hungarian Monarchy and the political origins of the Austrian Republics in the unitary and centralised provisional governments that were established in 1918 and 1945 after the two world wars. These historical roots of Austrian fiscal federalism have been responsible for the superior financial and legal powers of the federal government and the corresponding fiscal weakness of the states (Laender), which contrasts with their constitutional responsibilities and the partnership role which they have been nominally accorded within the political federal system. This is a frequently quoted peculiarity of Austrian federalism that has been described, as one involving basic asymmetries in financial relations.¹ The details of these asymmetries will be explained in the following chapters. They have led to substantial programs of political reform in the states² and a highly theoretical approach to reform

¹ Dieter Bös, 'Das Finanzsystem', in H. Schambeck (ed.), Das Oesterreichische Bundesverfassungsgesetz und seine Entwicklung, Duncker and Humblot, Berlin, 1980, pp. 717-36.

² Peter Pernthaler, Das Forderungsprogramm der oesterreichischen Bundeslaender, Schriftenreihe der Instituts fuer Foederalismus-forschung, W. Braumüller Verlag, Vienna, 1980, pp. 26-30.

in the federal Ministry of Finance without any practical effect upon federal financial relations.³

Theoretical Systems of Tax Assignment and Revenue Sharing in Federal Relations

Corresponding to the general purpose of federal systems, their financial relations form part of a general system of dividing, integrating and balancing powers based upon the autonomy and equality of the territorial units forming the federation. The main reason for the complexity of modern federal financial relations lies in the rapid social and economic changes of modern industrialised and urbanised societies. These changes cause different rates and forms of development in the regions and cities within a national political system and lead to dangerous gaps between public needs and financial resources in some jurisdictions while others achieve increasing economic power.

These world-wide tendencies cannot be tolerated in functioning federal systems, which are based more or less on the legal and socio-economic equality of their member units and are bound to equalise and harmonise conflicts and tensions between poor and rich regions or cities. On the other hand, the independence and competition among lower-level governments are basic principles in working federalism which must not be over-ruled by the federal government in its role of equalising economic and social conditions. This view corresponds to the old but repeatedly confirmed experience that financial dependence inevitably leads to political inferiority. Today every federal government is approaching the limit of its capacity to provide equalisation funds, as a result of the enormous growth of public budgets along with the emergence of limits on the growth of economies and limits on the capacity to raise taxes.

In view of these specific federal purposes of financial relations, the assignment and sharing of revenues has three basic aspects:

- (a) the sharing of financial resources in accordance with the constitutional tasks of federal, state and local governments;
- (b) the guarantee of a clear, consistent, effective and fair system of taxation to all citizens of the federation without irrational tax shelters or overlapping jurisdictions which involve double taxation;
- (c) the basic harmonisation and equalisation of financial resources among member states and local governments in accordance with their expenditure needs and revenue-raising capacities.

To meet these different (and to some extent conflicting) goals of federal financial relations, different kinds of financial arrangements have been developed. In Austria they are called (following German concepts) Systeme des Finanzausgleichs, which may be loosely translated as systems of

³ Bundesministerium fuer Finanzen, Expertengutachten ueber den Finanzausgleich der Republik Oesterreich, Vienna, 1978. See also Egon Matzner (ed.), Oeffentliche Aufgaben und Finanzausgleich, Wirtschaftsverlag Anton Orac, Vienna, 1977.

intergovernmental financial relations. It needs to be explained that these systems are not only forms of tax assignment and revenue sharing, but also serve as means of equalisation and harmonising the different fiscal powers and needs of state and local governments.

Austrian Fiscal Terms and Their Meaning

The term Finanzausgleich is used generally to describe not only all forms of revenue arrangements, including relations among states and local governments, but also the system of dividing tasks or competences. The following classes of financial arrangements may be distinguished:

- (a) aktiver Finanzausgleich - the division of tasks or competences or, as they are called in modern Swiss terminology, public sector responsibilities (this involves a division of costs among governments);
- (b) passiver Finanzausgleich - the division of taxing powers, taxes, grants and other revenues and so on (this involves a division of financial resources among governments);
- (c) horizontaler Finanzausgleich - the financial relations between governments of the same level (state-state or local-local);
- (d) vertikaler Finanzausgleich - the financial relations between different levels of governments (federal-state, federal-local or state-local);
- (e) primärer Finanzausgleich - the division of taxing powers, taxes and shares of taxes which can be used independently and freely as 'own resources' by governments in the exercise of their separate budgetary powers;
- (f) sekundärer Finanzausgleich - grants or fiscal transfers from one level of government to another (block grants, specific purpose grants or equalisation grants) to promote certain activities at the lower level, to help indigent governments or to equalise taxable capacities and the provision of public goods.
- (g) 'stiller' oder 'grauer' Finanzausgleich - corrections and changes to the official (legally constituted) system of financial relations involving:
 - (i) the sharing of costs by state and local governments, not necessarily voluntarily, on federal tasks such as roads, schools, railways, water supply and natural disaster relief;
 - (ii) changes in the federal laws that influence tasks and costs of lower levels (for example, health, schools, social welfare, statistics, environment, consumer protection);
 - (iii) the changing of regulations relating to shared taxes (such as the income tax) during the period the revenue-sharing arrangements are in force;

- (iv) changes in the conditions affecting the revenue bases of the other levels of government as a result of the political or economic policies of the federal government (such as changes in monetary or fiscal policy, public sector investment or labour policy).

Methods of Tax Assignment and Revenue Sharing

The Tax Separation System (Trennsystem). The tax separation system is based on the principle that each of the levels of government in a federal system must raise its own taxes according to its specific needs and its political perceptions. The advantage of this system lies in the degree of fiscal autonomy it offers and the clear connection between a government's political responsibility for the services it provides on the one hand and the financial burden that it imposes on its citizens to finance those services on the other. Especially in strong democracies, this nexus is very healthy as a means of ensuring expenditure constraint and political responsibility for the performance of government. For these reasons, tax separation should be the foundation of every working system of federal financial relations. The theory of fiscal federalism (see Frey, Bös, Thöni, Buchanan, Oates) emphasises that the resource allocation process, the responsiveness and competitiveness of governments are enhanced by the separation system and are weakened by the countervailing effects of harmonising and equalising measures. In spite of these theoretical and practical advantages, the tax separation system in its absolute form is nowhere realised in modern federal systems. The reasons for modifying the tax separation system by countervailing measures lie partly in its failure to respond adequately to the conditions of the national economy and partly in the modern view that social welfare needs to be promoted within a national or even an international economic framework.

The Tax Sharing System (Verbundsystem). The tax sharing system confers the responsibility for levying taxes on one level of government (federal or lower level), which then shares the resulting proceeds with other levels. There are different forms of tax sharing as follows:

- (a) Tax Transfer Systems. The tax sharing payment flows from the higher to the lower level (in Austria: Finanzzuweisungen und Finanzzuschüsse), for example in the form of grants of different types;
- (b) Tax Contribution Systems. The payment flows from the lower to the higher level (in Austria: Umlagen especially Gemeindeumlagen). A specific form of this type of sharing involves the sharing of the cost of major (federal or state) projects by levies on lower-level governments;
- (c) Surtax Systems. One government levies the basic tax and others impose surtaxes or additional taxes on the same revenue base, the surtaxes being transferred into their own budgets;
- (d) Participating Systems. More than one government or level of government participates in the revenue of a common tax (in Austria: Gemeinschaftliche Abgabe), usually by being allocated designated proportions of the total tax revenues net of administrative costs.

The tax sharing systems have the great advantage that they provide a means of harmonising local and regional revenue differences and of reducing the risks of economic fluctuations and their influence upon tax revenues. But, on the other hand, every tax sharing system inevitably reduces the independence and autonomy of individual governments, usually however, strengthening the federal government. In spite of this, no modern federation seems to work without one or other form of tax sharing, because of the overwhelming centralising effects that flow from political patterns, social and economic conditions and technical living arrangements within the nation as a whole.

Combined Systems. In modern federal countries the tax separation system and the tax sharing system are combined in different ways that give certain types of taxes exclusively to single levels of government and enable some or all levels to share the revenues of others (usually the highest-yielding and most stable taxes). In practice, the degree of federalism in financial relations is not determined by a choice between tax separation and tax sharing, but rather depends on the way the two systems are combined and balanced and on how the actual conditions of operating the systems as between the different levels are framed.

2 THE THEORETICAL AND INSTITUTIONAL BACKGROUND OF AUSTRIAN FEDERALISM

The highly centralised system of federal financial relations in Austria cannot be understood without some knowledge of the background of the legal institutions and the main political ideas that led to these institutions. This chapter will provide a brief survey of the general status of federalism in Austria, in comparison with the two neighbouring federal systems of the Federal Republic of Germany (Germany) and Switzerland.

The Philosophy of Federalism

Federal systems are not usually constructed in accordance with theoretical ideas but are a pragmatic and realistic response to the disadvantages that result from very small and very large political systems. Small political systems tend to be weak but human, while large units of government tend to be strong but bureaucratic, unresponsive and also - beyond a certain size - ineffective and inflexible. Federations try to combine the advantages of both small and large governments and to avoid the negative aspects of each of them. A well-known political theory has refined this tendency of political practice into a theoretical principle: the theory of subsidiarity. This postulates that the smaller government units must have all rights and powers to manage their own affairs freely and that the larger units must be restricted to tasks which the smaller units cannot carry out effectively, such as national defence, national transport, and national economic policies.

The second important idea of federalism is the guarantee of pluralism of territorial units which it provides and the opportunity for diversity and competition among lower-level units within a greater national political system. This territorial pluralism leads to a specific form of a very effective balance of power. The consequence is that federal systems are usually more liberal and democratic than centralised systems. So-called democratic centralism is, in reality, a very effective way of controlling society and making it adhere to a strict monolithic party line. It was no accident that dictatorial governments in Germany and Austria abolished federalism as soon as they came to power.

Legal Positivism and the Federal Idea

The specific European form for realising these political or philosophical federal ideas involves a legal concept of federalism - the Bundesstaat. This is a word that cannot be properly translated into English because the concept does not exist in either Anglo-Saxon thinking or reality. The German concept of Bundesstaat means a strictly legal system of institutions which must be clearly separated from the political concept of federalism. It can only be described in judicial terms of competences or powers, institutions and procedures which are positively identified by law and interpreted by the courts. And even this strictly legal system of the Bundesstaat is theoretically understood in three different ways, according to different models of the Bundesstaat that are taught and practised in Europe.

The 'Staaten-Staats-Theorie'. This is the oldest theoretical concept of the Bundesstaat, which was the basis of all federal constitutions in Europe. It says that the constituent states of a federation (Laender, Kantone) 'share' sovereignty with the union, both levels being sovereign states in their own right although limited in their tasks and powers by the

Constitution. This theory is still the preferred form of interpretation for the Swiss Constitution, but it is held to be logically inconsistent and false by most modern German and Austrian scholars. The main argument against it is the claim that sovereignty cannot be divided because only one power can be sovereign.

The Decentralisation Theory. Especially in Austria, the theory is widespread that there is no theoretical (or inherent) difference between a highly-decentralised unitary state and a federal country, which is simply a specific form of decentralisation. According to this theory, sovereignty lies in the (federal) constitutional law that creates and limits the powers of the constituent states and the union. The weakness of this theory is that it does not distinguish between powers of self-government which are created and limited by the Constitution and the powers of the states which are not created by union but represent original political powers that flow from the rights of self-determination of the citizens of the states.

The Organic (or Complex) Theory. This theory tries to combine legal, political and historical elements of the Bundesstaat. It emphasises the coordinative structure of the Bundesstaat and its constitution, which is founded in the historical independence of the constituent states and is maintained by their political autonomy and influence upon the federation. This theory, which is the most appropriate view of federalism in the opinion of the author, avoids the notion of sovereignty within federal relations but holds as fundamental the proposition that the power of constituent states is original political power and not a form of decentralisation or devolution of power.

