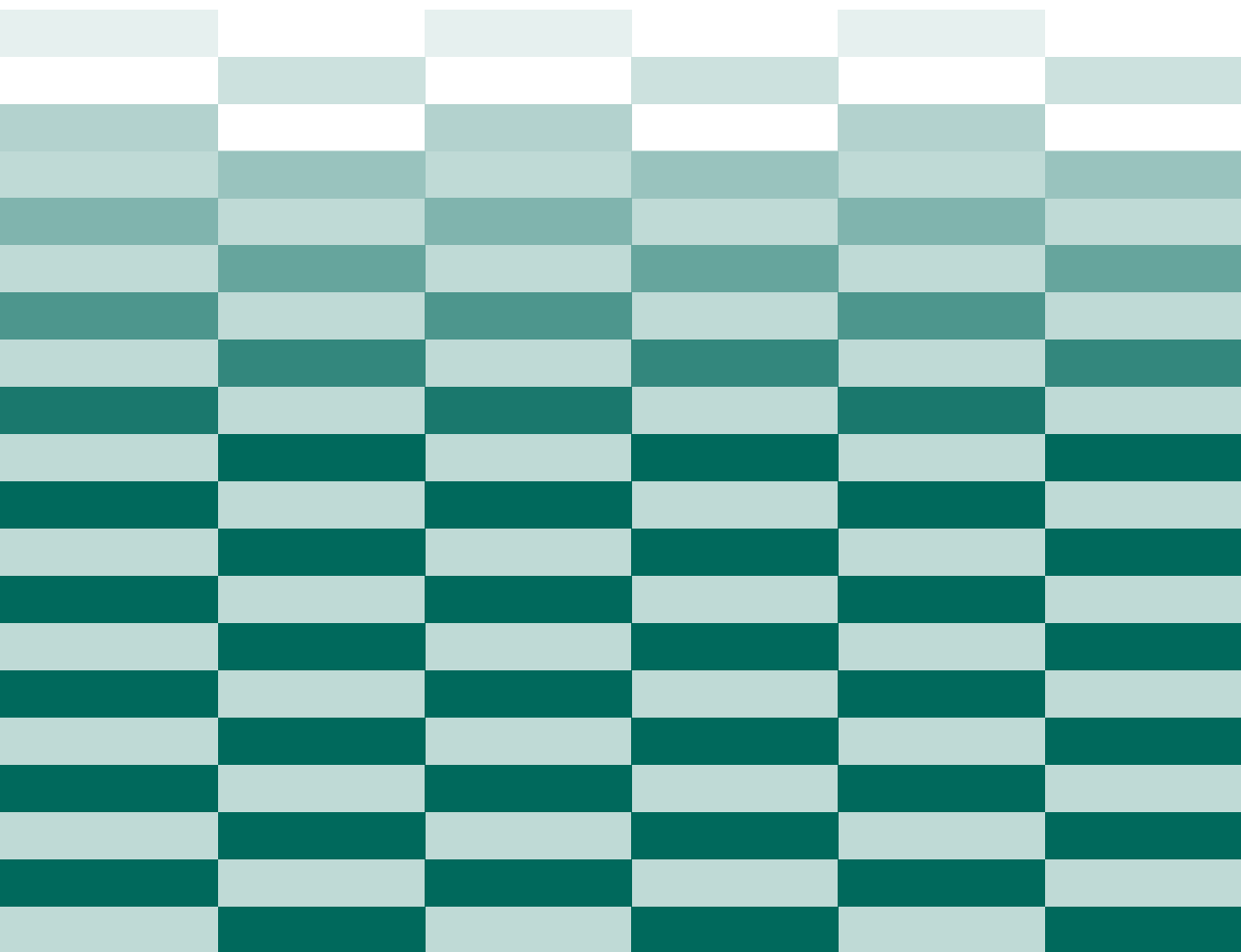


Distribution, trust and accountability

A reorientation of the financial relations in the Netherlands

November 2011



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Rfzv



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Profile

The Financial Relations Council (Rfv) is an advisory body of the Netherlands government and parliament. The Rfv was established by the Act of 21 February 1997 (Act for the Council of Financial Relations, Bulletin of Acts 1997, nr. 106).

Task

The Council's legal task is to give advice to the government and parliament either on request or on its own initiative on how the financial resources of the State can best be divided among the municipalities and provinces. The Rfv aims to establish a balance in the way financial resources are distributed, thus contributing to the effectiveness of the government as a whole.

Composition

A maximum of nine independent experts in the fields of public administration, politics and public finance combine to form the Financial Relations Council. These experts are selected based on their expertise and experience in civil society and are appointed by Royal Decree.

Procedure

The Council can provide advice upon request or on its own initiative. In general the advice relates to the funding of the municipalities and provinces, the tax system and to the distribution of specific grants – the advice covers all policy areas. It can also cover policy and its implementation. In the preparation of its advice the Council takes into account the opinions of citizens and organisations that have in-depth knowledge and/or experience relevant to the policy areas in question. The Council also contributes to the political, administrative and social debate through other activities (publications, meetings). In its advice, the Council gives considerable attention to the basic principles of financial relations, policy and discretionary powers and financial risks. Attention is also given to legal equality and legal certainty and transparency.

Secretariat

A secretariat supports the Financial Relations Council (and the Council for Public Administration). The administrative secretary and his staff report directly to the Council. The yearly work programme and latest developments determine the course of the Council's activities.

See www.rob-rfv.nl for full details regarding Council's advice and publications.

Foreword

The government's tasks on the whole are funded by tax revenues from citizens and businesses and other revenue raising entities. Central government is responsible for levying most income taxes. Central government is also responsible for distributing tasks and funds to the provinces and the municipalities. Over the past year, the Financial Relations Council has examined the question of the principles underlying this distribution and whether these still meet with requirements. In this report the Council presents its findings regarding the reorientation of these financial balances.

Municipalities and provinces are dependent to a large extent on central government for their income. In addition to decentralised autonomy, local and regional governments are also responsible for the execution of co-governance tasks. The distribution of funds to the local and regional governments is the result of the distribution of tasks, competences and responsibilities and these financial relations inextricably lead to administrative relations. The European Union is also part of these administrative relations and as such either directly or indirectly influences Dutch financial relations.

Relationships with civil society also influence administrative and thus financial relations. Government is dependent on the interaction with other sectors in society. This leads to the question to what extent this social reality has or should have on financial relations.

Essentially, administrative and financial relations are about the distribution of responsibilities, competences, tasks and funds. The distribution of tasks to local and regional governments therefore requires a customised distribution of resources. This requires a careful balance to be struck; not only whether the funds are sufficient for the described tasks but also whether the relevant (financial) risks for local and regional government are balanced in relation to the given policy freedom and the possibilities to generate their own funds. As the discretion to execute a task narrows the risks become greater and the restrictions tighter.

A good working system in financial relations is founded on the trust that related parties have in the functioning of the system. This requires a set of standards and principles to which the parties involved are accountable. This calls for a system of checks and balances in financial relations. The distribution of funds must be based on a recognisable and transparent set of standards and principles. Transparency also means that the receiving parties are responsible for accounting for the expenditure of their revenue. The question is who is accountable to whom and for what? This lies within the principles of administrative distribution and the responsibilities such as those registered in the constitutional principles (Thorbecke's house). In order to have a good working system it is important that these principles are respected and that expertise about the functioning of financial relations is permanently secured.

In short it is about distribution, trust and accountability.

The social and administrative dynamics demand that the set of the standards and principles on which financial relations are based are scrutinised at given times to ensure that they meet with expectations. The financial relations are part of a dynamic balance. The Council meets this task through the re-orientation of financial relations. In addition, it aims to create trust in the financial relations system for the future and to contribute to good inter-administrative relations.

The Council's view is that through elaborating recommendations, conducting research and through widening and deepening advice in broad financial relationships, it will contribute to making the system durable for the 21st century. In the Council's opinion, this should be preceded by a debate with the legislator.

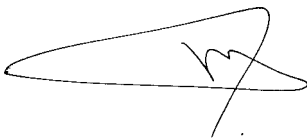
Many have shared their knowledge with the Council during the different phases of this project. The Council would like to thank them for their contributions and reflections and hopes to continue a fruitful collaboration with them after the conclusion of this project; the research agenda resulting from this project will serve as a good basis for this.

We are also grateful to Councillors Drs. Louise Engering, Prof. Maarten Allers en Drs. Hanneke Möhring MMC, member of the Council for Public Administration, for their contribution to this report. This project was supported by staff members Mr. Gerber van Nijendal, Kirsten Veldhuizen MSc and Drs. Rien Fraanje.

The translation of this advice was in the capable hands of Vivian Carter and was supported by Adrian Watson. Because of the many specifically Dutch aspects of Dutch financial relations, they had a difficult challenge. Their work has been invaluable and is much appreciated.

On behalf of the Financial Relations Council,

Chairman



mr. M.A.P. Van Haersma Buma

Administrative Secretary



dr. C.J.M. Breed

1. Introduction

1.1 Task of the Financial Relations Council

Tax revenues from citizens and companies generally fund the work of the government.¹ In the Netherlands the central government is responsible for levying most of the income tax. Within the Dutch administrative relations, central government is primarily responsible for the distribution of tasks and funds to local and regional government. Financial relations in this context then concern how these different tasks are financed. The first case concerns how tasks are financed through administrative relations and the second, about how other (commercial) activities of local and regional governments are financed.

The Financial Relations Council's task is to advise government and parliament about the legislation, policy proposals and their execution in the field of financial relations, in particular, those between the Government and the municipal authorities and the Government and the provinces.² The Council advises about the manner in which the Government's financial revenues can best be distributed among local and regional governments. This concerns advice, among other things, on the municipal and provincial funds, the tax instruments and specific grants. The Council also concentrates on questions concerning responsibility towards monitoring the expenditure of revenue. In addition, the Council focuses on strategic matters at the interface of administrative and financial relations.

The Council's main objective is to strive for a balanced distribution of revenue that fits with the distribution of tasks, responsibilities and competences in order to contribute to the efficiency of the government as a whole.

This is about striking a balance between the distribution of tasks and responsibilities and accountability and trust within the system. Such a balance does not come automatically subsequent to Government and local and regional governments having determined their tasks and roles in agreements (profiles), or after the legislator has rearranged tasks. External factors like economic developments, European legislation or changes in the structure and composition of the population also play a role here. In addition, the role and position of government towards society has changed in the past years because of the growth of the network society and the increasing awareness of this within public administration. Both developments influence administrative relations and thus financial relations.

1 A part of central government's tasks are financed by premiums and sources like revenue from natural gas. Local authorities also receive income from other sources such as interest on capital, profits from shares and from business activities.

2 Article 2 of the Financial Relations Council Act.

1.2 Objective

The purpose of this reorientation of the financial relations is for the Council to be evaluated – at its own request – by an independent evaluation commission led by Mr Arthur Docters van Leeuwen.³ Besides a positive assessment regarding policy advice, the Council has carried out a critical review of some tasks and distilled a number of questions. The Council has accepted the evaluation commission's considerations and has decided to further explore the issues raised. The Council decided to set up a project for this purpose and this report is a reflection of the outcome.