Division of Competences Between Union or Federal Government (Bund) and States (Laender)

General Structure. All European federal systems are based on a clear and stable constitutional separation of competences between the federal government and the states. This separation of functions combines several ways of sharing legislative and executive powers, which will be described below, but together they reflect one basic principle: the functions of the federal government must be clearly founded on written law as designated powers (the enumeration principle), while the residual powers reside within the general competence of the states.

This clear principle favouring state competences is weakened in practice by a number of standing rules of interpretation in favour of federal government, such as 'unwritten federal competences' in Switzerland, federal competences 'by the nature of the specific matter' in Germany, and the theory of 'connected matters' that follow a federal competence in Austria.

Generally competences cannot be changed legally without the consent of the states. However, in Austria amendments to federal constitutional law do not need the consent of the states or the states' house (Bundesrat), which has only a suspensive veto against the national parliament (Nationalrat) which the latter may over-rule. Therefore it is very easy to change the Constitution in favour of federal government in Austria; there have been about 250 amendments to the original Constitution of 1920, most of them reducing state rights or founding new central competences! The reform of this easy method of reducing state rights is one of the central points of the Forderungsprogramm der Bundeslaender (reform demands of the states), but negotiation with the federal government about this demand has not been successful up to now!

A typical structure of all European federations is the absolute predominance of federal legislation in various forms, whereas the states are mainly predominant in administrative and executive functions. This tendency may be acceptable to the administration and civil servants of the states - because they have substantial powers with little responsibility - but it has been described as an unsatisfactory system of executive federalism by many critical observers.

The Division of Legislative and Administrative Competences. The Austrian Constitution (Bundes-Verfassungsgesetz von 1920 (B-VG)) generally divides competences between the states and the federal government in accordance with four types of legislative and administrative arrangements:

- (a) Exclusive federal competence in both legislation and administration (Article 10, Article 14 Absatz (Paragraph) 1, Article 14a Absatz 2 B-VG). To this type belong more than 100 important functions including all courts (there are no state courts), civil and criminal law, police, armed forces, banks, industry, national roads and rail transport, mining, forests, water supply, hydro power, water pollution and protection, health, social security, unemployment, education services except for elementary and some agricultural education (school building and maintenance are state responsibilities), national economic planning, energy planning, radio and television (national broadcasting system).
- (b) Federal legislation but state administration (Article 11, Article 14 Absatz 2 B-VG). To this type belong only six matters, including citizenship, traffic regulation on roads and non-frontier lakes, social welfare housing, urban redevelopment, and administrative procedures in relation to state competences.
- (c) Federal legislation to establish general principles, with states responsible for by-law legislation and administration (Article 12, Article 14 Absatz 3 B-VG). To this type belong only a few matters, including basic social welfare, hospitals, land reform, electricity (except the national grid, national power plants and emergency policies and planning), school building and maintenance (except for high schools and universities).
- (d) Complete state competences in both legislation and administration. (Article 15 Absatz 1 B-VG). Formally this type includes all matters that are not specified as federal competences. This gives the states a residual or general competence, but since most important functions have been specified as federal either by the Constitution or by interpretation, there are only a few matters left for this type of full state legislative and administrative competence. These include some aspects of environmental protection; building laws, town and country planning, hunting, fishing, some aspects of agriculture, theatres, some aspects of youth welfare, sport, tourism, and local government (including local police).

Federal, State and Local Administration. There are four ways in which federal jurisdiction is exercised in Austria. Of these, the first involves exclusive federal administration by federal agencies established for the

purpose. These include military, police, financial, postal and railway authorities. The other three are called the three levels of administration. The first and second levels involve the delegated administration of federal legislation by state authorities. The first level is a so-called district authority (Bezirksverwaltungsbehörde), while the second level is the state governor (Landeshauptmann) who is elected by the state parliament and the head (premier) of the state government. In the third level, which applies only to a few matters of national importance, the federal minister is directly responsible for the administration as he is in general for the supervision of the states' administration of delegated federal legislation.

There are two levels of administration with respect to state legislation. These are the district authority and the state government (Landesregierung). There are however also on the second level the same administrative agencies which administer delegated federal tasks and, under the responsibility of the state government or of single state ministers (Landesräte), state administration (Amt der Landesregierung).

Local government councils administer both their own tasks and those delegated by federal and state governments (see below), but are supervised by district authorities.

These arrangements compensate for the highly centralised division of competences, since under the Austrian Constitution the states are given delegated responsibility for the administration of nearly all federal matters in the first two levels (Article 102 B-VG).

Formally, state administration of federal matters is only delegated competence and is therefore subject to central supervision and direction. But in reality state administration is quite independent. The state governors, who exercise the highest federal administrative authority in the states (the second level), are elected by the state parliaments and can only be removed by impeachment before the Constitutional Court (which is a highly theoretical provision and has never happened in Austrian history). The first level of federal and state administration is the district authority, which is governed by an appointed state officer (Bezirkshauptmann) who is the administrator to whom all district departments are responsible.

Local government frequently does not carry out its administrative tasks directly but delegates them to public enterprises (see below).

Due to the combined system of federal and state administration in the first two levels, the organisation of administration is very concentrated and uniform in Austria and returns to the state governments some of the influence and competences they have lost through centralisation in the formal division of competences. It should be mentioned that the states have to bear the costs of the delegated federal administration and of all matters where only legislative responsibility (not administrative) belongs to the federal government (such as hospitals, compulsory education and others), although the competence in both cases formally belongs to the federal government (Decision of Constitutional Court A 3/81 of 29 September 1982).

Police Powers. As states are constitutionally unable to establish their own police forces federal police perform state police tasks (e.g. traffic control, nature protection, building security). State laws which designate these police tasks must have the federal government's consent because the federal government has to bear the costs of those activities. This need for federal consent to state police laws is one of the most important matters on which the states seek reform because, lacking their own police competences,

the states are completely dependent on federal goodwill in exercising their legislative responsibilities. This means that there is no real autonomy of states in these matters.

Non-Government Administration (Privatwirtschaftsverwaltung). The Austrian political and legal practice has developed a safety-valve against the severe centralisation of the Constitution that contrasts with the reverse procedure of centralisation outside the Constitution in the United States. This safety-valve is the famous 'spending power' provision, which is like the gold-burdened donkey - it overcomes all constitutional barriers. In Austria the rule is (Article 17 B-VG) that every government can spend money on any constitutional competence and in so doing use all legal institutions and forms of private law and of private corporations. Governments may thus use all sorts of private law contracts, companies, subsidies and the like. These activities are described as non-governmental administration. This has a very wide scope: it comprises all forms of public subsidies, public housing, public works (roads, buildings, water protection, etc.), public enterprises, cultural activities and labour and fiscal policies through the budget. By means of private law conditions and regulations, in implementing its spending policies, governments can plan, influence and control the specific part of social or economic activities that are subject to the governments' spending programs.

Although the exemption of the non-governmental administration from constitutional division of competences also favours central government involvement in state competences, the importance of this principle for the states is much greater. This is because for them it is usually the only legal means they have of acting as modern governments, since they are so severely restricted in their constitutional competences. The fiscal problems arising from non-governmental administration across constitutional competences are naturally very complicated and will be dealt with later in this chapter and in Chapter 5.

Local Government of Communities (Gemeinden)

General Remarks. The federal Constitution (Articles 115 to 120 B-VG) guarantees to local government (the communities) the right of self-government and this can be legally defended (both against the federal government and the states) before the Constitutional Court. However, constitutional protection is given only to the institution of local self-government (with its competences), but not to individual communities, which might be changed in their size or even have their existence determined by state laws. Some states have thus passed laws to reform local government by reducing the number and enlarging the size of communities. Together with the financial incentive to amalgamation provided by horizontal financial equalisation, this has significantly reduced the number of smaller communities in Austria. Whereas in 1958 there were 2,675 communities with no more than 1,000 inhabitants, by 1978 there were only 606. The total number of communities in Austria fell from 4,019 in 1958 to 2,301 in 1978.

Competences and Main Tasks of Local Government. The Austrian Constitution specifies the tasks of local governments (communities) in a double way, through both a general competence clause and an enumeration of specific matters (Article 118 Absatz 2 and 3 B-VG).

The general clause defines the competences of local government as all matters that belong to the exclusive or predominant interests of citizens of

a local community and can be performed by the local government within its own borders and with its own administrative capacity.

The specific enumeration of local competences includes especially: local elections and civil service; local police; local traffic and roads; local markets; emergency and general rescue services; fire protection; building regulations; local town and country planning; cemeteries; schools and hospitals. In practice, the general clause has not proved to be as important as was intended by the Constitution, because judicial interpretation has restricted its application to the specific matters listed above. Each particular local government competence must be legally confirmed by federal or state law (according to which level is responsible for the particular matter). The law is subject to appeal by a local Constitutional Court, to establish whether it is consistent with the constitutional rights of communities.

In addition to competences relating to general government, communities (like the federal and state governments) have unlimited powers to run their own enterprises and to subsidise community activities, enter into private law contracts and establish companies. This area of local government activities now represents the most important part of community budgets. Local government enterprises cover such activities as: water and energy supply; traffic; sewerage; garbage; hospitals; sports facilities; and public housing. This sector also includes the basic social welfare function (Fürsorge).

In addition to these local government functions, communities have a great number of administrative competences delegated by federal and state governments. These tasks have to be executed under the direction of the federal or a state government and are financed by the community unless the relevant government delegating the competence specifies another way of financing (Constitutional Court Decision A 3/81 of 28 September 1982). The communities are not happy about accepting these tasks because they usually involve detailed control and administrative and financial burdens without any discretionary power.

The Statutory Cities and the Special Status of Vienna

Larger cities (those with more than 20,000 inhabitants) and some historically important cities may be given a special status by a 'city statute' (Stadtrecht). This is accorded by state law with the consent of federal government. These statutory cities have all the competences of local governments and also operate as district authorities in the first level of federal and state administration. At present, Austria has 11 cities of this type.

The historical capital of Austria, Vienna, which has a population of about 1.5 million (a significant reduction from the figure of 2 million which had been reached by 1918), has a dual status under the Constitution. It is a local government in its organisation and functions as well as a state like the other states of the federation. The institutions of the city therefore perform the functions of a state legislature and state government as well as those of a local government. In its financial relations, Vienna therefore participates in the tax sharing allocations of the cities as well as those of the states, with a constitutional limit expressed as a proportion of total state and local allocations (see below).

The Principle of the 'Uniform Community' ('Einheitsgemeinde')

According to the present interpretation of the Constitution, all communities - with the two exceptions of the statutory cities and Vienna - are considered to be equal in carrying out their competences and tasks (Pflichtaufgaben). This is a very awkward rule because communities vary very much in size, type and administrative capacity and receive very different tax sharing contributions according to the size of populations (under a graduated population-weighted formula). The reasons for this strange legal philosophy of uniform communities are on the one hand the ideological expression of the equality of communities irrespective of their size or geographical location, and on the other hand the legal stimulus either to unite smaller communities, and thus bring them up to normal size, or to form associations of communities in order to match the legal tasks and competences.

Associations of Communities (Gemeindeverbände)

The Austrian Constitution provides for special purpose associations of communities (Article 116 Absatz 4 B-VG) which can be constituted by either federal or state law. Communities must take the decisive responsibility for organising these associations and usually finance them according to their populations or on a similar sharing basis. Only two types of associations have the right to fix contributions according to their costs (social welfare and school associations). Associations of communities are not equal partners in the federal financial system and usually depend on subsidies from communities.

In practice communities often unite in order to develop special public services (water supply, sewerage services, garbage disposal, traffic, energy supply, etc.). For this purpose they usually establish private companies under civil law arrangements and set up special financing systems.

The Constitution also provides for a form of regional local government (Gebietsgemeinden, Article 120 B-VG) which would have the effect of uniting all communities of a district. But this provision has not been used so far due to strong political opposition by the states. Therefore financial relations take place between three types of territorial units (Gebietskörperschaften): federal government, states and local government (communities).

Non-Territorial Self-Governing Units and Quasi-Government Organisations

Non-Territorial Self-Governing Units. According to the standing interpretation of the Constitution every competent legislative authority has the power to create non-territorial self-governing units. These are very common in Austrian public administration, being used especially to organise economic or professional groups (so-called chambers - Kammern). These official interest-group organisations, of which membership is compulsory, have the right to raise their own revenues, to govern themselves within their specific interests, and to enter into collective bargaining with relevant organisations (thus a medical chamber may negotiate with a board of social insurance).

Another important branch of self-government is the social security system, which comprises about 20 major independent funds (Sozialversicherungsträger) and a central organisation of all funds (Hauptverband). Their costs are financed by special contributions and public

subsidies. The total amount of the social insurance budget is very large. Covering about 20 per cent of all public expenditures, it is more than the combined budgets of all states of Austria, or of all communities.

A specific traditional type of Austrian self-government is that of the so-called public establishments (Anstalten) and the public funds (Fonds, Stiftungen). These are established by law to provide specific public services (e.g., social welfare, hospitals, certain types of official banks, family benefits, agricultural and economic planning and regulation, social welfare housing, federal radio and television, etc.). Scholars have identified at least 200 administrative agencies created by federal or state law each of which has its own budget, its own power to levy contributions, and its own regulations. Very often, they exert great social and economic influence in their specific domains.

Quasi-Government Organisations. In Austria, it is very common for special public agencies or public services to be organised in the form of private law enterprises (companies). There are companies to operate national highways (one federal company co-ordinates them), to build hospitals, to carry out housing projects, to operate public transport systems, to operate schools, and to manage power plants. In some cases, they are jointly operated by communities, states and federal governments; in others only one government is involved. Some of these companies are entrusted with particular governmental powers (for example they can impose taxes or levies or charges), statutes and even have limited jurisdiction to enforce their own regulations. Others (especially at the local government level) have a monopoly of supply over services and goods. The essential purpose of these organisations is to free them from direct budgetary control while enabling them to operate as public institutions, enjoy the privileges of the public sector and receive financial subsidies. The principal problems of this increasing trend to set up quasi-government organisations is the diffusion of the public sector budget which ensues and the consequential lack of accountability and financial control. Budgets from which important segments are removed can no longer function as instruments of central financial planning and control. On the other hand, there are several economic advantages of these organisations, such as their ability to operate along commercial lines, make investment decisions on the basis of economic rather than political criteria, and - not least important - raise funds for public services without increasing taxes. A very important practical stimulus to the development of these organisations seems to be the proliferation of high-paid management jobs which they generate, which tend to be reserved for political appointments from the leading parties.

Austria's Structure of Government and Political System

Austria's system of government is organised in different ways at the federal, state and local government levels.

The federal government is appointed by the federal president (who is elected by the people for six years) in accordance with the wishes of the majority in the national parliament (Nationalrat). As elections to the national parliament are based on proportional representation (with lists determined by political parties), one might expect coalition governments to be a regular feature of national government. But due to the stability of electoral preferences of the Austrian electorate and the fact that there are only two major political parties (Socialist and Conservative) each with about the same potential vote capacity and another smaller party (National Liberal), there have been long periods of stable majority rule by one political party during the last twenty years. In the last election the

Socialist party lost its absolute majority in the federal parliament, so that it had to enter a coalition with the National Liberals.

In seven of the nine states, their constitutions make provision for a system of proportional membership of the government similar to that of the Swiss system. Each political party is represented in the government in proportion to the number of representatives of the party in the state parliament. Very small parties, such as the National Liberal party, may therefore not be represented in the government of a state (which typically has 7 - 9 members) because their representation in parliament is too small. Two Austrian states (Vienna and Vorarlberg) have their governments formed by reference to the same majority rule as for the federal government. In all states the head of the government (Landeshauptmann) is elected by a majority vote in the state parliament. This implies an important role for the majority party in a state, because the Landeshauptmann is responsible for all delegated federal administration in the state (the first and second levels of federal administration) and at the same time is the premier of the state government (Landesregierung). In 1983, six heads of state government were Conservative and three were Socialist.

Local governments are also elected on a proportional basis by local representatives (Gemeinderat). But in major cities the mayor (Bürgermeister), who is elected by majority vote of the council, has a predominant position, because he organises the administrative offices (Gemeindeamt and Magistrat) and may reserve also major parts of local administration to himself and officers nominated by him. This special form of mayoral administration occurs in some statutory cities. Local political parties are usually the same as national and state parties, but there may also be special local political groups in opposition to the established parties. The political importance of local governments is much greater than their constitutional position (especially in the western states). Many mayors or representatives of bigger communities are members of state parliaments.

A typical feature of Austrian political practice is the strong influence of interest groups at the national level (Sozialpartnerschaft), especially in relation to economic and social questions. At the state and local levels the dominant type of political process is that of consensual democracy, since with the exceptions noted all major parties are in government. But there may also be majority decisions in state and local governments in respect of some controversial questions. The smaller parties at state and local levels are therefore at the same time both government and opposition parties.

The practical importance of parliaments is very limited relative to executive governments and administrations at the state level. The constitutions of the states and the federal government also provide for some elements of direct democracy (peoples' initiatives and plebiscites) and, at the local level, direct petitions by particular groups of citizens (Bürgerinitiative). But the juridical and political importance of these institutions of direct democracy is rather weak and is by no means a real counterweight to or even an efficient control over representative government.

Co-operative Federalism in Austria

The three levels of government have developed many practical forms of co-operative federalism. There are conferences (periodical and for special purposes) of heads of governments and senior officers and special institutions for interstate co-operation (Verbindungsstelle der Bundesländer) and interlocal co-operation (Städtebund, Gemeindebund). The most important

legal forms of co-operative federalism are the formal treaties between federal and state governments or among the states themselves (Article 15a B-VG, as well as all sorts of private law agreements (also private law corporations) between all three levels of government. By means of these legal institutions, or by means of informal political agreements and budgetary decisions, federal and state governments also participate in a number of combined programs for the financing or subsidising of special public tasks (hospitals, roads, education, traffic systems and many others) or of less-developed regions.

The practical political importance of co-operative federalism in Austria is much greater than the constitutional position suggests. All major changes in the legal, political or financial situation of the states or of local governments are in practice negotiated and cannot be carried out without the consent of the states or local governments concerned. As there is a solid conservative majority in six of the states, no constitutional change (which needs a two-thirds majority and therefore the consent of the opposition) is possible against the will of the states. The political importance of the states in Austria's federal system is therefore much greater than their constitutional position might indicate. However, even allowing for this political power of the states, the predominant role of the federal government in the national political, economic and financial system and the dependence of all other levels on national planning and policy is still the principal feature of Austria's federalism.

3 HISTORICAL BACKGROUND OF THE PRESENT CONSTITUTION

Origins in the Austrian-Hungarian Monarchy

The present system of Austrian federal financial relations has its roots in the financial system of the Austrian-Hungarian Monarchy which eventually became a decentralised unitary state with provinces (the present Laender or states) as self-governing regional units. The decisive change in the system was the great tax reform of 1896, which introduced direct personal taxes (income tax and corporation tax) in place of many of the indirect taxes and duties that had provided revenue until that time. Until this tax reform, the Crown, the provinces and the communities all had separate taxes, the revenue bases of which were completely independent. The loss of these small but own-source taxes was compensated for by transfers from the central government financed by the new personal taxes. In this way there began the new tax sharing system that is still predominant in Austria. It is founded on the principle that the right to raise taxes is a central prerogative, while states and communities give up their independent taxing powers in favour of tax sharing from the high-yielding central taxes. Behind this system stands the great federal financial bureaucracy that manages the levying, administration and distribution of the shared taxes and effectively controls all government budgets.

World War I and its new economic and social pressures brought a dramatic change for the worse in the financial situation of provinces and communities. As they could not help themselves through compulsory credits or free access to the printing press or central bank finance, they needed new central transfers and grants to finance their tasks and public services.

The First Republic (1918-1938)

The period after World War I can be characterised as a desperate struggle for economic and political survival by the young and unlike republic. Its international financial dependence, the economic crisis and the political concept of union with Germany (Anschluss) were the main reasons for further centralisation in financial relations. The federal Constitution was first published in 1920 without any financial provisions - because there were still negotiations going on about these - and the financial provisions finally adopted in 1922 were characterised by being formally and materially separate from the federal Constitution. These provisions represented a separate fiscal constitution (Finanz-Verfassungsgesetz) that established the tax sharing and grant system, not distinguishing between the states and communities which were both treated as 'lower units' requiring central regulation and support.

In 1934 a new authoritarian Constitution was adopted which was even more centralist and which changed the financial positions of the different levels of government still further in favour of the central government. In 1938 Austria became a part of so-called Greater Germany (Grossdeutschland), which was a central state with some rudiments of self-government at the levels of states, districts and communities.

The Second Republic (Since 1945)

The time after World War II was again primarily a period of struggling for economic and political survival. In the beginning, the tax system of

Germany was taken over and combined with a provisional tax sharing system mainly on the basis of the regulations of the First Republic. In 1948 a new fiscal constitution (Finanz-Verfassungsgesetz) was issued - again outside the federal Constitution (which had reverted to the democratic Constitution of 1920) and inconsistent with its basic principles. Nothing of the historical centralised structure of the system was changed. Indeed, there was a significant retention of the centralising elements of Grossdeutschland's financial system. So the states did not even achieve the modest financial independence of the First Republic, but became even more dependent than the communities, on whose contributions they became partially dependent for their finances.

Thus the historical background of Austria's constitutional development reveals a continuing series of centralising steps and a continuing diminution of state financial independence. The original historical reasons for these processes - financial crises, dictatorships and military occupations - have long passed, but the centralisation they brought has remained to the present day.

4 THE PRINCIPLES OF THE CONSTITUTIONAL FINANCIAL SETTLEMENT

As noted in Chapter 3, in Austria federal financial relations are settled not in the federal Constitution (B-VG) itself but in a special fiscal Constitution governing the financial relations between the federal government and the other territorial units (Finanz-Verfassungsgesetz (F-VG)). The title and structure of this basic constitutional settlement make it clear that its concept of a federal state is shaped according to the decentralisation theory outlined in Chapter 2. States and communities are treated as the 'lower territorial units' that are, in a strict sense, only forms of local government at different levels and with different competences. The federal government is the sovereign that bestows financial competences and financial means through central legal and administrative measures. The basic elements of this federal constitutional dominance and tutelage system are set out in the following rules.

The Power to Assign and to Share Taxes

Unlike that of other federal systems, the Austrian federal Constitution does not assign specific taxes to the federal government or the states, but leaves this assignment to ordinary federal legislation (Para. 3(1) F-VG). Thus federal law has to assign taxes within an abstract framework of nine types of shared or exclusive forms of tax allocation that is regulated in constitutional law (Para. 6 F-VG - see below). Usually the tax allocation is made by a special tax sharing law which operates for a period of six years (Finanzausgleichsgesetz (FAG) currently in force from 1 January 1979 to 31 December 1984). But legally any federal law can change or supplement the current tax sharing arrangements. Besides the taxes that are assigned to them by federal law, the states theoretically have the power to create new taxes (the so-called right of tax invention) but as most possible objects of taxation are already used and assigned and double or additional taxation on the same revenue base is prohibited this theoretical tax-creating power is of very little practical importance (in 1978 it accounted for Schillings (S) 0.3 billion out of S 235.9 billion total tax revenue in Austria).

The Abstract Constitutional Tax Framework

The Constitution sets out the framework within which taxes may be levied or tax sharing arrangements entered into under federal law. Table 1 indicates the nine types of taxes which are distinguished and the revenues they yielded in 1978.

Competences of Tax Legislation and Administration

The competences of the different levels of government with respect to tax legislation and tax administration are not specified by constitutional law but depend on the assignment of specific taxes by federal law. After that assignment has taken place, the Constitution provides for the following system of competences:

- (a) Federal legislation and administration. All exclusive federal taxes, joint taxes and taxes that used to be federal taxes which have been delegated to state or local governments, but which remain the prerogative of central legislation and administration insofar as the delegating legislation may require.