1.3 Definition of the problem

From these recommendations, the assessment committee has pinpointed three strategic questions. The Council regards these statements as challenging hypotheses that each deserve to be thoroughly investigated, more thoroughly than the commission within its limited remit could do itself, and has focused its activities on these aspects.

The Council defined three strategic questions that require fundamental consideration:

1. Within the framework of “fiscal federalism” what kind of scientific discussion should be held and does this have any significance for the premise that local and regional financial considerations should be promoted as much as possible?
2. Is there any reason to reconsider or reformulate the normative character of Goedhart's third aspiration level, as defined in the Financial Relations Act?
3. What conclusions should be drawn from the observation that local and regional administrators increasingly operate in horizontal networks, which (according to the committee) cannot be confined to merely technical advice on the formal vertical funding streams?

1.4 Elaboration

Standards framework

Besides responding to these three strategic questions, the Council worked in more detail on its standards framework, as recommended by the evaluation committee. The evaluation committee found that it is insufficiently clear to third parties what the basis is for the Council's standards and considerations.⁴ Furthermore, the evaluation committee questioned the sustainability of the standards applied due to the changed relationships within public administration.

3 Financial Relations Council 2010a

4 Financial Relations Council 2010a, page 28

This finding is consistent with the Council's previous observation regarding the financial relations system whereby successive adjustments do not always seem to fit in with the original philosophy. This is not surprising: financial relations form a dynamic balance between theory and reality.⁵

In its 2010 work programme the Council indicated that, in view of current and future administrative and financial developments, it is reasonable to assume that the basic principles of the current financial relationships can withstand scrutiny.⁶ The review of the provincial and the municipal funds underline this need.

Advising on financial relations is only credible in conjunction with the administrative relations it refers to. The Council uses financial relations as the starting point to constrain the classical definition of financial relations: *the complete set of rules dealing with the allocation of control over resources to governments with which there is an administrative relationship.*⁷

This refers not only to transfers between levels of government, but also to the possibilities of levying taxes and financial supervision.

In the near future, the relationships between central government and local and regional governments will be under greater pressure. The cabinet plans to reorganise public finances. This will lead to a strong contraction of the national budget.⁸ In the endeavour to create a compact (central) government, it was decided to substantially redistribute local authorities' duties and responsibilities. This could lead to further administrative differentiation, choosing to implement regional solutions or central municipal structures, partnerships, self-qualifying authorities and the like.

These developments, but also the volatility that characterises the financial markets, has implications for public finances. They put the current financial relations under pressure and underline the relevance of a reorientation of current events and the future sustainability of financial relations.

While a certain stability of standards contributes to the trust in and transparency of the system's operation, the Council acknowledges that new developments, theoretical insights and discussions can lead to different views. The Council believes that a dialogue with all parties involved in the system to be of great value for the system's further development and future sustainability.

Social dynamics

The evaluation commission questions the sustainability of the standards used because the relationship between public administration and society has changed. The committee refers to the fact that municipalities, provinces and central government are no longer in a position to unilaterally

5 Van Zaalen 1989

6 Financial Relations Council 2009b

7 Wassenaar and Verhagen 2006, p. 12

8 Lower Chamber, meeting year 2010 – 2011, 32 417, nr. 14, Government Agreement VVD and CDA, Vrijheid en verantwoordelijkheid, p. 15 and annex.

determine the policy to be enforced. Governments have increasingly entered into dependency relationships with various sectors of society to achieve their goals. This is not only reflected in the increased importance of associated parties⁹ but applies in the broadest sense to all stakeholders in civil society. This observation raises questions about the extent this horizontalisation of administrative relationships should be taken into account in the shaping of financial relations.

Another development concerns 'socialisation' which mainly local and regional governments will have to face over the coming years. The question whether this is still a government task will become increasingly clear. Tasks and responsibilities, which have been carried out for decades by the government are now being given back to citizens who undertake various types of active citizenship such as community enterprises. This requires a different role for (local) government. This development also has a financial component: new structures also bring new types of funding and lending circles and crowd funding with them. Besides expertise, governments need time and space to be able to anticipate this development. For example, by becoming proficient in acquiring other types of funding sources besides traditional sources like the general benefit or their own tax instruments.

This has all led to a revision of the classical definition of financial relations. Financial relations involve: *the set of rules dealing with the allocation of power over revenue to governments between which there is an administrative interest and over relations involving a transfer of revenue from one government to another or to a social organisation in order to implement policy objectives arising from a public task.* Chapter 4 explains this further.

1.5 Responsible approach

With these considerations as a starting point, the Council has designed a process consisting of four tracks.

Track 1: Formulation of explicit norms

One of the evaluation committee's recommendations was to make a more explicit set of norms for the Council to implement in its advice. The general current standards and principles of financial relations are used to work towards specific standards. The Council has thus reverted to its advice in recent years and to developments of the financial relations since the revision of Grants to Municipal Authorities Act in 1997. Thus these explicit standards represent the current complexity in which the Council makes its appraisals and provide the opportunity to assess the (proposed) policy on its implications for the efficient and effective functioning of financial relations and thus strives

⁹ Associated parties are legal entities in which the local government has an administrative and financial interest. An administrative interest means a seat on the board of a legal entity or the right to vote. A financial interest is when financial resources are made available that are lost in case of bankruptcy of the associated party or when due to the associated party's financial problems, financial damages can be recovered from the State.

to contribute to the adequate funding of tasks, responsibilities and powers placed with (local) governments.

The explicit standard framework is not isolated. The Council felt a reorientation process was necessary because all kinds of developments externally influence the system. This reorientation process confirmed the desirability of a broad review of the principles. The explicit standard framework should be viewed in the light of a continuous development and up-to-date interpretation of the principles on which the system is based.

This is reinforced by the recent revision of the provincial funds allocation model and the reassessment of municipal funds. The imminent major decentralisation operations require rethinking about the foundations of the system upon which the financial relations system are based. Various changes influence each other and ultimately these must also be reviewed together with municipalities' and provinces' own incomes.

The Council observed an additional motive for the distance between the theoretical basis of the system, which is mainly based on economic and scientific theory and social reality. This has led, *inter alia*, to the Council broadening its outlook with expertise from the social sciences, and in particular, from public administration.

With the introduction of an updated framework of norms (Chapter 2), the Council wishes to contribute to achieving sustainable administrative and financial relations for the future and by reformulating the definition of financial relations, the Council wants to improve the reflection of social reality in the political-administrative discourse.

Track 2: Consulting experts

Three expert meetings were held in March 2011. It was decided that these meetings would comprise 10 to 25 participants per meeting.¹⁰ The purpose of these meetings was twofold. On the one hand, participants were asked about the proposed explicit framework of standards. In addition, they were asked to reflect on statements in this project in order to gain new insights. The interviewees were selected on their specific expertise. Their expertise was either purely financial or they were involved in issues in common with public finances and another field or, they had some expertise in administration involving financial aspects. The discussions in the meetings focused on a mixed team of financial and administrative management experts.

Track 3: Involving social actors

The Council organised a survey involving social actors. This comprised of in-depth interviews with a number of researchers carrying out research into the field of horizontalisation of administration.¹¹ Furthermore, extensive interviews were held with experts in civil society. They were asked about the

¹⁰ See Annex 2 for list of participants

¹¹ *Idem*

current methods of financing and funding, how public enterprises report their accountability and whether they saw opportunities or possibilities to improve both the financial and the accountability structures. With these objectives in mind, responses were gathered to this project's leading question: *to what extent should the horizontalisation of administrative relations be reflected in the design of financial relations?*

Track 4: Administrative confrontation

During a consultation round with a substantial number of those involved in the administrative management environment in which financial relations (and the Rfv) operate, views were exchanged on three main questions concerning the draft framework of norms and recent developments regarding decentralisation and the funds of municipalities and provinces. These interviews not only provided thoughts on the topic and views on the issues presented but also yielded new material. These themes are one of the reasons for establishing a research agenda (see Chapter 5).

The Council will continue to maintain a dialogue with a wide range of parties in order to reach an advice. Based on the results of this project, the Council will renew its talks with (representatives) of the different administrative levels and sub-levels.

1.6 Conclusion

With the completion of these four tracks, the Council has gained insight into what the underlying principles will be for its future advice. This report reflects the findings regarding the main questions of the reorientation project. In addition, the Council sets out in broad terms its views regarding a number of issues on financial relations which the government and parliament, the provincial executive board and provincial council and the municipal council are currently facing.

The Council sees this publication as a prelude to a broad follow-up process; this report should be seen more as an initial start rather than the final word on financial relations. Because of the choices made, some aspects of financial relations could not be included and have been left out. The themes investigated have, in many cases, given rise to follow-up questions which in turn have resulted in more questions. Due to the lack of time and research capacity, it was not possible to answer these questions within the scope of this advice and as a result in Chapter 5, the Council has decided not only to present its findings and conclusions but to also indicate questions which need further research. The Council also provides suggestions for a framework in which attention to financial relations issues can be safeguarded.

With this standpoint, the Council wishes to contribute to the further considerations on the implications of recent developments and policy choices still to be made. This explicit norms framework could perhaps also be implemented outside the Council's advisory framework. Contributing to knowhow and providing insight into the understanding of financial relations is important for confidence in the system's operation. The Council stresses the importance of timely anticipation of the proposed changes to the financial relations system (Chapter 4). The Council foresees this as an impulse in view of the pending fundamental debate between government and parliament on financial relations. In this way, the system can repeat the results it has had in the past.

2. Principles of financial relations

2.1 Introduction: what are financial relations?

Before determining which standards and basic principles apply in the formulation and evaluation of a balanced distribution of resources, we should query why financial relations exist?

Generally speaking, financial relations concern: *the set of rules that deals with the allocation of control over resources to government over which it has an administrative relationship.*¹² This not only involves transfers between governmental levels but also the options for allocating levies and financial monitoring.

Financial control is a means for achieving a goal. It is not surprising that money is often seen as a synonym for a means to an end. It is a means to achieve objectives. There are three general types of instruments available to a government wanting to achieve these goals i.e. financial and economic instruments (financial contributions), communication tools (persuasion, influence, information, benchmarking and education¹³) and legal instruments (laws and regulations, authority and enforcement). In other words it uses the carrot, the sermon and the stick approach. These instruments are often used in conjunction with one another. In financial relations it is about interaction; the balance between these different instruments.

The first reason why there are financial relations is because the tasks and corresponding expenditures are distributed over the administrative levels in a different way to the income revenue. This is called vertical imbalance. The second reason for financial relations is that there is a difference in the financial capacity between administrative units with the same tasks and costs. This then is termed horizontal imbalance. In fact, if the costs for an administrative unit are high and it also has a limited taxation capacity, this could lead to disproportionately high costs and an uneven distribution of burden for citizens. Financial relations ensure there is a certain amount of compensation.

The objective of financial relations is to create sufficient revenue for the various governments so that the tasks, powers and responsibilities are mutually consistent. The organisation of financial relations should be able to support the administrative power of its own local and regional governments.

The tasks of the provinces and municipalities include those which, given the local regional and social needs, include those which they have taken upon themselves (autonomy, see section 2.2.2) as well as duties imposed by other authorities (co-governance, see section 2.2.3).

12 Wassenaar and Verhagen 2006, p. 12

13 Council for Public Administration 2002

2.1.1 The Council's basic principles

This chapter includes a list of basic principles and standards regarding financial relations upon which the Council bases its advice. The primary reason for developing a framework of norms stemmed from the observation of the Rfv Evaluation Commission, under the leadership of Mr Arthur Docters van Leeuwen, that it was insufficiently clear to parties what the Council's norms and considerations and recommendations were based upon.¹⁴

These basic principles and norms are partly based on laws and regulations such as the Financial Relations Act (Financiëleverhoudingswet) (FVW), the Provinces Act, the Municipalities Act and related regulations. On the other hand they are based on theoretical insights such as those formulated in (scientific) literature. These generally concern more or less generally formulated basic principles, accepted by the parties involved, regarding an effective organisation of the system. On the other, this relates to the interpretation of norms which have been laid down in the course of time by the Council in different recommendations as viewpoints.

This is an ideal-typical distinction. This distinction is in many cases clear. Basic principles and norms are in many cases generalised and formulated in absolute terms, while in practice these are dynamic and may even lead to reciprocal tension. For example, the third aspiration level does not automatically lead to the most efficient use of resources. In addition, norms and basic principles only have meaning when they are put into practice. Financial relations ultimately constitute a dynamic balance between political-administrative motivations and theory.¹⁵ In addition, knowhow about the rules of financial relations is sparse. The Council has previously found that there are many myths and misunderstandings about how financial relations function.¹⁶ Insufficient insight or erroneous assumptions can be disastrous for the support of financial relations. This is why the Council also sees it as its task as guardian of the financial relations system, to continually collect information related to financial relations operations. The aim of the Council is also to gain a good insight into how those involved experience the functioning of financial relations.

Summary

This chapter systematically describes the basic principles and norms used by the Council on which it bases its advisory opinions. It has been attempted to always indicate the origin and the meaning of the norms for the different components. The Council's viewpoints should be considered as complementary to the legal and theoretical norms and are distilled from recommendations made in recent years. Chapter 3 further discusses the developments and discussions about financial relations and examines the question of the extent to which the existing standards require revising.

¹⁴ Financial Relations Council 2010a, p. 28

¹⁵ Van Zaalen 2002

¹⁶ Financial Relations Council 2002

2.2 Basic principles resulting from the administrative design

Financial relations assume there are administrative relations. Administrative relations determine how tasks, responsibilities and powers are divided between the respective territorial and functional levels of government. Financial relations reflect intergovernmental relations: *revenues lead to (governance) task*. It is therefore important to first determine what the guiding principles in the administrative organisation are. Furthermore, there is a certain interaction between the administrative and financial relations.

2.2.1 A decentralised unitary state

Legal basis

The concept that is laid down in the Dutch Constitution is that of a decentralised unitary state whereby at a decentral level, the provinces and municipalities possess a certain degree of autonomy from central government.¹⁷ The Netherlands has three general intergovernmental levels: national, provincial and municipal government. In practice, there is interdependence among the authorities whereby complex administrative relations have emerged. Central government is responsible for determining the allocation of tasks and assigning the power over resources including governing levies. The Dutch political-administrative system is somewhat hybrid: 'a strange marriage between unity and plurality'. This is also reflected in the notion of 'decentralised unitary state'.¹⁸ Cooperation between the various tiers of government is an important factor for the functioning of a decentralised unitary state.

Europe has increasing influence too. The State of the Netherlands is a treaty partner and as such, it must comply with the obligations it has entered into. This all reinforces the idea of *multi-level governance*, working besides one another and with each other in domestic and international levels of authority.

There are also functional administrative organs bound to areas as in the case of the water boards. A decentralised unitary state implies that administrative tiers have access to and control over freedom of policy and over sufficient (partly their own) financial resources.

17 Council for Public Administration and Financial Relations Council 2005.

18 Toonen 2000, p. 203-222.

Views of the Council¹⁹

- The administrative structure should contribute to an efficient and effective use of collective resources by the various authorities. An important criterion for the establishment of public administration concerns the extent to which this contributes to a balanced, efficient and effective distribution of tasks and responsibilities and to an adequate accountability of the appropriation of public resources.
- The scale of the municipality and/or province should be adequate to be able to perform the task, including the ability to bear the corresponding financial risks.
- Increasing the scale of the municipality does not automatically lead to cost saving.²⁰
- Central government's direct allocation and financing of tasks to collaborating parties makes financial responsibility and the involvement of local governments diffuser and undermines the principle of 'extended local administration'.
- For an individual authority, the disadvantage of inter-administrative cooperation is that this binds them to financial obligations arising from this collaboration whereas as an individual authority, limits their direct opportunities for decision-making and or executing any influence.

2.2.2 Autonomy

Legal basis

Local governments are autonomous democratically elected levels of government with an "open house holding"²¹. Article 124 of the Dutch Constitution stipulates that provinces and municipalities have the powers to regulate and administer their own internal affairs.²² Autonomy means that, within the frameworks set by law, local governments can determine their own tasks and priorities and are responsible for this policy and its implementation.²³ This means that they are at liberty to undertake any tasks they deem necessary unless they are unauthorised to do so by higher legislation. Local authorities are therefore not subordinate to central government.²⁴ The water boards have a functional administration and therefore have a closed economy.

19 Financial Relations Council 2010b

20 Allers 2010, p. 341-342

21 In principle, "open house holding" means that under the powers laid down under various Acts of Parliament, an administrative body within local government is free to undertake and carry out its tasks under its own responsibility providing that these activities or actions are not restricted by law. See also the Council for Public Administration and the Financial Relations Council 2007

22 See also *European charter on local autonomy* 1985

23 Article 118 of the Province Act; Article 108 Municipalities Act

24 Council for Public Administration and Council for Financial Relations 2005

Views of the Council

- Autonomy means that local authorities must have adequate freedom of policy and expenditure. To guarantee local governments' freedom of expenditure and of policy they must have sufficient funds at their disposal.
- Autonomy also means that each local authority is responsible for sound financial management. This implies that each local authority is accountable for effective and efficient management to its elected parliamentary representative.
- An “open house holding” authority requires a separate and substantially large taxation area. Local authorities should also have sufficient financial funds so that they can develop their own initiatives and enable them to substantiate their autonomy.

Clarification

Autonomy and political freedom are often used as synonyms. They are closely related but have a different origin. Autonomy involves the right to one's own initiative. When we speak of policy freedom, it means the freedom to make one's own choices and decisions regarding policy within the existing statutory tasks. The position regarding an “open house holding” and taxation area is slightly more nuanced. Water boards do not have an open economy but they do have their own large taxation area. However, the water board taxes are more like levies. The provincial tax area can be primarily characterised as a financing source. Municipal taxes are becoming more like a buffer to absorb financial setbacks.²⁵

Supervision

Legal basis

In addition to monitoring compliance with the laws and regulations by various agencies (inspections) there is also financial supervision. The financial supervision of municipalities is regulated by the provinces in the Municipalities Act (Articles 203-208). The Dutch government regulates the financial supervision of the provinces as set out in the Provinces Act (Articles 207-215).²⁶

Explanation

Local governments are subject to financial monitoring by higher tier authorities. This is not contrary to the principle of autonomy but is intended to prevent shifting financial risks to third parties. Municipalities with structural deficits can apply for supplementary finance on the grounds of Article 12 of the Financial Relations. Article 12 is a vital link for municipalities in financial relations.

25 *Scenario's gemeentelijk belastinggebied in relatie tot de bestuurlijke verhoudingen, bijlage bij TK-stuk nr. 26, o.a. p. 25 and : /Financial Relations Council 2005*

26 See also Article 8, *European Charter on Local Autonomy 1985*

Views of the Council

- There should be a basis of trust in horizontal supervision.
- Horizontal supervision must be the guiding principle; the necessary set of tools of the municipal council and provincial councils are to be optimised. On the basis of more (and further increases) in horizontal accountability, better use of benchmarking and more transparency there is room for reducing the province's (vertical) supervision. The introduction of a financial policy stress test is one of the aspects in the efforts towards strengthening horizontal control.²⁷
- The municipality or the province is primarily responsible for its own financial policy. Financial supervision by another tier of government should largely support horizontal accountability.
- Article 12 of the Financial Relations Act (FVW) does not sanction financial mismanagement; municipalities with bad management must bear the consequences themselves.
- Financial supervision should be risk oriented and applied proportionately.

2.2.3 Co-governance

In addition to the constitutional autonomy of local governments, central government is also responsible for delegating tasks and responsibilities to local governments. The character of co-governance is inextricably linked to the local government unitary state. There is a difference in the amount of leeway municipalities have to respond to the local situation in number, nature and quality of facilities and the way in which co-governance tasks are executed.

Views of the Council

- A clear division of tasks avoids disorder, administrative pressure, limited decisiveness and the shifting of responsibility for financial risks.

2.3 Decentralisation

Legal basis

In principle, government tasks are left to the most decentralised, legitimate tier of government, given the scale and the interests involved, assessed on who can do the job best. Central government founds its support for decentralisation through the Municipalities and Provinces Acts which promotes the transfer of powers and duties to territorial authorities. The Provinces and Municipalities Acts require central government to demonstrate that the task done by a "lower" level of authority is *not* well-managed.²⁸ The subsidiarity principal is valid within the European Union, which means that Europe should refrain from taking action in matters that can be dealt with by lower authorities.

²⁷ Financial Relations Council 2004

²⁸ Financial Relations Council 2004

Theoretical insights

One of the leading doctrines within fiscal federalism is the doctrine on the power over the allocation of funds between local governments and concerns the benefits of decentralisation. According to this theory, decentralisation contributes to an effective and more efficient balancing of costs and benefits, but it can also be used as an instrument to innovate policies, to strengthen citizen involvement and to encourage policy competition.²⁹ Benefits from a decentralised policy can only be gained when there is a reasonable degree of policy freedom. That means central government's role must be restricted to determining the conditions, regulations and accountability requirements. This restraint is also applicable to compiling additional rules through European legislation.³⁰

The advantages of decentralisation:³¹

- Customisation. Better allocation of funds by taking into account differences in preferences and differences in costs. This means that public policy can respond better to local/regional conditions and anticipate needs/requirements/expectations which are happening at these levels.
- Innovation. More innovation through experimenting with different approaches to a problem. The best practice is then copied. The risks of failure are limited.
- Democracy. Decentralisation promotes democratic policy and decision making. Greater influence of citizens in local policy (more direct) than in national policy. Democracy is more identifiable and accessible because of its proximity and the smaller scale of administration.
- Integrated policy. It is assumed that sectoral solutions are inadequate to do justice to the complexity of the problems that arise locally regionally and merge in a local administrative level.
- Decisiveness. Decentralisation is beneficial to decisiveness. It is assumed that local governments respond better and more quickly to changing circumstances than central government.
- Policy competition. This creates a sort of quasi-market because there are evenly matched authorities with similar problems thus allowing citizens to compare the performance of local governments. This stimulates administrators to work better, for example, by providing services or lower taxes.
- Information efficiency. Much of the information needed for effective policy is available at the local level.