Table 1

THE ABSTRACT FRAMEWORK OF AUSTRIAN TAXES AND
REVENUE COLLECTIONS IN 1978

	Billion Schillings
(1) Exclusive federal taxes	76.2
(2) Taxes divided between federal, state and local governments -	
(a) joint taxes, where revenue is shared	132.9
(b) state surcharges on federal taxes	0.006
(c) taxes from the same revenue source	14.0
	146.9
(3) Exclusive state taxes	1.6
(4) Taxes divided between state and local governments	-
(5) Exclusive local taxes -	
(a) autonomous tax power of local government granted by federal law	9.2
(b) assigned by federal law	} 2.0
(c) assigned by state law	
	11.2
	235.9

- (b) State legislation and administration. Exclusive state taxes, taxes divided between state and local governments and exclusive local taxes that are not assigned or delegated by federal law. This competence is of small practical importance due to the actual tax assignment by federal law.
- (c) Federal legislation is competent for regulations to prevent double taxation by states, for adjustments to international tax agreements, to protect federal revenues, to prevent restrictions on free trade between the states or with foreign countries. The practical importance of this immense competence is minimal because of the very limited taxing powers of the states.

The Constitutional Basis of Grants and Contributions

As for the assignment and sharing of taxes (Primärer Finanzausgleich), the Austrian Constitution prescribes only abstract rules for the wide-ranging adjustments to the tax allocation arrangements that are made through grants and contributions (Sekundärer Finanzausgleich). The actual forms of these instruments of adjustment which are adopted by the federal and state governments are determined by the laws or, in some cases, by the budgets of

the granting governments. The Constitution provides the following types and competences (Paras 12, 13 F-VG).

(a) General and Specific Purpose Equalisation Grants

These fixed ratio grants (Schlüsselzuweisungen) are designed to equalise for differences in the yields of tax sharing or specific purpose grants among states or communities. The ratios are specified in federal or state laws and are determined by reference to the difference between the average per capita tax yield of all states or communities and the per capita yield for the individual state or community. That is, below-average states or communities have their yields brought up to the average. These grants are used both to equalise for differences in tax sharing grants and to equalise the deficits of certain public services (theatres, hospitals, etc.).

Equalisation grants are within the legislative and administrative competence of the granting authority. Due to the financial dominance of the federal government they are nearly always federal grants. Only one state (Vorarlberg) makes equalisation grants to communities to correct for disparities in tax sharing grants.

b) Equalisation Grants for Revenue Needs

Equalisation grants to meet general revenue needs are provided for by the Constitution to compensate for extraordinary financial burdens, or to help recipient governments balance their budgets. The granting authority has legislative and administrative competence. The practical importance of this type of grant is minimal, because the specified purposes are mainly taken care of by the system of horizontal tax sharing and equalisation or by loans and specific purpose grants. The balancing of local budgets is supervised as by the states (Article 119a Absatz 2 B-VG).

c) Specific Purpose Grants

This type of grant is very frequently used in Austria. It is regulated by federal or state law according to the granting authority. The inequity of granting competences between the federal government and the states is based not only on the unequal financial position but also on the fact that the federal government may use either its general (unlimited) financial legislative competence or its specific (limited) task competence, while states are restricted to their very limited task competences. The only exception to this strict limitation is in the area of non-government administration which, as noted above, is not bound to state competences.

Specific purpose grants may incorporate both spending conditions, as to the uses to which the funds may be allocated by recipient governments, and revenue conditions about matching contributions. The grants thus impose constraints on the budgets of recipient governments and involve tight planning and control of the whole grant program by the federal government. Especially where there are no direct federal competences, as in the fields of agriculture, housing, cultural affairs, hospitals, etc., specific purpose grants are frequently used as instruments of central planning. The Constitution also gives the granting authority the right of supervising the use of grants (Para. 13 F-VG). This leads to strict federal control of some areas of state administration.

Contributions

The Austrian Constitution provides three types of contributions, as follows:

- (a) The General Contributions of Communities to the States (Landesumlage). This type of contribution compensates the states for the loss of their own taxes to communities during the German Occupation, which were not restored after the War because of the opposition of the communities. The Constitution provides that states may raise a contribution from communities up to a limit that is fixed by federal law (now 10.5 per cent of the communities' share of joint federal taxes). This type of contribution is vehemently attacked by the communities, who argue that it inhibits the financing of the enormous increase in public services that has occurred at their level (transport, housing, environmental protection, urban renewal, etc.). The states respond by saying that they will only be prepared to renounce their claim to these contributions if their share of the joint federal taxes is raised by an equivalent amount. This is impossible because it would lower the federal share, which the federal government argues is already too low.
- (b) Special Contributions of Communities. State legislation may require communities to make special contributions to the state, to other communities or to community associations, to compensate for the cost of local public services carried out by these other authorities on their behalf. Such services may include, for example, local welfare services, schools, medical care, regional hospitals, water supply and sewerage, and protection of the environment.
- (c) Contributions of States to the Federal Government. Contributions of states to federal funds or particular federal projects can only be raised on the basis of agreements with the states. There are two types of agreements: the civil law contract - which is the most frequently used type - and the interstate public law treaty. The latter must be validated by both federal and state parliaments. Interstate treaties (Article 15a B-VG) are used to finance two major federal funds: the water supply and conservation fund and the joint hospital maintenance fund. These funds finance special projects of states and communities and subsidise the deficits of public and private hospitals.

Constitutional Rules for Expenditure Responsibility and Cost Sharing

The principle of coincidence of competences and financial responsibility (Paras 2, 4 F-VG). The Constitution starts from the 'basic principle' that each government must bear the costs of its own activities (Para. 2 F-VG) and that all provisions regarding taxing powers and tax sharing must enable the different levels of government to finance their tasks with revenues from their own sources (Para. 4 F-VG). Own-source revenues are those over which governments have full budgetary control, including shared taxes which cannot be changed without their consent. Grants and contributions are not treated as own-source revenues when they relate to specific purposes or special demands. This basic principle may have theoretical importance for fiscal

federalism, but in practice it has little more than propaganda effect. The reasons for this are the high abstraction of the principle itself, political arguments about the responsibility for different kinds of public services, the effect of the exemption of the spending power and of non-government administration from the division of constitutional competences. In practice, cost sharing and financial transfers are steadily increasing and thus eroding the basic principle of financial independence. Federal and state politicians know very well that the real financial status of their governments depends on hard financial negotiations and not on highly abstract legal principles.

The power to shift costs of government administration. In contradistinction to the foregoing principle of financial independence, the Constitution gives the 'competent legal authority' the power to establish exemptions and variations to the principle without any indication of the limits or even the reasons for such changes. The 'competent legal authority' is either the competent financial authority when contributions to costs are made to other authorities or the general regulation competence (Articles 10 to 15 B-VG) when contributions to costs are required from other authorities. Examples of the first type of cost shifting involve cost contributions to states by the federal government for basic social welfare and elementary school teachers to states by the federal government (Paras 2, 3 FAG). As examples of the second type of cost shifting is the requirement that the states assume the cost of delegated federal administration (Para. 1 FAG). As noted above, the states also frequently shift costs to communities by requiring special purpose contributions.

In addition to formal cost shifting by the competent legal authority, there exist in practice a great number of private law or gentlemen's agreements which involve cost sharing between governments. These represent informal cost sharing arrangements outside official financial legislation (Grauer Finanzausgleich). Common examples of this type involve temporary loans from the states or leasing arrangements in respect of federal projects (universities, schools, highways, federal railways, and military barracks) which are of local or regional importance, and federal grants or subsidies for state or community projects that are regarded as having national political importance. These arrangements usually involve political deals between governments.

5 FISCAL RELATIONS BETWEEN THE DIFFERENT LEVELS OF THE FEDERAL SYSTEM (VERTIKALER FINANZAUSGLEICH)

The Principle of Political Financial Agreement

The assignment and the sharing of taxes between the different levels are formally regulated by a federal tax sharing law (Finanzausgleichsgesetz (FAG)). This covers the six years from 1 January 1979 to 31 December 1984. Although the federal government may make unilateral decisions about financial relations without regard to the views of the 'lower' levels, in practice there have always been tripartite negotiations before the adoption of new tax sharing laws and there has always been a political agreement (Finanzausgleichspakt) between the three levels about the principles of assignment and sharing of taxes for the next period. Of course the bargaining positions of the federal government and of states and communities are not equal. As a result of its legal and financial superiority, the federal government is in the position of being a principal dealing with agents and can effectively determine the starting positions and the limits of the financial bargaining.

Some scholars have compared the position of the states and local governments with the well-known 'prisoner's dilemma'. Due to the fact that financial relations are based on political bargaining and agreements between the levels, changes in the structure or in tax sharing ratios are very limited and the system itself becomes more and more sacrosanct to the member governments. Of course, that is only true so long as the federal government conforms to the principle that financial relations should be settled by agreement between the levels. There are indications that this may change as the financial needs of the federal government become more acute in the context of the country's general economic problems.

The General Structure and Development of Tax Sharing

Tax sharing (Finanzausgleich) in Austria is characterised by the increasing importance of joint federal taxes and the steadily decreasing importance of other taxes, especially the taxes that are exclusive to particular levels - even those of the federal government. The reason for this development is the high income elasticity of the yields of joint taxes and the relative stagnation of certain local government taxes (real estate tax, business tax, beverage tax), while exclusive state taxes are practically non-existent. The basis of sharing the joint taxes reflects historical ratios of distribution (see Table 3 below). These ratios have resulted from tripartite bargaining and compromises between the three levels and cannot be easily changed. The adoption of different ratios for different taxes facilitates compromises but from an economic point of view is not rational. A single ratio for all joint federal taxes would be more neutral and efficient and its effects would be more readily apparent. The consequence of the different sharing bases has been a disproportionate growth in the shares of the joint taxes which accrue to the three levels of government, the federal government being favoured by its high proportions of personal income tax (60 per cent) and value-added tax (70 per cent); which are both highly elastic taxes. Revenues from these increased from 25 per cent of all taxes in 1958 to 53 per cent in 1978.

Special Federal Funds and Non-Government Agencies

Revenue sharing between governments is only part of the financial relations and public finance arrangements in Austria. As mentioned above, a considerable part of the public sector is organised as non-territorial self-governing organisations, public funds or even as private law companies. These organisations do not form part of the official sharing of finances between the levels of government, except for any subsidies they receive from general revenues through government budgets. Apart from these subsidies, which are especially important in the social welfare and health insurance system, the huge public or quasi-public funds are financed by direct fees, rates and charges (for example, road tolls) that are not subject to financial sharing. The size of these 'parafiscal entities' may be gauged by the fact that the social security funds alone are one-third bigger than each of the combined state and local revenues and more than half the size of the federal government's revenues. There are no official figures for the whole sector, but the funds are undoubtedly central funds which have the effect of weakening the financial positions of other levels.

Assignment and Sharing of Taxes Under the Tax Sharing Law (FAG) of 1979

The 1979 legislation on tax sharing and tax assignment, which remains valid until 31 December 1984, was agreed to on 15 December 1978 after strongly-contested tripartite negotiations about the shares of the communities and states. The ratios of division and assignment are shown in Tables 2 and 3 and their vital importance is demonstrated by the amounts raised by the various taxes in 1978, the last year of the old arrangements (Table 2), and the estimated revenues for 1982 (Table 3).

Sharing of Joint Federal Taxes

The joint federal taxes are the most important source of revenue for states (98 per cent) and local governments (67 per cent). Therefore the tax sharing system has a decisive influence on their financial positions. This is the reason why there are many different ratios for dividing and redistributing the revenues of the shared taxes among states and local governments, each ratio being the result of bargaining and compromises. Although the sharing of the joint federal taxes is primarily a vertical settlement between the different levels, the distribution in effect incorporates fiscal equalisation criteria so that horizontal and vertical financial settlement cannot be clearly separated in Austria. Table 3 shows the basis of distribution of the different shared taxes among states and local governments.

Because of its ambiguous character as a state and local government, there is a general limit on the share Vienna can receive (Para. 9 FAG). The reason for this limit was partly historical and partly the imbalance of the capital's population compared to that of the other states of Austria, which could have led to a predominance in tax sharing. Today the population and the economic capacity of Vienna are no greater than those of the larger states so that the legal limit on Vienna's sharing is merely theoretical and has never been attained. The limit is 30.4 per cent of the total state or community share; any excess entitlement above this is reduced by one-half until an absolute limit is reached at 33 per cent of the total state or community share.