The possibilities of decentralisation are limited because of:

- Diseconomies of scale. They need to have a range to achieve policy performance at lower prices e.g. through the advantages of specialization (economies of scale). However, there appears to be a tipping point at which larger production costs disproportionately increase diseconomies of scale. Execution of these diseconomies of scale can be restricted by dividing decision making (local) decisions and execution (regional or by the market) through voluntary cooperation or by outsourcing.

29 Oates 1999

30 Council of State 2009

31 Boogers 2009

- External effects. When we talk about external effects we mean the decisions of an administrative level that have either a positive or negative effects outside the boundaries of a particular administrative level (i.e. municipal, provincial). Local authorities are accountable to their own residents (voters). Less account is held with non-residents/companies/other government bodies. Therefore, external effects can lead to suboptimal results.
- Uniformity. A primary reason for centralization is to promote or maintain a uniform range of facilities and policy unity. Uniformity strengthens transparency, predictability, legal certainty and legal equality for citizens, solidarity and national identity. The importance of uniform appliance and treatment is particularly important for personal income budget provisions. However, local execution does not need to get in the way of national legislation.
- National interests. Some services may actually only be regulated (inter)nationally. This relates to objects of national importance (e.g. macro-economic policy, defence, legal certainty).

Explanation

Decentralisation is not necessarily the right choice to make but dependant on weighing up the pros and cons of a specific case. Decentralisation can have some disadvantages.³² That is why decentralisation is not always appropriate. The benefits and disadvantages need to be weighed in each case.

Views of the Council³³

- By decentralizing tasks, responsibilities and resources local governments are able to contribute to a powerful, small, and service-oriented and efficient government service (compact government). The condition is that central government respects the principle, “This is either your task or it isn’t”
- Effective decentralisation means that local governments are responsible for considering the most efficient and effective use of the available resources. This is the only way that decentralisation can contribute to reducing the burdens of bureaucratic responsibility.
- Successful decentralisation requires financial stability and a calm approach towards policy; not a too hasty evaluation and/or adjustment of policies and distribution.
- A clear division of tasks avoids disorder, administrative pressure, indecisiveness and the shifting of financial risks.
- It is important that local authorities have coherent tasks. This allows them to use their pooled resources in a coordinated fashion in both time and place and promotes a more logical and more efficient set of administrative tasks (economies of scope).
- Task and scale must be matched. When tasks are decentralised, it should be taken into account whether it is a question of execution or policy assessment.

³² Allers 2011

³³ Council for Public Administration and Financial Relations Council 2000

- There will be administrative repercussions if during the policy assessment the involved interests go beyond levels of responsibility due to, for example, external effects. A shifting mechanism must be avoided so that whether endeavours are undertaken or not, they do not lead to savings or costs elsewhere in the system.
- In the event of differentiated tasks being allocated to (groups of) municipalities/provinces, central government should ensure that there is adequate funding for that task.
- When it concerns implementing a task efficiently, it is in the first case up to the level of government itself to determine how this can be organised in the most effective and efficient way. If, however, the general opinion is that the extent of the administrative scale is an impediment to cost-effective implementation, it will be up to central government to draw its conclusions for the consequences. That is to say: adapt the administrative scale or shift the responsibility to another administrative scale.
- Types of co-financing can easily lead to an inefficient balancing of costs and benefits because each party only assesses its share of the costs. Co-financing is in many respects, particularly a symptom of disorder in financial relations and administrative responsibilities.³⁴

Compensation principle

Legal basis

Article 2 of the Financial Relations Act is important in respect to the decentralisation of tasks. This determines that when quantifying policy and task changes central government should clearly indicate what the financial implications are for local governments and how local governments can deal with the financial consequences.

Explanation

Article 2 of the Financial Relations Act does not require central government to also make money available for new tasks. The government should indicate how the costs can be covered. Article 108, paragraph 3 of the Municipalities Act and Article 105, paragraph 3 of the Provinces Act obliges central government to compensate co-governance costs. It is important to note that Article 2 of the Financial Relations Act also applies when local governments are no longer required to carry out certain tasks. This can lead to central government cutting benefits to local authorities. It is assumed that, in practice, executing tasks decentrally increases local efficiency but in many cases, the full amount of the national budget is often not transferred but used as an efficiency reduction.

Views of the Council

- Article 2 of the Financial Relations Act also applies to European regulations. Article 2 of the Financial Relations Act also applies to directly enforceable European legislation.³⁵
- Article 2 is also applicable if central government indicates that it will cease to finance these tasks. In these cases, it is also central government's duty to specify how decentral governments can assimilate the consequences.

³⁴ Financial Relations Council 2002

³⁵ Financial Relations Council 2004, p. 12

2.4 Funding sources

The previous section described the basic principles regarding the division of tasks within a decentralised unitary state. This section discusses the how these tasks can best be funded. There are different funding sources available to fund local tasks such as charges, rates, levies, own resources, taxes, the general grant and specific grants. Section 2.4.1 begins by first describing the characteristics and functions of the various funding sources and section 2.5 further discusses the order of preference.

2.4.1 Different funding sources

2.4.1.1 Charges

*Theoretical insights*³⁶

In principle charges lead to an optimum balance between costs and benefits because deciding, paying and enjoyment are all related. But sometimes introducing charges is impossible or undesirable: charges can only be applied when people can be excluded from using facilities. Charges are undesirable when they are too high or when they are too ineffective. Central government's use of a facility can also be seen as desirable (merit goods) and in that case, there are no charges or a "symbolic" fee could be charged. Some facilities are considered as basic social rights (education, housing, health), making them accessible to everyone, regardless of income.

Explanation

Prices in this case are, for example, what people pay for entry into swimming pools and theaters, et cetera. Prices also play a role in the supply of goods and services between government bodies.

2.4.1.2 Fees

A fee (right or levy), is a payment for a public service (i.e. issuing a passport) for which an individual act is compensated.³⁷ They are designation levies with earmarked revenue. The conditions determine that rights and levies must fully cover costs and therefore may not be considered as a source of income.

³⁶ Allers 2006

³⁷ Article 229 of the Municipalities Act

2.4.1.3 Taxes

Legal basis

Tax is characterised as a levy with no directly individualised compensation. Income from taxes can be spent freely and local governments are responsible for determining the tariff themselves. The type of taxes the municipalities and provinces may levy is limited and laid down in the Municipalities Act and the Provinces Act.³⁸

Theoretical insights

A substantial local/provincial tax area is needed for the efficient and effective functioning of government as a whole. Increasing tasks also brings an increased risk for governments. The taxation area should be arranged to ensure risks are taken responsibly and are adequately covered.

Local taxes must not cut through the macroeconomic policy or income policy of central government. Optimum allocation is important as well as efficiency. Therefore, there should not be too many different types of local/regional taxes because imposing central taxation is often cheaper.

Besides funding (part of) local government's expenditures, taxes also serve other purposes:³⁹

- Democratic function. Local democracy benefits from the power of local government to fit, to a certain extent, their own services and tax levels.
- Allocation function. Because they have more know-how of specific local circumstances, local governments are better equipped to make an assessment between the benefits of collective municipal facilities and the financial forfeit they propose to citizens and businesses.
- Regulatory function. Decentral authorities can use certain taxes to regulate the behavior of citizens and businesses.
- Compensation function. To compensate shortcomings in the distribution of the general grants or specific grants.
- Effective use of own taxes. According to the so-called mental accounting theory, administrators decide on the allocation of resources and are also dependent on the source of this income.⁴⁰
- Buffer function. In order to cope with financial risks or setbacks which are part of a task or responsibility, it is desirable that local authorities have a back-up capacity of their own – a financial buffer – which is fed by general reserves and unused tax capacity.

Explanation

The explanatory notes in the Financial Relations Act still pose that differences in tax rates are designed to reflect differences in preferences.⁴¹ However, in practice municipal tax rates are gradually converging together. Central government sees the practical significance of local taxation areas

38 Article 219 para. 2 Municipalities Act; Article 221 para. 2 Provinces Act

39 Council for Public Administration and Financial Relations Council 2005, pp. 58-59

40 Thaler 1980, pp. 39-60

41 Lower Chamber, meeting year 1995-1996, 24 55, nr. 3, p. 20

increasingly being restricted to a buffer function.⁴² In view of the size of the provincial taxation area, the financing role of the provinces is dominant.

The level of local taxes is restricted because of practical limitations:

- High local taxes lead to tax competition.
- Large differences in tax burden are politically difficult to accept.

In addition to taxes, Central government needs “tools” for its income and macro-economic policy. The law prohibits local government from implementing an incomes policy.⁴³ The practical argument is that a local incomes policy does not work in a large local taxation area because it triggers migration. This is based on the Tiebout theory which argues that citizens express their preferences by choosing the area that has the most favorable combination of services and tax rates.

Views of the Council

- Consider at the local level whether the benefits of facilities against the necessary tax sacrifice contribute to the efficient and effective functioning of government as a whole. The condition is that the taxes levied are sufficient and are raised by local governments.
- It is important that the tax is applicable to a broad composite group of taxpayers. Taxes as general reserves should cover the widest scope possible.
- Municipalities and provinces should be able to fund through taxes their own policy choices. Differences in tax rates indicate differences in autonomous choices of policy.
- Simplicity and practicality are important criteria for restricting the perceived costs of local taxes.
- The Council calls for a broadening of local taxation areas and, at the same time, a reduction in national taxes together with a reduction of general grants and specific grants.

2.4.1.4 Municipal and provincial funds

Subject to the statutory obligations, grants from the municipal and provincial funds can be spent freely. Local government is only accountable to its own democratically elected parliament. The municipal and provincial funds consist of three types of grants: the general grant, integration grants and decentralisation grants.⁴⁴ In terms of efficiency and legitimacy, local government is accountable to its own elected parliament for the expenditure of revenues from funds. Each municipality/ province is responsible for its own efficiency.

42 Scenario's gemeentelijk belastinggebied in relatie tot de bestuurlijke verhoudingen, Bijlage bij TK-stuk nr. 26, o.a. pag. 25 and 68; [Scenarios of municipal tax areas in relation to administrative relations, Annex to Lower Chamber document no. 26, p. 25 and 68;] Financial Relations Council 2005

43 Article 219, para. 2 Municipalities Act; Article 221 para. 2 Provinces Act

44 The temporary additional grants for municipalities in financial difficulties provided under Article 12 FvW is also one of the municipal funds grants discussed here.

The general grant

Legal basis

The legal basis is regulated by the Financial Relations Act, in particular in Article 5 paragraph 1 and Articles 6 et seq. 11.

Theoretical basis

The freedom of expenditure of general grants leads to an optimal balance between expenditure targets.

Explanation

The general grant was introduced in 1865 when it was created to compensate for the restriction of the local tax area. In a strict sense, the general grant is a supplement to the administrative level so that it can generate its own income. Originally, the funds were used to redistribute joint tax revenues but, as a result of the reorganisation of specific grants, it has increasingly changed into a means to finance co-governance tasks. In addition, general grant funds are being set aside more and more for communal purposes.⁴⁵

The supplement to the private area of the general grant is illustrated again in the fact that the tax capacity is decisive for the size of the general grant of an individual municipality or province. The general grant therefore contributes to balancing the capacity between authorities within a government level. The annual increase of the general grant is linked to the adjusted net government expenditures, according to the principle 'up and down the stairs together'. This is referred to as the standardization system.⁴⁶

Views of the Council

- The standardization system provides local governments with security and does justice to the principle of equitable treatment between governments. The amount of the general grant should not depend on the individual policies of the municipality or province.
- Direct distribution and other incentives are contrary to the principle of the freedom to spend the general grant. This also applies to the designation or appropriation of parts of the general grant as funding sources for certain tasks by central government.
- The use of fictional budgets for certain tasks from the general grant is at odds with the broad and uninhibited nature of the general grant.
- Excluding the use of the general grant for specific (community) objectives or specifically allocating funds is undesirable because this is detrimental to the grant's general features.

45 Examples are the National Implementation Programme known as the i-NUP; the financing of the Quality Institute Dutch Municipalities (KING)

46 This principle is applied in financial relations between central and local governments. If government has more money to spend then this is also the case for municipalities and vice-versa.

Integration grants

Legal basis

Integration grants are part of the municipal or provincial funds and are characterised by deviating from the general grant distribution and/or standardization system (Article 5, paragraph 2 and Article 13 of the Dutch Grants to Municipal Authorities Act, FVW). Integration grants are grants which are temporarily distributed in a different manner but which are eventually transferred to the general grant. Integration grants can be used freely; central government does not require their expenditure to be accounted for.

Views of the Council

- Integration grants are an appropriate instrument for redistribution effects or as a means to (gradually) solve other temporary problems prior to finally transferring funds to the general grant. This is under the condition that it is clearly indicated beforehand that this measure is temporary.

Decentralisation grants

Legal basis

Central government can distribute decentralisation grants through the municipalities or provinces funds without being bound to the general grant's distribution system (Article 5, paragraph 2 and Article 13 of the FVW); decentralisation grants can be used freely. Local governments are not accountable to central government for their expenditure.

Views of the Council⁴⁷

Some types of decentralisation grants require application procedures and plans to be submitted and so on, which is contrary to the free and unconditional character of the municipalities and provinces funds. Decentralisation grants thus contribute to blurring financial responsibilities.⁴⁸

Decentralisation grants should also be included in the reorganisation of specific grants, the objective being to enhance policy and discretion of expenditure and to restrict the pressure of regulation.⁴⁹

2.4.1.5 Specific grants

Legal basis

Specific grants are tied expenditure transfers from central government to local governments (Articles 15a and 21 et seq. FVW). Local governments are accountable to central government for these funds.

Specific grants are normally only issued for decentralised tasks when this funding method is considered to be especially appropriate.⁵⁰ The disadvantages of specific grants are that they lead

47 Financial Relations Council 2007

48 Goedvolk and Kooistra 2008; De Sonnaville 2010

49 Financial Relations Council 2010

50 Article 17 para.2 Financial Relations Act

to an inefficient use of public funds and generate high administrative and accounting burdens. The Explanatory Memorandum to the Dutch Grants to Municipalities Act (FVW) lists four circumstances in which specific grants are allowed:

- If funding through own resources is not possible due to a different course or when political income considerations dictate otherwise.
- If the grant is temporary due to the nature of the subject.
- If there is not enough or insufficient information regarding the scope of the costs of the corresponding task or activity.
- If no structural characteristic can be determined for the costs of the task or activity so as to base the distribution of funds through a general grant.

Block grants⁵¹

A block grant is a collection of small specific grants to a maximum of 10 million euros nationally, per ministry which is freely disposable within a policy theme (Article 16a FVW).

Explanation

In practice, there are a multitude of other reasons to justify introducing specific grants such as policy enforcement, building support for national policy, steering etc.⁵² By introducing the 'single audit, single information' which allows municipalities and provinces to provide central government with information once a year, it reduces the accountability burden and includes the controls the organisation carries out itself.

While still relatively limited, Europe has an increasing influence on financial resources. European financial resources usually have their own individual and complex accounting methodology, which in some cases, undermines the enthusiasm of claiming funds.

Views of the Council

- Due to the high degree of uniformity required in the execution of tasks (resulting in the absence of policy freedom resulting in financial risks) funding through specific grants is then the obvious choice.
- Wherever possible, specific grants should also contribute to the policy and freedom of local government spending. Bureaucratic burdens should, wherever possible be avoided.
- Pooling resources should lead to one budget with one allocation formula for one budget under one law and one minister bearing the responsibility.⁵³
- The disadvantages associated with specific grants in terms of application and accountability burdens also apply for European contribution plans. This is why they should not be preferred.

51 Financial Relations Council 2007

52 Verhagen 2001

53 Financial Relations Council 2008

Explanation

The difference between grants from the municipalities/provinces funds and specific grants has over time become increasingly blurred. This is because the spending allowance for specific grants has become increasingly broader and because the use of the municipalities/provinces funds – contrary to the basic principle – sometimes causes restrictions to be imposed.⁵⁴ The key difference lies in the recognition of the legality of the spending. Central government is responsible for specific grants whereas responsibility for the municipalities and/or provinces funds lies with its own individually democratically elected body.

2.5 The order of preference

Legal basis

The explanatory notes to the Financial Relations Act are based on the classical order of preference.⁵⁵ This means that local governments tasks are best funded through charges, followed by levies and their own taxes, than through general grants and ultimately through specific grants.⁵⁶

Theoretical basis

According to mainstream economic theory, funding preference increases prosperity.⁵⁷ Funding from own income – through taxes and other such own resources – should be preferred when charges are not desirable or possible. In this case, administrators must directly balance the usefulness of services against the deployment of own resources.⁵⁸ The basic principle is that all the costs and benefits are carefully considered; the last euro spent by the government must be spent as wisely as the last euro spent by citizens themselves. This is on the condition that as far as possible, one party decides, pays and benefits. This prevents shifting responsibilities to other levels of government or other sections of society.

The classical order of preference has been a frequent topic of discussion.⁵⁹ The result reveals a tendency towards a more subtle approach, namely that the preferred sequence for autonomous tasks is different to that for co-governance tasks. First and foremost, within the current administrative relations there is hardly any absolute autonomy, it is a matter of more or less autonomous and co-governance tasks. These co-governance tasks vary from ones with a high degree of policy freedom to highly regulated co-governance tasks.

54 Chamber of Audit 2009

55 Lower Chamber, meeting year 1995-1996, 24 522, no. 3, p. 11

56 There is no mention of a funding preference or alternative types of funding like those indicated in Chapter 4. These types of funding do not really play a role like charges because their purpose is to allow interested parties to contribute to the costs.

57 Boorsma and Allers 2006

58 Oates 1972

59 Boorsma and Allers 2006; Bordewijk 2004; Var der Lei 2007

The following is the classical order of preference for autonomous tasks:

- If an (autonomous) task has far-reaching consequences for inhabitants or administrations of other governments (external effects) a specific grant is often the most appropriate instrument.
- The external effects may frustrate the efficient and effective considerations regarding the use of resources.

The following applies in the absence of external effects:

- Charges to be kept within technical and moral/political boundaries as far as possible.
- Levies (only applicable for individually attributable specific services).
- Local taxes.
- General grant.

In addition, the following principle applies in co-governance: he who pays the piper calls the tune.

This leads to the next preferred sequence:

- Cost covering specific grants (the State determines, so the government pays).
- In order to promote efficiency, part of the costs can be covered by the general grant, or where possible through budgeted grants.
- For general co-governance tasks that must be executed in all municipalities/provinces, the general grant is to be preferred because of the low transaction costs.

Explanation

The practical significance of the preferred sequence should pose for each task the implicit question about which type of funding is the most appropriate. However, in the final assessment, ultimately mainly political and administrative considerations play a role. The actual size of the various types of funding differs from that which would be expected on the basis of the preferred sequence.

Views of the Council

- The method of funding a task must logically follow from the laws and regulations which are connected to this task. As the degree to which municipalities/provinces are bound to laws and regulations that restrict freedom of policy and spending, and thus entail a budgetary risk, the more obvious choice for funding will be via cost-covering specific grants.
- Specific grants bring some inherent disadvantages. Funding through a specific grant not only has implications for the accountability and efficiency but it also limits the possibilities for consideration and can obstruct the efficient appropriation of resources.
- The advantage of the general grant is that the transaction costs are low for both central and local government.
- Transferring a specific grant to a general grant reinforces comprehensive assessment and accountability. Decentralisation grants have, in many cases, the same disadvantages as specific grants and do not contribute to strengthening comprehensive assessment.

2.6 General grant distribution

The distribution of the general grant is the third leading aspiration level. There are two other basic important principles besides the third aspiration level: cost orientation and globality.

2.6.1 Third aspiration level

Legal basis

At the third aspiration level there is a (more or less) full equalisation of facilities. When distributing resources among local authorities the taxation capacity is taken into account so as to achieve equal tax rates and equal levels of service. Price differences are then also taken into account. If a local government wants to provide a higher (or lower) than average level of facilities to its citizens, this means citizens will be charged a higher (or lower) than average tax rate. Each municipality/province must be able to provide its citizens with local or regional facilities which are equivalent to the taxation rate. Equal facility capacity does not imply an equal capacity level. Whether and how the potential is used is, in principle, up to the administrative level in question and is an independent assessment. In the explanatory notes to the Financial Relations Act, the third level of aspiration is outlined as a guiding principle for distribution of the general grant.⁶⁰ The legal basis for the third level of aspiration is embodied in Article 7 of the Financial Relations Act.

Theoretical basis

Prof. Goedhart provides the theoretical basis of the third level of aspiration.⁶¹ Goedhart distinguishes different levels for reducing inequality in local government service capacity. His conclusion is that for a small, densely populated and homogeneous country like the Netherlands, the third level of aspiration is the most appropriate level of equalisation.

Explanation

The third level of aspiration can be seen as a type of intergovernmental solidarity. Experts disagree about the interpretation and application of the third level of aspiration. This discussion is addressed in Chapter 3.

60 Lower Chamber, meeting year 1995-1996, 24 552, no. 3. p. 8

61 Goedhart 1982

Views of the Council

- The third level of aspiration is a desirable level of equalisation but it will never be reached. To do so requires a disproportionate amount of effort which itself is at odds with other principles such as autonomy and globality.
- The third level of aspiration is about the entire apportionment of the general grant.
- Equalisation based on the third level of aspiration originally concerns an equalisation of the taxation capacity. But when it does not concern the availability of other own income from own policy choices or business activities but is a historical fact (such as income from capital in public services), there is a reason to also include these in the equalisation.⁶²
- The third level of aspiration is only applicable for the apportionment of the revenue supported grant. Many specific grants have a different level of equalisation. Since each municipality/province must be able to contribute equally to the non-specific grant costs, the premise works indirectly for the entire financial relations.

2.6.2 Costs orientation

The objective of achieving the biggest possible equalisation of service capacity is operationalised through the cost orientation principle. The following should be taken into account when elaborating a distribution system:

- structure characteristics that influence the demand for services
- structure characteristics that influence the cost of a facility
- Positive and negative external effects.
- differences in the assigned tasks
- differences in capabilities of the administrative levels to generate revenue.