Table 2

ASSIGNMENT AND SHARING OF TAXES UNDER FEDERAL AUSTRIAN LAW FROM 1 JANUARY 1979

	Revenue in 1978 Billion Schillings
(a) <u>Exclusive federal taxes</u>	
(1) <u>Certain income and wealth taxes</u> , including: corporation tax (7.2), wealth tax (3.3), housing contribution (2.5), employer's contribution to equalisation of family burden (child endowment) (16.9)	31.0
(2) <u>Special excise taxes</u> , including: tobacco tax (6.5), federal oil tax (9.9)	16.6
(3) <u>Duties and fees</u> , including: federal stamp duties (3.1), court fees (1.2), insurance tax (1.6)	7.9
(4) <u>Customs and monopoly revenues</u> , including: import and export taxes (2.6), monopoly of spirits (0.2)	3.4
(5) <u> earmarked contributions and surtaxes for special purposes</u> , including: housing (6.4), disaster funds (7.4), general contribution to family burden equalisation (child endowment) (6.8)	17.3
	76.2
(b) <u>Taxes divided between federal, state and local governments</u>	
(1) <u>Joint federal taxes</u> , including: income tax assessed (13.4), income tax deducted (38.9), VAT (70.9), alcohol tax (1.8), motor vehicle tax (2.5)	132.9
(2) <u>State surtaxes on federal taxes</u> : betting taxes	0.006
(3) <u>Taxes on same base</u> : federal business tax (4.8), shared business tax (4.8), pay-roll tax (4.4)	14.0
	146.9
(c) <u>Exclusive state taxes</u>	
(1) <u>Taxes assigned by federal law</u> , including: fire insurance tax (0.3), advertisement tax (0.3), taxes on hunting and fishing (0.4)	1.3
(2) <u>Taxes based on the state rights of tax invention</u> , including: special purpose tax for Vienna's underground railway (0.26)	0.3
	1.6
(d) <u>Exclusive local taxes</u>	
(1) <u>Taxes based on autonomous resolution of local government</u> , including: real estate taxes (2.3), excises on drinks and ice-cream (2.6), fees and duties for local public services (4.3)	9.2
(2) <u>Taxes assigned by federal or state law</u> , including: tourist traffic tax (0.3), special purpose property taxes (0.6)	2.0
	11.2
Total	235.9

Table 3

DISTRIBUTION OF JOINT FEDERAL TAXES BETWEEN LEVELS OF GOVERNMENT (PRIMARY FINANCIAL SETTLEMENT), 1962

Tax	Total (Billion Schillings)		Federal		State		Local		Basis of Distribution Among States	Basis of Distribution Among Local Governments
	%	%	%	%	%	%				
Income tax (assessed)	25.0	43	30	27	state tax yields		60% local tax yields 40% local business tax yields		graduated populations weighted according to population size 1 (below 1,000) to 2 (above 50,000)	
Income tax (deducted)	75.0	59.191	22.727	18.182	state populations				local tax yields	
Tax on interest	0.6	10	15	75	state tax yields				39.13% local populations 50.00% graduated populations 10.87% local yields of business tax	
Value-added tax	100.0	69.692	18.558	11.750	97.06% state populations 0.4% Vienna 2.45% state populations without Vienna				local consumption of beer	
Beer excise	0.72	17	57	26	consumption of beer in the states				local populations	
Alcohol excise	2.3	40	30	30	state populations				-	
Inheritance and gift tax	0.8	70	30	-	state tax yields				-	
Oil excise (additional to federal oil tax)	2.0	2	74	24	22.04% state populations 22.04% state areas 14.6% state yields of motor vehicle tax 14.6% state yields of business tax 14.6% state length of roads 11.82% special allocation to Burgenland, Niederösterreich, and Steiermark (eastern states)		25% local populations 25% local areas 16.67% local yields of motor vehicle tax 16.67% local yields of business tax 16.67% local length of roads			
Motor vehicle tax	1.52	50	50	-	state tax yields				-	
Purchase of land tax	2.1	4	-	96	-				local tax yields	
Tax on land speculation	0.06	4	-	96	-				local tax yields	
Tax on gambling casinos	0.43	70	15	15	state tax yields				local tax yields	
Arts promotion tax	0.08	70	30	-	state populations				-	

Modification of Tax Sharing by Transfers Between Governments (Sekundärer Finanzausgleich)

The yield of financial revenues as provided by the tax assignment and tax sharing (the primary financial settlement) is modified by a number of transfers (grants, contributions and cost sharing payments) between governments (the secondary financial settlement). The most important examples of these transfers and their amounts are shown in Table 4.

As shown by Table 5 the secondary financial settlement by transfers mainly favours the states. This is because of the substantial transfers and cost sharing payments from the federal government and the communities for such matters as teachers' wages, housing and general and special contributions of the communities. A strange form of double transfer is the financing system for public housing. The costs of this program are deducted from the state and community shares of the joint federal taxes and are then returned by the federal government to the states as specific purpose grants.

As noted in Chapter 4, in addition to these official transfers there are numerous non-official cost sharing arrangements between the federal government, states, communities and quasi-government organisations to finance special projects (such as roads, hospitals, schools or universities) or subsidise private expenditures. The main reason for this unofficial cost sharing (tertiary financial settlement) is that state and local governments seek certain types of federal expenditure within their territories and in return agree to share the costs with the federal government.

There is no doubt that the secondary and tertiary financial settlements are constitutionally, politically and in most cases also economically inefficient. The unofficial transfers and cost sharing arrangements in particular have the effect of increasing the dependence of the states and communities on the federal government. In addition, these arrangements are steadily eroding the official financial settlement, which is intended to grant financial and political independence to the subordinate levels for six years and to provide a legal and rational system of equalisation within each level.

Analysis of the States' Position in Austria's Financial System

As shown above, the position of the Austrian states in the financial assignment and tax sharing system is peculiar for a federal system. The typical elements of this situation are:

- (a) the states have no own taxes of any importance, receiving only about 4 per cent of their tax revenues from sources under their own control;
- (b) their main revenues come from the sharing of joint federal taxes in a tripartite system with local governments, the shares being fixed by federal law without constitutional prescription of sharing ratios;
- (c) a substantial part of their revenues (more than 25 per cent) is derived from transfers, cost sharing and contributions, again fixed by federal law without constitutional guarantees;

Table 4

MODIFICATION OF TAX SHARING BY TRANSFERS BETWEEN GOVERNMENTS, AUSTRIA, 1978

Type of Transfer	Granting → Recipient Government	Amount of Transfer
		Billion Schillings
<u>Compensation transfers,</u>		
including:		
Salaries for state teachers	federal → states	12.5
Pensions for state teachers	federal → states	2.8
		15.4
<u>General purpose equalisation grants to communities,</u>		
including:		
13.5% of the regular share of joint federal taxes	federal → states (fixed share) → communities (according to special purpose)	2.2
State equalisation grants to communities	states → communities	1.1
		3.3
<u>Equalisation grants, including:</u>		
Equalisation of state per capita tax yields (joint federal taxes)	federal → states	0.500
Equalisation of communities' per capita tax yields	federal → states (fixed share) → communities	0.683
Sharing of theatre, hospital deficits	federal → communities	0.013
Federal railway stations in communities	federal → communities	0.070
		1.4
<u>Other specific purpose grants (federal), including:</u>		
Theatres	federal → states and communities	0.100
Tourist traffic	federal → communities	0.050
Local transport systems	federal → communities	0.100
Environmental protection	federal → states and communities	0.05
Disaster damage subsidies	federal → states	0.3
		0.6
<u>Special federal programs, including:</u>		
Housing	federal → states	9.5
Water supply and conservation	federal → states and communities/community associations	1.1
Vienna Subway	federal → communities	0.3
Urban renewal	federal → states	0.2
Agriculture	federal → states	0.8
		11.9
<u>Cost contributions, including:</u>		
General community contribution to states	communities → states	2.0
Social welfare (basic)	communities → states/community associations	1.5
School	communities → community associations	0.4
Family burden equalisation	states → federal	0.1
Hospitals	communities → states	0.5
Other	states → federal	0.4
		4.9
Total		37.5

Table 5

SHARES OF TAX REVENUES BY LEVELS OF GOVERNMENT, 1959 TO 1978

Year	After Primary Financial Settlement			After Secondary Financial Settlement			Total	
	Federal %	States %	Local %	Federal %	States %	Local %	%	Billion Schillings
1959	69.8	11.9	18.3	63.3	18.3	18.4	100.0	32.2
1963	69.8	12.3	17.9	62.4	18.5	19.1	100.0	49.3
1968	69.7	13.0	17.3	61.3	20.2	18.5	100.0	77.5
1973	68.9	13.6	17.5	55.1	25.5	19.4	100.0	135.1
1978	69.0	13.8	17.1	55.0	26.9	18.1	100.0	224.8

- (d) there is a substantial reverse flow of state funds to the federal government by means of an unofficial financial settlement (Grauer Finanzausgleich) in the form of cost sharing, prefinancing and subsidising of federal projects and programs of specific regional interest. This tertiary financial settlement is regulated by private law agreements and instruments or by political gentlemen's agreements.

The effect of these four elements is that the Austrian states are completely dependent on the federal government insofar as their finances are concerned, irrespective of whether or not the funds they receive are adequate. This is the result of the centralising history and the political theory mentioned above. All the efforts of the states to change this situation, which does not recognise their constitutional position as a partner in the federal system, have so far failed.

6 FINANCIAL RELATIONS WITHIN THE SAME LEVEL OF GOVERNMENT (HORIZONTALER FINANZAUSGLEICH)

General Remarks

The Austrian Constitution and the financial settlements do not make separate arrangements for horizontal equalisation, but provide for equalisation to be achieved through tax sharing within the primary and secondary vertical financial settlements between the different levels of government. The most important equalising effect stems from the specialised system of sharing joint federal taxes as mentioned above. It is thus not surprising that the federal government controls the equalisation instruments and procedures even at the local government level. But in addition to these centralised equalisation instruments, the states also have responsibilities and tasks in harmonising and supervising local finances. The federal government recently proposed a program designed to assist communities directly through federal grants (equalisation grants for revenue needs). This was strenuously opposed by the state governments because it would give local political influence to the federal government, when constitutional and political practice had assigned the responsibility for supervising local government to the states.

Equalisation Between the States: The Different Sharing Systems

Of the total tax revenues of the states under the primary financial settlement, 96 per cent is derived from tax sharing. The division of the total state share of joint taxes among individual states is different for each of the joint taxes, as shown in Table 3. There are three different systems of sharing:

(a) Population. This distributes the state share of a tax according to population, based on the principle that there is a relationship between population and the size of public expenditure. Originally this distribution was considered relevant to the cost of basic public services such as public transport, water, energy, schools, hospitals and similar services. But it is now regarded as appropriate also for social welfare and redistributive expenditures.

The main effect of the distribution arrangements is an equalisation of rich and poor states, since they make regional financial capacity independent of the regional tax yield. On the other hand, the equalisation effect is restricted by migration between rich and poor states, involving a population movement from east to west in Austria and a steady increase in the financial power of the western states. There is also a problem with old cities and old mining and industrial areas, especially when they have economic and structural problems. The population basis of distribution suggests that there is a relatively high need for public services in these areas, associated for example with urban renewal and housing problems in Vienna (with an estimated need in the next ten years of over S 200 billion) and with public subsidies for declining industries (such as the need to subsidise nationalised coal mining and steel industries in eastern and southern Austria).

Despite these special problems, it seems that the weight given to population reflects the political and economic philosophy of yesterday which favoured urbanism, industrialisation and economies of scale. The sociological, human and environmental problems which resulted from this

development, which cannot be solved by providing more financial capacity, are becoming more obvious in all industrialised countries, including Austria. They require a philosophy of decentralisation and a new equilibrium between town and country that can only be gained by equal provision of public facilities and services in urban and non-urban areas. This requires more than a distribution of grants and expenditures on the basis of population.

A final problem with this basis of tax sharing is the difficulty of obtaining accurate population statistics. The Austrian use of ten-year census periods, which themselves have a time lag of 1.5 years before final results are published, is unsatisfactory because expenditure needs associated with increasing population are ignored within ten-year periods and governments therefore complain of an annual loss of public finance capacity caused by the long periods between population reviews.

As shown in Table 3, population is used as the basis of distributing most important taxes, especially the deducted income tax (Lohnsteuer), the value-added tax (VAT) (Umsatzsteuer), the alcohol tax and parts of the oil excise and arts promotion tax. Deducted income tax and VAT account for about two-thirds of all taxes shared by the states. The equalising effect of the equal per capita basis of tax sharing in Austria is therefore very important (see Table 6).

(b) Tax yields. The tax yield basis of distribution means that every state receives that proportion of the total state share of joint taxes which corresponds to the proportion of the tax yield in its territory to the national tax yield. It applies to assessed income tax, the tax on interest, inheritance and gift tax, motor vehicle tax, the tax on gambling casinos and part of the oil excise. The tax yield basis favours the financially-stronger states and causes disparities among the fiscal capacities of states. However, these disparities are largely removed after the secondary financial settlement, because of the relatively small part of state total fiscal capacity that is due to actual tax yields (see Table 6).

(c) Specialised Tax Sharing Criteria. As shown in Table 3, rather curious and complicated systems of sharing are used for beer excise (regional consumption) and oil excise. The main difficulty with the consumption basis of sharing beer excise is that one cannot be sure where beer is actually consumed. Therefore the law provides for a very complicated system of 'abstract beer consumption' based on special monthly reports of breweries, retailers and customs offices (for imported beer). The artificial sharing of oil excise on the other hand is based on a comparison of the length of roads, numbers of motor vehicles and businesses in the states, with a favoured weighting for the eastern states due simply to the former Russian occupation of those states. The effect of these ratios on state finances is, however, very slight because of their small yield (in 1980 the beer excise raised S 612 million while the oil excise raised S 1,871 million).

The Federal Per Capita Equalisation Grant

The relatively small per capita disparities among the states as a result of the predominance of the population basis of distribution are almost equalised by a special federal equalisation grant (Kopfquotenausgleich). This grant is paid by the federal government to states which do not receive the average per capita fiscal capacity of all Austrian states from their shares of joint federal taxes. Its rate corresponds to the difference between a recipient state's fiscal capacity and the average per capita fiscal capacity. Five Austrian states (Burgenland, Niederösterreich,

Table 6
EFFECTS OF FINANCIAL SETTLEMENTS ON STATE REVENUES, 1958 AND 1978(a)

	Fiscal Revenues Per Capita in Austrian Schillings				Gini Coefficient			
	Austria 1958	Burgenland(b) 1978	Salzburg(b) 1958	Salzburg(b) 1978	Austria 1958	Austria 1978		
State taxes	24	162	11	102	43	200	0.2101	0.2499
State yield of joint federal taxes	373	3,057	157	1,157	536	6,734	0.1142	0.2358
Revenues after primary financial settlement	493	4,169	412	3,808	544	4,527	0.0367	0.0272
Revenues after secondary financial settlement	731	8,784	671	8,279	788	9,493	0.0277	0.0255

Notes: (a) Excluding Vienna.

(b) Burgenland is the state with the lowest fiscal capacity while Salzburg has the highest capacity.

Oberösterreich, Steiermark and Kärnten) receive this equalising grant and therefore are brought up to the average tax sharing revenues. The three western states (Vorarlberg, Tyrol, Salzburg) and Vienna obtain a slightly higher proportion of tax sharing funds due to their higher tax yields. How little the differences are, however, is indicated by the fact that the equalising block grant as a whole was only S 731 million in 1980.

Disparity Effects of the Secondary Financial Settlement

As noted in Table 5, the states obtain a large proportion of their financial capacity from grants, cost sharing arrangements and contributions of local governments under the secondary financial settlement (Sekundärer Finanzausgleich). Neither cost sharing arrangements nor the general community contributions to states (10.5 per cent of the communities' share of joint federal taxes) have much effect on state per capita shares because they are closely related to the populations of the states. Some specific purpose grants (such as those for public housing, water or Vienna's subway system) have regional or local effects because they depend on regional or local conditions. Nevertheless the total effect of the secondary financial settlement on state revenue relativities is quite low (see Table 6). As a result official financial settlement grants to Austrian states produce an average financial capacity that does not differ much from an equal per capita distribution and therefore depends very much on the size of the population of the several states. Only a slightly higher capacity is granted to the three rich western states and Vienna due to their higher regional tax yields in some minor taxes.

The Effects of the Tertiary Financial Settlement

As mentioned above, there exists a network of unofficial financial relations among governments and quasi-government or non-government organisations in Austria, which is called 'grey financial settlement' (Grauer Finanzausgleich). It exists in every type of agreement between governments about cost sharing in respect of federal projects, in joint arrangements for subsidising private or quasi-government funds, and in joint regional development planning authorities. The impact of these refinancing systems on the official tax sharing and grants systems is very great indeed and leads to specific differences in the relative financial situations of states that follow no rational principles. Rather they reflect whether political relations with the federal government in Vienna are good or bad, as is shown by the example of Tyrol, by that state's skill in attracting projects of nation-wide interest (such as Olympic Games, traffic and tourist facilities) that have to be financed by special joint arrangements. Those somehow irrational financial relations, that follow to a certain extent the pattern of co-operative federalism, have been criticised because of the increasing financial dependence of states and communities and the confused financial situation of governments they cause. There are no national or state statistics on the size or the relationship of the tertiary financial settlement to the official financial settlement.

Equalisation Between Local Governments: Disparities in Yields of Exclusive Local Taxes

Unlike the situation of the states, the tax yield of local government taxes still forms an important part of the communities' fiscal revenues, even though the proportion has dramatically changed during the last twenty years

from two-thirds to one-third of their total revenue (see Table 7). The most profitable community taxes are different types of business taxes, pay-roll tax and real estate taxes, which can theoretically be varied by autonomous statute of the communities within certain legal limits, but which in practice have been raised everywhere to the highest possible level because of the overstretched financial capacity of the communities. In spite of the legal equality of all communities their actual financial positions vary significantly, because the yields of their taxes depend very much on local economic and structural (industrial, agricultural or residential) conditions. The well-known example, whereby an industrial community collects business and pay-roll taxes and the neighbouring communities have to bear great infrastructure burdens because the workers live there and not in the industrial community, illustrates the wide scope for variations in the fiscal capacities of local governments under the system of local taxation. There is no direct equalisation of local government taxes as between different communities, but only grants from federal or state governments and equalising provisions for the sharing of joint federal taxes.

The Equalised Sharing of Joint Federal Taxes Among Local Governments (Primary Financial Settlement)

The sharing of joint federal taxes somewhat reduces the fiscal disparities of local communities but on the other hand the methods used create other differences in fiscal capacity.

The Calculation of State Proportions of Community Shares

The sharing of joint federal taxes among communities is carried out in two steps.

The first step is called (Oberverteilung or general sharing). Under this, the communities' total share of joint taxes (calculated according to the different bases of distribution listed in Table 3) is divided between the nine states according to the ratios fixed for the different taxes (Table 3).

The second step is called (Unterverteilung or special sharing). Each state's share is divided among the communities according to the criteria indicated in Table 3, but with several deductions which are described below.

The effect of this two-step sharing is especially significant when taxes are divided according to weighted population size, because in this case for the first step not the total population but the population structure by size of communities is decisive in determining the states' proportions of communities shares. It therefore happens quite frequently that communities of the same population size have different shares of federal joint taxes in different states.

The General Deductions from Community Shares

Before the shares of joint federal taxes are divided between the individual communities of a state (special sharing), there are three different types of deductions withheld by the states:

Table 7

EFFECTS OF FINANCIAL SETTLEMENTS ON COMMUNITY REVENUES, 1958 AND 1978(a)

	Fiscal Revenues Per Capita in Austrian Schillings				
	Austria All Communities	Burgenland Communities	Salzburg Communities	Communities 0-500	Communities 50,001-250,000
Exclusive community taxes	1958 494	207	673	171	979
	1978 1,985	1,111	3,041	1,241	3,145
Local yield of joint federal taxes	1958 638	267	877	220	1,261
	1978 3,933	1,821	7,439	2,566	6,504
Revenues after primary tax sharing	1958 643	319	846	292	1,208
	1978 4,379	3,058	5,936	3,179	6,718
Revenues after grants to communities	1958 781	414	1,037	452	1,318
	1978 5,376	3,693	6,862	4,541	7,586
Revenues after contrib- utions to state and community associations	1958 589	281	853	338	1,059
	1978 4,490	3,086	5,973	3,661	6,584

Note: (a) Excluding Vienna.

- (a) The first is the contribution to the state, which is fixed by federal law at 10.5 per cent of the communities' share and forms part of the state's fiscal revenues.
- (b) The second is a deduction for community equalisation funds, which is fixed by federal law at 13.5 per cent of the communities' share and is allocated by the state at its discretion as grants to individual communities to meet special needs.
- (c) The third is a per capita fiscal equalisation grant, which must be subsidised by the communities of the state as a whole. (This contrasts with the states' per capita equalisation, which is financed by the federal government.) Its amount is equal to 30 per cent of the difference between the fiscal capacity and the fiscal need of the particular community. Fiscal need is the average per capita fiscal capacity of the communities of the state calculated on the basis of weighted populations. Fiscal capacity is the local yield of business and real estate taxes in the last year. To finance this equalisation grant the communities have to give up 5 per cent of the communities' share for the state; this is also deducted before dividing the state's share among individual communities. The equalising effect of this grant is not very great because it is based on the average local real estate and business tax yield and because the graduated population proportion leads to new disparities between large and small communities. About 1.6 per cent of the total fiscal revenues of the communities as a whole is involved in this fiscal capacity grant.

Graduated Population Weights

About 70 per cent of the communities' share of joint federal taxes is weighted according to the size of population (see Table 3). This weighted proportion is fixed by federal law (Para. 8(3) FAG) as indicated in Table 8.

The population weights are intended to allow for the relatively higher expenditures of larger communities, especially for the infrastructure services performed by local government. The multipliers are, however, not the result of economic analysis but of political negotiations. They have been steadily reduced over time but remain the subject of almost unanimous scholarly criticism. A claim that the whole system of population weighting was unconstitutional (because of its inconsistency with the constitutional principle of uniform and equal communities noted above) was rejected by the Constitutional Court in 1981 (Decision A 7/80 of 30 November 1981). Especially criticised has been the favoured position of Vienna and the neglect of structural or geographical reasons for high financial burdens of some communities (e.g. the high cost of public facilities and services in mountain areas of some states).

The Equalisation Effect of Grants and Contributions (Secondary Financial Settlement)

The structure of the secondary financial settlement is completely different as between the state level and the communities' level. While states nearly always have their fiscal capacity augmented by grants and

Table 8

POPULATION WEIGHTS FOR COMMUNITIES

<u>Community Population</u>	<u>Population Weight</u>
Not exceeding 1,000	$1\frac{1}{6}$
1,001 to 10,000	$1\frac{1}{3}$
10,001 to 20,000	$1\frac{2}{3}$
20,001 to 50,000	2 ^(a)
Above 50,000	$2\frac{1}{3}$ ^(b)

Notes: (a) Statutory communities with populations of up to 50,000 also have a weight of 2.

(b) Vienna also has a weight of $2\frac{1}{3}$.

contributions (to the extent of about 25 per cent of their total revenues), communities both gain and lose fiscal capacity. Only during the last 10 years has the balance of these fiscal movements been positive for the average community, which now receives about 12 per cent of its revenues from grants and contributions.

The equalisation takes place primarily between the communities of the same state, because the most important equalising formulas are based on state averages or are determined by state decisions. Only few direct federal grants are made directly to communities (Paras 20, 21 FAG; see also Table 4). An attempt by the federal government to extend the range was vehemently rejected by the states. The consequence of this fiscal mediation by states is that the equalisation of communities is primarily equalisation within states and not across the states on a national basis. As shown in Table 7, however, the equalisation process works also in the direction of reducing the very high differences between local fiscal capacities in the rich and poor states.