Explanation

Besides being practically impossible to determine objectively all cost factors, it is also undesirable to do so. This will have too a strong normative effect on the distribution system resulting in the misuse of the policy freedoms of municipalities and high research costs.

Views of the Council

- When costs are paid through the general grant they should be considered as unavoidable expenses for which the relevant level of government is responsible.
- When apportioning the general grant care should be taken to ensure that no disproportionate importance is given to the cost differences between municipalities through different kinds of allocation criteria (cost orientation).

62 Financial Relations Council 2009

- The apportionment of the general grant should be parallel to the actual costs/expenditure development and should not anticipate possible cost developments. Costs first have to be developed. In other words, a different distribution of resources should not be sought too quickly. This causes unnecessary stress to local governments and leads to policy costs for central government.
- The apportionment of the general grant is not a steering instrument for central government policy.⁶³
- There must be no pressure with regards to the scale of administration or towards downsizing from the apportionment of the general grant.
- The apportionment of the general grant is based on the collective preferences of all the entities involved and thus it is not decisive on the effectiveness of spending. The premise is that differences in individual municipalities/provinces' spending is based on differences in preferences and/or differences in efficiency. The average level of expenditure determines the apportionment. Each municipality/province is entitled to its own (in)efficiency.
- In view of the freedom of expenditure of the general grant, it is inappropriate to impose expenditure and accountability requirements

2.6.3 Globality

The general grant apportionment system does not need to be too detailed. The system should operate based on 'globality'.

Views of the Council⁶⁴

- Apportionment should be transparent. Far-reaching complexity affects confidence in the distribution system.⁶⁵
- Allocation criteria should be neutral. Extensive detailing of the apportionment indirectly affects the autonomy of municipalities.
- The data used for the allocation criteria should be unambiguous and determined without subjective judgments. Equality of rights and legal certainty are reflected in the requirement that an independent body can objectively ascertain standards. These standards should be determined unambiguously and without subjective judgment. In addition, the data must be verifiable for local governments.
- Only criteria with sufficient added value will be included in the apportionment system.

63 Financial Relations Council 2010b

64 Financial Relations Council 2011b

65 Financial Relations Council 2009

2.7 Concluding remarks

This chapter described the norms and basic principles underlying the current system of financial relations. The Council's views have been added to these norms and basic principles. The Council notes that the system of financial relations has become progressively more complex and that the original standards and basic principles have increasingly become overshadowed. This is largely due to changes in administrative relations. There is an increasingly complex interaction. At the same time, there is a growing importance of funds for financing decentralised tasks, due in part to the decentralisation of government tasks. The apportionment of the general grant has become more sophisticated, whereas the importance of the municipal taxation area is limited. The introduction of a distinction between management and development tasks for the apportionment of the general grant marks a gradually changing view of central government of the role of the provinces within public administration.⁶⁶ The financial relations thus reflect changed administrative relations. The method of funding should indeed be in accordance with administrative relations. However, in many cases the adjustment of financial relations is seen as a technical matter, whereas in reality it is about fundamental administrative choices. Allocating resources via the general grant also involves inter-governmental trust and the manner in which trust in the accountability of the expenditure of resources is given to the leading democratic legitimate administration.

In view of imminent decentralisation measures, the Council advocates a careful introduction process before finally transferring over to the general grant. What needs to be determined beforehand is whether it should be directly introduced into the funds or after the chosen evaluation period. Before the funds are finally transferred, it must be clear whether the regulations, size and the final apportionment warrant a final transfer. This assessment can also include resources from the same policy area that were already distributed via the general grants. This will encourage full consideration within the policy area. Hasty assessments often provide no clear picture about the results and impact.

3. Developments and debates regarding financial relations

3.1 Introduction

The previous chapter described the present set of standards. It described the norms, insights and principles on which the Council has based its opinions in recent years. It is like a rear-vision mirror. The Council has thus complied with the evaluation commission's advice to specify its set of standards. This framework has subsequently been discussed in expert meetings and discussions with various interested parties and experts.⁶⁷ During these expert meetings, despite sometimes intense discussions, a fairly broad-based consensus was ultimately reached on the current set of norms. Many discussions focused on applying these norms and the administrative context in which they are applied. It was stressed that more emphasis should be given to the principle of inter-administrative trust. In addition, the parties involved discussed the theoretical accuracy of the standards (third level of aspiration, funding preferences, etc.). Attention was given to the dynamics that make it necessary to adjust components of the set of standards to make them sustainable for the future. Chapter 4 addresses the changing role of local governments and how the way in which they achieve results in society is largely dependent on the interplay with other sectors in society.

Explanation

First, a brief summary of the findings are given regarding the two main questions resulting from the evaluation. Section 2 discusses the significance of financial relations in the discussion on fiscal federalism⁶⁸ and on the premise that decentralised financial considerations should be promoted as much as possible. Section 3 raises the question whether the normative character of Goedhart's third level of aspiration, as defined in the Financial Relations Act, should be reconsidered or reformulated. Section 4 continues by discussing the increased importance of the regionalization of financial relations.

67 See Annex 2

68 The study of the allocation of power over financial resources between local authorities

3.2 Fiscal federalism

Description

The literature on fiscal federalism defines two characteristics.⁶⁹ There is a neutral description of fiscal federalism that compares fiscal federalism to the control over the allocation of funds between local governments (this, in fact, is not very different to the usual definition of financial relations) and a more normative definition based on the assumption that the decentralisation of tasks and the relevant control over the financial resources (especially a large taxation area) leads to the most efficient and effective use of public funds.

In fact the term fiscal federalism, says exactly what it is. It originates from federal states like the United States of America. It is not possible to transfer the normative details of fiscal federalism to a decentralised unitary state like the Netherlands because of the differences in structure and organisation between the two types of states. Apart from this, there is a social context and geographical factors to be considered (the Netherlands is a densely populated country with short tracks to the centres of power). The Netherlands is not a federal state but a decentralised unitary state in which the emphasis is more on unity than on the diversity of its constituent units. The local and regional differences in citizens' preferences are relatively limited.

In the Dutch situation, decentralisation is also expected to contribute to a more effective and efficient balance between costs and benefits. The assumption is that decentralisation promotes policy innovation, strengthens citizen involvement and fosters policy competition. Upon allocating the tasks and resources, account has been taken of the desired uniformity of task performance, scale and external effects et cetera both in theory and in practice. The set of standards in Chapter 2 highlights a slightly more subtle view on the allocation of tasks and resources to local authorities. Nevertheless, the prevailing thought is that a decentralised allocation of tasks and resources contributes to an effective and efficient use of resources.

Decentralisation

In the Council's opinion there is no evidence to suggest that decentralised financial considerations lead to an efficient reconsideration of assessment. If decentralisation is to have any significance, then local governments must actually be able to give substance to the decentralised tasks themselves. However, this does require that after transfer of state tasks and powers, the state's influence is limited to steering the socially desirable effects (outcome) according to the adage, "you either control it or you don't"

There is, partly because of financial reasons at the national level, wide support for the decentralisation of tasks, although it is clear that the limits of decentralisation within the current administrative structures are emerging. The decentralisation of many government tasks relies on the organisational capacity of municipalities and provinces to link business functions with each

69 Oates 1999

other and to work efficiently. The implementation capacity should, in many cases, be organised at a higher level. It cannot be disputed, that after decentralising tasks, the subsequent organisation of implementation issues at a higher level also indirectly affects the freedom of policy of local authorities, because benefits of scale can only be achieved by introducing at the same time uniformity/harmonization of this implementation.⁷⁰ This threatens the loss of the envisaged benefits of decentralised allocation of tasks, namely those of customisation.⁷¹ The Council believes it conceivable that due to the planned large-scale decentralisation of municipalities (youth care, Exceptional Medical Expenses support (AWBZ begeleiding), the Act 'Work to your abilities', in Dutch: Wet werken naar vermogen) that some parts of these tasks will in time increase thereby upsetting the current overall inter-governmental balance. The size of the decentralisation tasks implies broad responsibilities that directly affect the privacy of the residents of municipalities and indirectly that of the governance of the country (municipal regionalisation and municipal redivisions).⁷²

Extensive decentralisations bring about large financial risks that put pressure on the financial policy discretion of the municipalities and the provinces. This is because all local governments are required to implement the decentralised tasks. It should therefore be determined by every large decentralisation, whether the local taxation area is sufficient to be able to run and/or to hedge these risks. Decentralisations threaten thus to provide a limited contribution to strengthening the political and administrative autonomy of municipalities and provinces.

Funding Preference

The doctrine of funding preference is closely related to the normative interpretation of fiscal federalism. The criticism about funding preference consists of several elements:

- the extent of the various funding sources shows that, in reality, there is little interest in a funding preference;
- the funding preference does not take into account the blurred distinction between the various forms of funding.

Funding preference is a rational economic classification principle that clashes with political rationality. It does not automatically follow that the theoretical preference also leads to the size of various funding sources according to this preference.

Moreover, the theory of funding preference is often simplified to establishing that local government's tasks can best be financed from own income, then from the general grant and finally from specific grants. Boorsma and Allers already concluded that the generally worded order of preference is incorrect.⁷³ As indicated in Chapter 2, there could be good reasons for external effects and co-governance for funding through a specific grant. From central government's perspective,

70 Financial Relations Council 2010

71 Allers 2010

72 Council for Public Administration 2011

73 Boorsma 2006 p. 16, 103-109

specific grants are a good funding instrument to promote a (semi) collective public good. The choice of the most effective form of funding will also depend on the nature of the administrative task.

The disadvantage of specific grants is much less evident than in the past. The responsibility burdens have been significantly reduced. Specific grants guarantee to large extent central government's involvement and the distribution of resources. Co-governance tasks with a limited discretion and/or a high degree of dependence on factors that are not influenced by local government such as macro-economic development, call for the responsibility for the necessary funding to lie with central government.

The traditional funding preference ignores the blurring of the distinction between the different funding types: general funds, decentralisation and integration grants, special-purpose grants, specific grants (lump sum) and the like.⁷⁴ The introduction of a distinction between development and administrative tasks for the distribution of general grants from the provincial funds has made the differences become more diffuse.⁷⁵ Strictly speaking, the Financial Relations Act's legal framework is circumvented by introducing an equity investment criterion via a decentralised grant which, on the basis of statutory requirements, should not be possible.

The general grant is often seen as being equivalent to autonomy as are specific grants to co-governance. According to the definition, the Work and Social Assistance Act (WVB) is a specific grant. In practical terms, this grant is very similar to a general grant; surpluses can be spent freely whereas deficits must (in the first instance) be covered by general resources. This leads to an inadequate distribution of resources for assistance benefits thereby threatening to affect the distribution of the general grant. The general grant is not a catch net for distribution disparities from other specific grants and the general grant is not meant for this purpose either.

The idea that transferring resources via the funds of provinces or those of municipalities leads to autonomy and by definition the decentralisation of tasks brings freedom of implementation is no longer true. To ensure effective decentralisation this requires adequate room for policy and spending freedom. The network society requires horizontal connections to be made at a local level.

This requires administrative and organisational ability to carry out this responsibility. Firstly this involves an administrative and organisational issue and is only in a derived sense, a financial relations issue.