The grants to communities have clear-cut equalising effects because they are made to communities within a state with smaller than average fiscal capacity. However, the community contributions to states and community associations (see Table 4) usually increase disparities in fiscal capacity, because they are based on average per capita ratios and therefore do not distinguish between communities. The community shares after the secondary financial settlement are therefore less equal than after the primary financial settlement (see Table 7).

Special Equalisation Arrangements for Vienna

As mentioned above, the ambiguous constitutional position of Vienna as both a state and a local government led to the legal limitation of the city's share of the joint federal taxes (Para. 9 FAG). In reality, however, a

comparison of the position of the capital before and after the primary fiscal settlement shows that Vienna contributes much more to the common tax revenue than it earns as a state and community (see Table 9). The relative position of Vienna in the fiscal system has improved in recent years, because her own tax revenues have been stagnating while those of the western states have been increasing. This means that these rich states (and their communities) also contribute more to the yield of the joint federal taxes than they get back from the sharing system. In the long run, the prescribed limit on Vienna's share of the joint federal taxes may become effective, as the capital's fiscal situation has been deteriorating and has only been alleviated by special federal assistance and increasing public debt.

Table 9

EFFECTS OF FINANCIAL SETTLEMENTS ON COMBINED STATE AND COMMUNITY REVENUES, 1958 AND 1978^(a)

	Revenues Per Capita in Austrian Schillings					
	Austria		Burgenland		Vienna	
	1958	1978	1958	1978	1958	1978
Exclusive state and community taxes	612	2,378	218	1,214	922	3,215
State and local yields of joint federal taxes	1,277	7,990	424	2,979	2,253	16,897
Revenues after primary tax sharing	1,301	9,135	732	6,866	1,843	11,260
Revenues after grants to communities	1,612	14,510	1,085	11,973	1,912	15,779
Revenues after contributions to state and community associations	1,393	13,489	907	11,072	1,759	15,429

Note: (a) Including Vienna.

The Effects of the Tertiary Financial Settlement

Austrian communities are generally in a very bad financial situation at present, because heavy borrowing during earlier times of prosperity has left a legacy of high debt charges and because their public services are steadily becoming more costly to provide. Many communities have also competed with each other in providing public goods (sporting facilities, schools, roads, etc.), with the result that they have to incur high operating costs. Therefore communities often depend on state or federal subsidies outside the official financial settlement. There are several public funds which are mainly used for loans to communities or communal enterprises. One reason for the huge communal debt has been the use of joint financing systems for federal projects of local importance. Mainly because of ideological reasons, Vienna has become involved in huge economic enterprises which produce large deficits that have to be partly covered by special federal subsidies.

Although there are different theoretical views as to the necessity for fiscal policy for economic stabilisation and the extent to which it should be used for that purpose, in practice all governments use tax and budget policy measures of some kind as instruments of stabilisation. In federal countries, the problem of allocating and harmonising stabilisation policy is a frequently discussed topic, because there are important interactions between fiscal stabilisation arrangements and tax sharing or the allocation of taxing powers to different governments. On the revenue side, there is the problem of the sensitivity of tax shares to changing economic situations and the question whether taxation policy should be centralised or decentralised (which has implications among other things for the level of private spending). On the expenditure side, the problem is one of adopting counter-cyclical policies to offset the effects on prices and employment of fluctuations in private income and expenditure policies.

In responding to these problems, governments must adopt flexible budget and debt policies. Both are difficult in federal countries, because state and local governments may have different views from those of the federal government about the economic situation and the appropriate budget result and borrowing requirement. On the other hand, economic policies within a federal system are normally so interdependent that harmonised taxation and public investment decisions are required. If this harmonisation is achieved through federal grants or limits on state and local taxes and expenditures, a substantial erosion of the financial independence of the lower levels of government is implied.

Stabilisation and State and Local Government Taxation

It has been seen that the Austrian federal government has the legal power to determine the key elements of stabilisation policy for all levels of government. Federal legislation sets the tax rates for all major taxes (exclusive and joint federal taxes) and imposes very tight limits on local tax autonomy. State taxes are not of any importance for fiscal policy because they contribute such a low percentage of state revenues (no more than four per cent as a maximum).

But not only is the relationship between public and private income and spending powers in general almost completely determined by federal law; the basic tax assignment and sharing of revenues between levels of government are also regulated by federal fiscal legislation. As the federal government is decisive in formulating stabilisation policies at all levels, state and local government revenues themselves depend on federal stabilisation policy decisions. Taxes that depend for their yields on the level of economic activity cause procyclical budgetary fluctuations for lower governments which cannot be influenced by their own policies in such a way as to enable them to control their budgetary margins. In the Austrian system of primary financial settlement this applies to the exclusive local taxes to some extent (especially the business tax and the pay-roll tax), while the states' shared taxes are so diffused that they move relatively in line with economic fluctuations.

All levels of government wish to have highly elastic taxes (especially the value-added tax and the deducted income tax). The gradual movement from exclusive local taxes to shares of joint federal taxes in the communities is a very clear indicator of their increasing dependence upon federal

stabilisation policy. As shown in Table 7, the proportion of exclusive local taxes to total community revenues before transfers had decreased from nearly four-fifths in 1958 to less than one-half in 1978. As for the states, their revenues from the primary financial settlement are subject to the same stabilisation effects as the federal government's own tax revenues. But the decisive disadvantage for them also is their dependence on federal fiscal decisions.

Stabilisation and Public Expenditures

Table 10 shows the shares of the different levels of government in public expenditure, with the proportions for state and local governments increasing between 1958 and 1978 at the expense of the federal government.

Table 10

SHARES OF GOVERNMENT EXPENDITURES BY LEVELS OF GOVERNMENT, 1958 TO 1978

Year	Federal %	States ^(a) %	Vienna %	Local Government ^(a) %	Total	
					%	Billion Schillings
1958	71.0	10.1	8.0	10.9	100.0	58.3
1963	68.4	10.5	8.5	12.6	100.0	86.4
1968	64.4	12.7	9.2	13.7	100.0	133.9
1973	58.1	17.6	10.4	14.0	100.0	243.1
1978	59.5	17.0	10.9	12.6	100.0	446.1

Note: (a) Excluding Vienna.

The system of financial settlements between the three levels of government as provided by constitutional law should leave full responsibility for public expenditures to individual governments. But in practice a considerable part of the secondary financial settlement and all the transfers of the tertiary financial settlement influence the expenditure decisions of recipient governments. Especially the specific purpose grants, the grants for special needs, and the combined financing and subsidising systems are instruments of central planning which are used to control the expenditures of lower-level governments. In spite of these great influences on the expenditures of state and local governments, the federal government argues that it needs to have still more responsibility for stabilisation and redistribution policies. Table 11 shows that for social welfare expenditure this argument is not convincing. States are substantially involved in regional and local economic stabilisation by means of infrastructure and labour policies and subsidies to private enterprises. Also state grants to communities are frequently used as means of economic stabilisation.

Stabilisation and Public Borrowing

Generally, all levels of government (federal, state and local) have control over their own borrowing, subject to two exceptions:

Table 11

EXAMPLES OF REDISTRIBUTIVE EXPENDITURES BY DIFFERENT LEVELS OF GOVERNMENT

Selected Categories of Expenditure	Expenditure Per Capita			Average Annual Increase
	1958	1968	1978	%
	Schillings			
<u>Federal:</u>				
Labour market	149	253	829	9.0
War pensions	197	304	713	6.7
Social insurance	179	1,285	3,232	15.6
Equalisation of family burdens	361	955	3,556	12.1
Stabilisation of prices	124	296	293	4.1
Total	1,010	3,094	8,622	11.3
<u>States (excluding Vienna)</u>				
Basic welfare, youth welfare	121	275	879	10.4
<u>Vienna</u>				
Basic welfare, youth welfare	247	391	1,345	8.8
<u>Local governments (excluding Vienna)</u>				
Basic welfare, youth welfare	59	109	235	7.2
<u>Social welfare expenditure by different levels^(a)</u>				
Federal	-	3,111	8,804	11.6
State (excluding Vienna)	-	142	707	18.2
Vienna	-	578	7,793	11.9

Note: (a) Social Welfare (Soziale Wohlfahrt) is an official concept in the Austrian uniform rules which applies to budgeting at all levels of government (Voranschlags- und Rechnungsabschlussverordnung, BGBl Nr. 159/1983). It includes the following categories: general basic welfare; assistance for blind and other handicapped persons; war pensions; homes for aged persons, children, mothers and nursing homes for other groups; disaster relief; equalisation of family burdens (e.g. child endowment, school books, school busing); assistance for refugees; and social policy including unemployment relief.

(a) Borrowing by state or local governments and of their public enterprises must have the consent of the federal Minister of Finance when it involves foreign currency or is undertaken in foreign countries, or when it takes the form of public bond issues (Para. 14 F-VG).

- (b) Public borrowing by local governments can be subject to the general control of or specific approval by state governments, depending on the budgetary situation of individual local governments.

A large proportion of public borrowing is raised by special public funds, public enterprises, quasi-government organisations and the great nationalised banks. All borrowing by federal and state governments (including extensions or conversions) must be based on a formal legal authorisation for each particular credit, either as part of the annual budget legislation or through special borrowing laws.

The federal budget law for the year 1983 (BGBl Nr. 1/1983) authorised the federal Minister of Finance to borrow money in Austria or in foreign countries up to S 74.267 billion (this was the estimated deficit in the government's budget of S 400.077 billion) under the terms and conditions specified in Article VIII of this law. These provide that interest rates are not to exceed 2 1/2 times the official Austrian interest rate; loan terms may be up to 30 years; single loans are not to exceed S 8 billion. On the Austrian capital market, federal loans usually comprise more than 55 per cent of the total issues of public bonds.

Stabilisation and Public Debt

As deficit spending is one of the most widely used instruments of stabilisation policy, the extent and structure of public debt provide an indication of the stabilisation efforts of governments. There is no direct way of influencing lower-level governments in their debt policy except through the control of local government budget policies by states. This can bring about budget balance in a particular community but cannot control its spending and financing policies. Some states have deliberately refrained from budgeting for deficits over long periods and have therefore given the impression of having too much money compared with the federal and local governments with their heavy borrowing requirements. The consequence has been pressure on the states to give up some of their financial revenues or to reduce federal grants to them.

As the official financial settlement could not be easily changed (because of its complicated interdependencies and the difficult compromises which it has involved between a great number of partners), the main pressures have been on the level of the tertiary (grey) financial settlement. 'Good' (deficit spending) states have been favoured by special regional federal grants and stabilisation programs, while 'bad' (balanced budget) states have had to make substantial contributions to federal projects (railway, highway, school, university, etc.) which they have wanted to be performed within their territory. Even the state with the most federalist philosophy and the proudest defender of state autonomy in economic policy (Vorarlberg, the far western state which has been in a very good economic position during recent years) no longer hesitates to borrow and spend as much money as it can in order to compete for federal grants and special programs. A nearly perfect equivalence in deficit spending and debt policy of all state governments has been achieved as a result of the strong influence of the centralised fiscal and monetary policies of the federal government and the Federal Reserve Bank (Nationalbank).

Stabilisation Accords Between Governments

A very instructive example of the possibility of harmonising stabilisation policy in a federal system with a mixed economy were the five so-called 'stabilisation accords' of the years 1971 and 1972. In these years, Austria's economic situation was very difficult, due to the inflationary effects of high prosperity, the need to reach an arrangement with the European Economic Community and the problems of introducing a value-added tax in place of the former turnover tax. The federal government therefore tried to restrain public expenditure at all levels of government. Furthermore the Federal Reserve Bank and the trading banks were bound to a restrictive credit policy and prices and wages were frozen. Most of these effects could have been achieved by legal measures but the federal government sought co-operation through gentlemen's agreements in order not to disturb unduly the operation of the economy and the ordinary market processes. The time limits of the agreements were about six months and they resulted in a dramatic reduction in the inflation rate without causing any serious unemployment or recession problems. Of course, such general and comprehensive stabilisation agreements could only work effectively in an extraordinary situation, and they have not been repeated since that time.