Tax Area

The link between *open house holding* and an *autonomous tax area* is often less straightforward than assumed. For example, Dutch water boards do not have an *open house holding* but have a large autonomous tax area. Strictly speaking, these are not taxes but earmarked levies. When provinces

74 Court of Audit 2009

75 Financial Relations Council

lose their *open house holding* this does not mean that it interferes with the municipal surcharge. This is primarily a financial instrument. Conversely, even without their own tax area, the municipalities could dispose of their own *open house holding*. The independent nature of the general grant equally contributes to freedom of policy and spending. However, an autonomous tax area is part of an essential component to develop tasks on their own initiative.⁷⁶

Empirical evidence in scientific publications supports the claim that a large tax area leads to a more effective balance between advantages and sacrifices.⁷⁷ In politics, pleas for a larger decentralised taxation area have been ignored up to now. On a national level it evokes visions of an unconstrained local tax burden. This is partly contradicted by the present meagre development of property tax (OZB).⁷⁸ It must be remembered that there are virtually no limits to the amount that local tax can be increased and yet the size of local taxation remains limited. The annual increase in property tax revenue has been modest for many years.

There is also local opposition to increasing the property tax. There is a call to increase local tax areas, but in reality many local administrators avoid increasing taxes. Pressure to restrict local tax burdens is high because no municipality wants to top the list because of high local taxes. Local administrators fear criticism because of high charges, even though there may be good reasons (i.e. better service levels). Savings to cover (additional) expenditures are sought elsewhere. These are sought in maintenance, expenditures on things like art and culture and on sport and equipment. There is no single criterion concerning the size of the tax area for issues on funding autonomous tasks. A large local tax area could, in principle, threaten the depletion of the collective level of local public services. It could also cause the opposite to happen. The willingness of citizens and businesses to contribute to the cost of collective public services is under pressure. At the same time, citizens are opposing the closure of swimming pools, libraries and the like. It is all about finding the right balance.

In the Council's view it remains desirable to introduce a larger decentralised tax area and, at the same time, to lower central government taxes.⁷⁹ For reasons of efficiency, the Council also recommends abolishing a number of small local taxes or combining them.⁸⁰ These small general taxes confuse citizens because the name implies that they are targeted taxes (i.e. dog owner's tax). They thus obscure the local debate on raising and using the proceeds. The Dutch Association for Tax Science (Vereniging voor belastingwetenschappen) has published a study assessing how much room there is for local taxes per task on the basis of policy freedom.⁸¹ The conclusion was that there are sufficient grounds and opportunities to substantially expand decentralised taxation and, at the same time, to lower national taxes and reduce general and specific grants. Differences in local tax burdens

76 Council for Public Administration and Financial Relations Council 2005

77 Geys, Heinemann and Kalb 2010, pp 265-278; Allers 2004

78 Lower Chamber, Meeting Year 2011 – 2021, 33 000 B, no. 2. p.7

79 Financial Relations Council 2010

80 Advice from the Committee for Local Taxation 2005 (Stuurgroep verkenning decentraal belastinggebied)

81 Report by the Commission Tax Research Local Government by the Association of Tax Science 2009

are a type of differentiation. A mature democracy requires local governments to be responsible for setting their own taxes and then to explain and account to their citizens for the choices made. It is precisely by widely increasing the recognition of citizen involvement that uncontrolled increases in charges are prevented. By taking into account the usefulness of services and offsetting this against sacrificing a tax at the decentralised level, it will contribute to the effective and efficient functioning of government as a whole. It is important that voters can decide on the amount of taxes and the relevant service level. It is important that citizens get the message that local democracy is not a 'wish fulfilling democracy' either. It is not a question of 'you ask and we provide', but instead there should be an increasing awareness that it costs money to fulfil wishes. Wishes are not optional and these must be balanced against increases in the provincial and municipal taxes or by reducing or relinquishing others.⁸²

3.3 The third aspiration level

Description

The third aspiration level entails that each municipality/province must be able to provide its citizens with the same tax burden and therefore also with the same package of local or regional public services. The distribution of resources among local authorities takes cost differences into account (e.g. road maintenance costs more if the soil is poor than if the soil is good). Besides the cost of services, differences in tax capacity should also be taken into account. The tax rates should be the same to the level of services provided. If a local government provides a higher (or lower) than average level of services to its citizens this means that a higher (or lower) than average tax rate should be charged.

Thoughts on the third level of aspiration

The third level of aspiration has long been the reference point in the distribution of the general grant because this is considered to be the most appropriate level of settlement.⁸³ This fits in well with the fact that the Netherlands is a small, densely populated and homogeneous country. Large differences in services capacity and/or tax burden would not be accepted. This is a political-administrative choice and therefore a normative one. This does not mean that this leads to the most efficient distribution of resources in all cases.

However, the third level of aspiration threatens to become a mantra. When consulting experts the Council came across different interpretations of the term. This instigated the Council to reformulate the third aspiration level and to reflect on an adequate translation of the principle in the allocation of the general grant. The negative or positive opinion on the principle in many cases seems to be partly motivated by the perceived explanation. In practice, it also shows that the opinion depends on the outcome. Different interpretations contribute to waning support for the third level of aspiration.

82 Council of State 2009, p. 23

83 Lower House, Meeting Year 1995-1996, 24 552, no. 3, p. 8

The third level aspiration is not about mathematically determining the most favourable settlement. Van der Dussen, former chairman of the Municipal Finance Council (*Raad voor de gemeentefinanciën*) postulated that generally the Netherlands leans towards third level aspiration but it could be above, just below or at the same level.⁸⁴ Former secretary of both the Municipal Finance Council and the Financial Relations Council Mr Van Zaalen, found that the third level aspiration will never be achieved unless there is willingness to invest a disproportionate amount of effort, which is again at odds with other principles such as autonomy and globality.⁸⁵ There is a reason for calling this the third *aspiration* level, in other words it is a level to which one aspires while reality dictates that its attainment is not feasible.

Costs settlement

The principle implies that a municipality/province which has higher costs should be given compensation. In practice, the debate about the third aspiration level is often a discourse on whether the distribution is based on truly unavoidable expenditure – i.e., costs. Costs reimbursement is ultimately a political-administrative consideration. How can additional building costs on an area with poor soil be avoided? Is a central function a fact or is it an administrative choice? Why is it important to fund the costs of a historical central administration? It is wise to make each distribution issue transparent and to explain which elements can be funded.

Revenue equalisation

The equalisation of revenues primarily involves the equalisation of differences in tax capacity. The equalisation of other own resources is another item for discussion. Insofar as these incomes derive from business activities for which local governments also run risks (e.g. exploitation of building ground), there is a reason to include these additional own resources to achieve the third aspiration level. Where the other own incomes are related to structural characteristics and are also used for expenditures, it is obvious that (extra) revenues should be included for payment of related costs (e.g. tourism taxes). In the case where it concerns more or less coincidental historically determined incomes from assets that are not directly related to own policy, it is clear that they should be included in the implementation of the third aspiration level. The principle of discretionary powers also plays a role here. The question is ‘what is the extent of the disruption and at what price is equalisation acceptable?’ The provinces mainly determine the differences in the ‘other own resources’ (OOR) by income from (former) utility companies. It involves a substantial source of income not directly related to provincial costs. For municipalities, revenues from (former) utility companies also play a role. The amounts between municipalities can differ more than 50 euros per capita. The volume of this source of income is, in relation to the total of the municipal costs, far more limited than in the provinces. Moreover, it is an almost impossible task to clearly determine for all municipalities what the differences in income arising from (former) shares in public utilities are. All things considered, the Council concludes that it is not viable to equalise revenue raised from

84 Van der Dussen 1989

85 Van Zaalen 1989

(former) shares held by public utility companies in municipalities. Also the Council concludes that this supports its plea for a more global distribution of general grants.

Scope

There is a widespread belief that the third aspiration level covers all distribution issues within financial relations. The third aspiration level only applies to the distribution of the general grant. This misunderstanding is partly due to the fact that the general grant is the backbone of financial relations. The general grant should take into account the municipality/province's net costs (i.e. after deducting the costs from specific grants)

The third aspiration level, therefore, is about the full distribution of the general grant. The third aspiration level fully applies here. This does not necessarily apply to the individual expenditure clusters. There are clusters where it is assumed that distribution is provided for in the fourth aspiration level. In other words, the same standards of service from all authorities concerned. The Population Affairs Department and Administrative Affairs Department clusters are examples. A municipality has little choice of aspiring to a lower level because the law states very precisely which standards a municipality must adhere to. In the Netherlands, the pursuit of the same level of service standards is paramount. The case is different for ecological or historical clusters.

The law does not state that a municipality must provide public parks or a place for historical items. Distribution is based on every municipality being at least able to provide the same service package without charging its citizens disproportionately for these services.

The aspiration levels for specific grants have a very different role and meaning. First, in strict terms the equalisation of the taxation capacity has no effect on specific grants. It is true that the distribution of the general grant is based on net charges. Therefore, if a specific grant is not cost-effective this indirectly affects the distribution of the general grant. Each municipality/province must be in a position to equally contribute to the costs not covered by the specific grant.

For a cost-effective specific grant for all municipalities/provinces, it is essentially not about reaching the third aspiration level but about ensuring that each local government achieves the same standard of service level (that is, the fourth level of aspiration). Other specific grants, such as incentive schemes or investment contributions are indeed about achieving a differentiated package of standard services. This could involve things like centres with a national or regional importance or ensuring that a municipality is willing to start a pilot project.

Others point out that the third aspiration level does not need to be assessed by a municipality or a province, but by area. From this perspective it does not matter whether the province or the municipality provides to the level of the standards, the only thing that is important is that the standard is achieved in that area. Although this view seems congenial, it does ignore the administrative reality that the allocation of resources is based on a division of tasks and responsibilities of administrative units, each with their own profiles: municipalities and provinces.

Effect of the third aspiration level

The effect of the third aspiration level through equalisation also causes nearly the entire question of the tax burden to be under discussion. There are indications that the equalisation of tax capacity leads to an unequal tax burden for citizens. A municipality with a low tax capacity is forced to levy a higher tariff in order to generate the same (extra) revenues. The only way for all of the municipalities to fund the same service level is by implementing this tax tariff. If a municipality changes this tariff, it could enable another municipality to provide a larger service package from its tax revenues.

The amount of equalisation

Due to the extent of the equalisation of the tax capacity it appears that municipalities do not sufficiently benefit from the added value they create through their policies. In the current distribution of municipal funds, 80 per cent of the residential property tax capacity and 70 per cent of the property tax of non-residential capacity is equalised. This extensive tax capacity equalisation works counterproductively. This is why the Council advocates adjusting to a lower equalisation rate. This can be justified because the equalisation of the tax capacity has been overshot and can no longer be substantiated by the municipality and results in higher property valuation. This is also consistent with the findings in the report of the *Stad en Land* published by the CPB⁸⁶ Netherlands Bureau for Economic Policy Analysis (Dutch: *Centraal Planbureau*).

Conclusion

It should be concluded that the third aspiration level should serve as a normative basis. Liberalizing the third aspiration level does not justify the underlying principle of distributive justice. There is broad consensus on the need for administrative solidarity within an administration layer. However, in practice there is too much emphasis on an assumed principle of equality. This is why there is a less extensive and detailed equalisation of costs and revenue capacity.