General Remarks

The system of financial relations in Austria which has been described in the previous chapters is not really a federal system. It gives the federal government the legal powers to share and assign taxes without the consent of states and local governments and the power to change the fiscal system by transfers, special programs and cost sharing systems. Although the efficiency of centralised tax administration and the equalising effects of the system are recognised by all governments, the states and local governments are very discontented with their weak constitutional position, which leaves them in a very unequal bargaining position when the periodic six-year financial settlements are negotiated. The weak financial position of the states, lacking as they do relevant taxing powers, and of local governments, subject as they are to contributions to and discretionary grants by the states, may be criticised both theoretically and from a political point of view.

There has been a number of theoretical and practical proposals for the reform of intergovernmental financial relations and for their adequate constitutional regulation. Of major importance was an official inquiry of the federal Ministry of Finance in 1978 on the 'Financial Settlement in Austria'. This was carried out by a team of more than 30 authors and the report consisted of more than 3,000 pages.¹ The official political point of view of the states was put in an official petition for reform by the states, which was presented to the federal government in 1976.²

Own Revenue Sources of the States

One of the basic reform proposals in respect of Austria's federal financial relations has been for the restoration of at least some independent taxing powers. Without this, it is not possible to describe Austria as having a federal financial system, because the essential elements of regional tax variation and tax competition between the states is missing. The Austrian states never had significant taxes of their own but they lost the last remnants during the German Occupation and the period of occupation by the Four Allied Powers after the Second World War. Since that time states have depended for at least 96 per cent of their total fiscal capacity on shares or contributions from federal and even local governments.

This has resulted in a serious democratic failure in the federal system because the connection between public services and taxing decisions is essential to parliamentary representation, political planning and government accountability. If they lack responsibility to their citizens as taxpayers, states are no more than decentralised spending agencies of the federal government.

¹ Bundesministerium fuer Finanzen, Expertengutachten ueber den Finanzausgleich der Republik Oesterreich, Vienna, 1978. See also Egon Matzner (ed.), Oeffentliche Aufgaben und Finanzausgleich, Wirtschaftsverlag Anton Orac, Vienna, 1977.

² See Peter Pernthaler, Das Forderungsprogramm der oesterreichischen Bundeslaender, Schriftenreihe des Instituts fuer Foederalismusforschung, Vol. 19, W. Braumüller Verlag, Vienna, 1980, pp. 26-30.

Such a system also does nothing to limit the revenue and spending power of governments by tax competition - as fiscal federalism should do - but rather increases fiscal pressures by separating the power to govern and spend money from the power to raise revenues. This effectively makes fiscal relations between governments a matter to be politically negotiated and leads to a national sharing system in the form of a cartel. Any theoretical reform program for Austria's fiscal relations must therefore provide at least the following elements:

- (a) the constitutional specification of federal and state tax powers;
- (b) constitutional limits on the tax sharing system with clearly defined distribution arrangements including appropriate equalisation principles and instruments; and
- (c) changes in formal constitutional arrangements to provide for substantial participation of the states or their representatives (e.g., through the Bundesrat).

The political reality, however, is different. The official state petition of 1976³ sought only very limited taxing power for the states to be granted by federal law, and not by constitutional law, and did not even mention the need for a constitutional guarantee of states independent taxing powers. Even this weakened form of tax power was not strongly asserted by the states, because of the great practical importance they attached to sharing the two main joint federal taxes: the value-added tax and the income tax.

From these two taxes, the states now receive some 70 per cent of their total tax revenues, and the shares are increasing because of the high income elasticity of the two taxes. No exclusive state tax - except perhaps a hypothetical alternative or equivalent tax to one of the two joint federal taxes - could ever match the state shares of the two federal taxes. The political efforts of the states are therefore concentrated on the defence or even the extension of the state shares of the joint federal taxes. This attitude is reinforced by the fact that the political responsibility for the rapid increase of tax rates has rested exclusively on the national government. This suits the states, most of which are ruled by political parties of the opposite political persuasion, very well.

Legal Participation of the States in Basic Financial Settlements

It has been observed that the basic financial settlements in Austria, involving the division of taxing powers, the shares of joint federal taxes, and the major transfers (grants, contributions and cost sharing arrangements), are regulated by federal legislation with only a suspensive veto power by state representatives in the Bundesrat. The states are therefore in a worse position than are local governments in most unitary systems, because the latter usually have a constitutional specification of their competence and responsibility. Although in practice financial settlements have always been negotiated between federal, state and local governments, this is not equivalent to a constitutional solution because the governments' bargaining positions are unequal and there is no legal

³ Forderungsprogramm der oesterreichischen Bundeslaender, op. cit.

obligation for the federal government to negotiate at all. This is especially the case with transfers, where the position of the granting federal government is even more independent than in the case of the primary financial settlement.

It is a peculiar legacy of the former fiscal position of the central government that laws concerning the federal budget and federal grants are not (unlike all other federal legislation) subject to deliberation and suspensive veto by the state representatives in the Bundesrat. They merely require autonomous resolutions of the first chamber of parliament (Nationalrat). This is especially odd in view of the size of the federal budget and the dependence of the states on it. Reform proposals therefore unanimously demand:

- (a) a constitutional obligation to negotiate financial settlements, including all kinds of transfers, with the governments concerned;
- (b) effective legal participation of the state chamber (Bundesrat) in all legislation concerning financial settlements and state finances in general (also the federal budget insofar as it covers shares or grants to states).

Legal Participation of Local Governments

The question of the proper relations between states and local governments is also very difficult. In the present system of financial settlements, local governments are on the one hand comparable to states in their bargaining position, especially with respect to the periodical tripartite negotiations with the federal government. On the other hand, local governments at present depend very much on discretionary grants from the states, decisions on which are made without any legal participation by local governments. States and communities therefore have different views on the need for changes in the position of local governments with respect to other governments. The states argue that they should be the main partner in negotiations with the federal government and represent local governments in those negotiations, because the latter are not on the same constitutional level as states. Local governments argue that they should be an equal partner in the financial settlement because they have budgetary responsibility for public services and should no longer be subject to state supervision and discretionary grant powers. The special interests of communities, they say, require effective participation by them in the state process of making grants and contributions to local governments. They also want to have constitutional recognition of the need for official representation of communities at federal and state levels.

Reform of Public Subsidies to Private Organisations

It has been seen that Austria's Constitution provides no explicit rules for or limitations on the spending power of governments. Each level therefore subsidises virtually everything it wishes to in accordance with its political interests without any restriction to nominal federal, state or local competences. This leads on the one hand to an impenetrable jungle of subsidy programs by different levels for all kinds of services. Thus a private profession of public subsidies experts has become established and the system causes an enormous waste of public funds.

The predominant position of the federal government in financial relations means that federal subsidies are by far the largest and most widespread of the three levels. In practice public subsidies of the federal government provide an indirect way of intruding into state and local government affairs without regard to legal competences or changes to the Constitution. Although this phenomenon seems to be common to all federal systems (especially those of the U.S.A. and Switzerland), its centralising effect in Austria is accentuated by the overwhelming fiscal and legal powers of the federal government in this country.

The states therefore demanded, in their petition of reform in 1976, that:

- (a) federal subsidies to private organisations should only be given directly for purposes of national importance and for other purposes should be given as special grants to states on the basis of prescribed conditions (with a principal requirement that there should be no direct federal programs in state territories or competences);
- (b) joint federal programs (especially those involving matching conditions) and cost sharing systems should only be allowed on the basis of legal agreements (state treaties as provided for under Article 15a B-VG) and with full state participation in the planning processes;
- (c) new federal programs in states or aid to non-government units should only be allowed with the consent of the states concerned.

Reform of Transfers and Unofficial (Grey) Financial Settlements

The present arrangements for three levels of financial settlements are - notwithstanding their remarkable effects - very unsatisfactory for state and local governments. On the one hand, the lower-level governments have become dependent on discretionary grants and varying contributions of higher levels than on predetermined shares of taxes. On the other hand, the revenues they receive from shared taxes and transfers are not available wholly for their own services but must be used also for certain federal services or joint programs without any real opportunity to choose, influence or reject the programs.

A reform of transfers must therefore achieve the following goals:

- (a) a reduction in the volume of special (cost sharing) grants to the states (which account for about 25 per cent of their total revenues) by making appropriate provision for the increased volume of state public services and duties in the tax sharing arrangements (the primary financial settlement);
- (b) the development of standards and methods to specify special objectives and establish criteria for transfers, including the development of arrangements to design and control transfers through joint committees representing both granting and recipient governments;
- (c) the abolition of gentlemen's agreements and private law treaties as means of regulating refinancing and cost sharing systems between governments, and their replacement by

official financial regulations or legal agreements according to the Constitution (Article 15a B-VG).

Reform of Quasi-Government and Non-Government Organisations

The main fiscal problem of quasi-government and non-government organisations results from their exclusion from the budgets of federal and state or local governments, which leads also to their exclusion from the general fiscal sharing and equalisation system between the governments. This exclusion (which has been called a flight from the budget⁴) weakens legal and political control over the public finances; reduces the part of the budget subject to formal appropriation; and prevents the budget from giving a true picture of the real volume and pattern of the public finances.

Therefore many scholars have demanded the reintegration of these excluded fiscal systems (which are sometimes called Parafisci), especially the huge social security system which covers social insurance, health, accidents and a general pension plan. The reintegration of these public funds, which account for about 20 per cent of all public expenditures (and the proportion is rapidly increasing), would help to bring social expenditures into line with the reality of the general economic situation and thus limit the growth of public expenditures and taxation. At the same time, the integration of the social security system into the general budgetary and fiscal equalisation system would give more security to citizens - especially to existing and future pensioners - because an isolated pension system is likely to be financially unstable and subject to the threat of reduced levels of support in times of economic crisis.⁵

Reform of Horizontal Equalisation Between Local Governments

The system of fiscal equalisation between states works quite well, because the scope of their public responsibilities is fairly even and their needs are principally related to population size. However, equalisation between local governments is unsound from a theoretical point of view and seriously discriminates against a large number of smaller communities. Some states are also unhappy about the basis of local government equalisation, because their general contributions and their equalisation burdens depend on the fiscal capacity of communities, which varies in a very irrational way with the size of population. It is mainly the graduated population weights (which vary according to population size from $1\frac{1}{6}$ to $2\frac{2}{3}$), which cause the disparities between the eight large cities (above 50,000 inhabitants) and the large number of smaller communities (1,293 in 1978). As mentioned above, there are two main arguments against this system of weighting. On the one hand, population size is no longer a reasonable indicator of the differences between the structures and the fiscal needs of communities, because some smaller communities have much greater fiscal burdens than others which are not reflected in the population weights. On the other hand, the weighting system is inconsistent with several constitutional principles. From the theoretical point of view, one single measure of the fiscal needs of local

⁴ Christian Smekal, Die Flucht aus dem Budget, Schriftenreihe des Instituts für angewandte Sozial - und Wirtschaftsforschung, Heft 29, Wien, 1977.

⁵ Dieter Bös, Das Finanzsystem, op. cit., p. 725-26.

governments is unsatisfactory and misleading. At least the following indicators of fiscal disparities among communities should be taken into account:

- (a) communities should be distinguished according to their relative proportions of business enterprises and residential areas;
- (b) rural (mainly agricultural) communities should be distinguished from suburban communities in large cities;
- (c) allowance should be made for the special needs of state capitals and district centres;
- (d) mountain communities should have their high costs of service provision recognised;
- (e) the differential costs of providing school, hospital and recreation services should be taken into account; and
- (f) the impact of tourism on community services should be assessed.

As with states, there should be a critical review of and a considerable reduction in transfers at the local government level. The fiscal capacity of communities should depend mainly on their own taxes and on fixed tax shares and not on discretionary grants. A constant demand of local governments is that the general contribution of communities to states should be abolished. It no longer has any rational purpose.

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