Financial relations should be set up so that in the distribution of resources, enterprising municipalities/provinces are not sanctioned but stimulated. The Council considers that the third level of aspiration (specification and refinement) should be reformulated. This means that allowance should be made for the differences in costs of the equalisation of income capacity so that each municipality/province is able to provide its citizens with the same local and regional services package for an overall equal tax burden. This conduces in terms of structure, to enabling similar types of municipalities/provinces to provide the same service capacity for an overall comparable tax burden. Upon translation into this structure, it is important that increasing the revenue capacity through the policy efforts of enterprising municipalities/provinces does not completely cream off the allocation of resources. Income and risks arising from business activities, such as land development, are not included in the equalisation. The Council considers this adjustment to be in the interest of future developments of financial relations.

86 Report Netherlands Bureau for Economic Policy Analysis (Dutch: *Centraal Planbureau*).2010

3.4 The growing importance of the region for the municipality

A municipality is part of different regions: a regional labour market, a regional housing market, a 'health care' region, an education area, an economic region, a security region, a regional social employment organisation et cetera. These concern different types of social, geographic as well as administrative regions. The municipality as the local administrative unit is generally seen as the principle distributor of financial resources.

The regions' influence on the municipalities costs are taken into account in the distribution of the general grant. A municipality receives a contribution towards extra costs based on its central role, for example, in the area of art and recreation this is via the criterion of potential customers. In addition, some municipalities are earmarked as central municipalities for a particular service such as social care or women's shelters. The distribution takes into account the structural characteristics of the regional care areas. Where the expenditures for these specific grants are exceeded then the (central) municipality will in most cases have to meet these costs from its own resources.

The costs associated with 'social' regions like the labour market or the housing region which are part of a municipality are even more indirect. These are not included in the distribution of general grants. Distribution under the Work and Social Assistance Act (WWB) does take into account the conditions in the region's labour market.

An increasing part of the municipal tasks involves regional steering. This enables an increasingly larger share of municipal expenditures from being included in a comprehensive assessment at local level. It undermines effective decision-making. This partly involves voluntary forms of cooperation for task implementation. However, in part it also involves mandatory forms of regional cooperation such as for security regions, the regional agencies and, in the future, for youth care. This results in not only a (financial) administrative issue but in an issue regarding allocation.

The administrative problem often concerns the limited and indirect opportunities an individual municipality has in administering the expenditures of a joint regional cooperation. The financial obligation arising from this collaboration affects the municipal budget. The paradox in this voluntary inter-municipal cooperation is that an individual municipality often chooses to collaborate for reasons of efficiency but subsequently, it is increasingly tied to decisions taken at the regional level which limit the influence of the individual municipalities.

Direct allocation

The Council continues to believe that direct allocation and funding of tasks by central government to cooperating parties undermines the financial responsibility and involvement of local governments, thus the principle of an 'extended local government'. It should be noted that, within these cooperating parties, local authorities remain responsible for the deployment of the available funding. This does not have to be an impediment to central government directly paying the money especially when they have the most appropriate scale to decide on how that money is spent. According to the Council, this is only applicable if it is a matter of actually covering the costs for

the regional task and not if the municipalities are also responsible for contributing from their own resources.

Dual funding of a regional task, partly from a central government grant and partly from a contribution from participating municipalities such as in the case of the security region, obscures the overview of the actual costs.⁸⁷ Thus the distribution of the Public Order and Security cluster in the municipalities' funds is established on the individual costs of the municipalities for the fire brigade services and distributed on the basis of objective municipal structural characteristics. Seen objectively, the contributions from some municipalities (especially small ones), given their structural characteristics are too high in comparison with other municipalities (especially central municipalities, municipalities with a relatively higher risk) whose contribution is too low.

The Council considers that the allocation of funds to municipalities should take place through the municipal fund and distributions of the general grant should follow the actual expenses of the municipalities. If these are based on a fixed amount per capita because this has been agreed in the security region, then so be it. The whole assessment is made at the municipal level, hybrid structures are conducive to shifting the responsibility to others and inefficient choices.

The increasing influence of financial obligations arising from (mandatory) regional cooperation has led the Council to undertake further research.

3.5 Concluding remarks

This chapter discussed important aspects of financial relations which were the topic of a lot of discourse during the reorientation process. This concerned the doctrine of *fiscal federalism*, the third aspiration level and the increasing importance of the region for municipalities.

With regard to *fiscal federalism*, the Council considers that decentralised financial decision-making can contribute to an efficient use of public funds. It is also important that local governments are indeed able to organise their own decentralised tasks. This requires that after the transfer of central government tasks and powers, the State's administrative ambitions are limited to steering towards the desired social effects (outcome). This is according to the adage 'it is either your concern or isn't'. Introducing a more distinguishable decentralised taxation area and, at the same time, reducing state tax will further contribute to increasing the efficiency of local decision-making. Abolishing or bundling of small general levies prevents any local confusion and argumentation. It is important to structure the system so that enterprising municipalities are not sanctioned for increasing their earning capacity.

The third aspiration level is a normative basis for distributive justice. The Council notes that in effect, too much emphasis has been placed on the assumed principle of equality. In the third

87 Financial Relations Council 2006; Financial Relations Council 2010c

aspiration level, the distribution of the general grant should take into account the differences in costs and differences in income capacity, allowing each municipality/province with similar structural characteristics to provide its citizens with the same local and regional services package for an overall equal tax burden. When the general grant is distributed it should not result in revenues from municipalities/provinces who have managed to increase their earnings capacity being completely creamed-off.

Due to the extensive process of decentralisation, due to organisational, commercial or policy reasons municipalities are increasingly being forced to cooperate and coordinate on a regional level. This withdraws an increasing part of municipal spending at the local level from a comprehensive assessment. It is a mechanism that undermines the functioning of local democracy but also the principle of decentralisation, the precise purpose of which is to strengthen local involvement. This growing influence of financial obligations arising from (mandatory) regional cooperation has led the Council to carry out further research.

After thoroughly considering the themes discussed in this chapter, there is more to be said about the subject. The Council's aim has been to take the discussion a step further and is looking forward to the next stage in the discourse.

4. Financial relations in a horizontal society

4.1 Introduction

Chapter 2 described the assessment framework for financial relations. This was on the premise that financial relations in principle should follow administrative relations. This does not imply that from the viewpoint of an effective and efficient deployment of public funds that the financial relations cannot set any preconditions on the administrative relations however, the primacy does lie with administrative relations. Traditional administrative relations are characterised by a high degree of verticality and as a logical consequence; the financial relations are also organised vertically: it is decided at the national level which authority receives which task from which funds.

In order to implement their policy, authorities largely rely on cooperation with or implementation by civil society or the private sector. This development is known as horizontalisation.⁸⁸ More specifically, under horizontalisation it is understood that hierarchical and centric relationships have given way to equality and reciprocity. If we say that society has become horizontal, we mean that differences based on ranks, positions, ethnicity or incomes have become less important.⁸⁹

In addition to the above social horizontalisation, the Council distinguishes two types of administrative horizontalisation. Exogenous horizontalisation refers to those developments that occur outside the government, but which affect the horizontalisation of government. Moreover, the government can choose to enter into relationships based on equality with other parties (endogenous horizontalisation).⁹⁰

This report seeks to answer the question regarding the extent social horizontalisation affects the design of financial relations between central government and local authorities. To answer this question, it must first be ascertained what makes up this horizontal reality and how authorities function in it. These themes – essentially administrative and social relations – are the main issues in this chapter. Section 4.2 outlines the development of the tasks of local authorities and social organisations. This is followed by section 4.3 which describes the emergence of the network society. This section is in fact about social horizontalisation. Section 4.4 discusses the performance of local governments within networks and whether there is indeed a question of exogenous and endogenous administrative horizontalisation.

88 The Netherlands Institute for Social Research (SCP) is a government agency which conducts research into the social aspects of all areas of government policy. The main fields studied are health, welfare, social security, the labour market and education, with a particular focus on the interfaces between them.

89 The Dutch Council for Social Development (Raad voor maatschappelijke ontwikkeling, RMO) 2002

90 This division in three is inspired by Blom and Schillemans 2010

Section 4.5 addresses the significance of the verticality of the current system of financial relations on the local horizontalised reality, and section 4.6 covers five items for the system of financial relations in the horizontal reality. Section 4.7 sets out the Council's conclusions regarding whether or not to adjust the current system in response to the horizontal reality.

4.2 Task division in the past one hundred and fifty years

The municipality is for its citizens where the 'first government tier' originates. Since about 1850, the number of municipal tasks and powers relating to the life, welfare and prosperity of its citizens has increased significantly. At first, the motives for government intervention arose from the need to maintain public order and safety. After 1870, there was a further intensification and expansion of municipal duties due to developments such as population growth, industrialization and urbanization.⁹¹ These tasks and responsibilities included among others, care for the unemployed, poor relief, employment supervision, education and healthcare. Local government played a role or it took it upon itself to fulfil this role in many areas of life. The main issues were tackling the causes and consequences of poverty. Municipalities thus entered an area that, until then, was dominated by private organisations which had traditionally been active in the areas of care, welfare and combating poverty.

Many of the tasks municipalities took upon themselves were based on their constitutional autonomy, which, in the course of time, have been incorporated into national legislation. The 'social issue', poor living and working conditions, child labour, low wages and mass unemployment led to more national social legislation and to the nationalization of health care. Traditional health care providers such as the church and other social organisations were not able to cope with the increasing demand for care and community services.⁹² These social organisations, emerging from several pillars, were increasingly dependent on funding from (national) contributions.

In the period after the Second World War, there was an exponential increase in the number of fields and the intensity with which the government saw a role for itself. The Dutch welfare state was introduced. This was accompanied by far-reaching policy centralization. In the 1970s, the government's involvement reached even further: besides preventing undesirable developments, the state wanted to actively steer society. This led in 1986 to the complaint that "the development in the constitutional relations between central government, provinces and municipalities in particular in the last decades has led to the Netherlands becoming a centralist state organisation."⁹³

Due to growing individualization, since the late sixties there has been an increasing decline in citizen identification with civil society organisation based on political or ideological preferences. It is the

91 Derksen and Korsten (red.) 1989; Van der Meer, Raadschelders and Kerkoff 2011, p. 267

92 Wagenaar, Kerkhoff and Rutgers 2011, p. 267

93 Hennekens 1986

beginning of depillarization whereby not only the differences but also the hierarchy within the pillars disappears.⁹⁴ The relationships within and between governments also change.

The financial crises in the eighties prompted major cutback operations and resulted in decentralisations and deregulation operations. Central government tasks were decentralised and delegated to the provinces and municipalities, put at a distance from the central government in hybrid type organisations⁹⁵, privatised or left free to enter the market.⁹⁶ By reducing the administrative burden in this way, it changed the relationship between government and society. Former government services were put at a distance and their role became that of private partner of the government and its objective to achieve policy goals. This strengthened the development of a horizontal society; thereby governments contributed self-confidently to transferring their influence and responsibilities to the market, society or privatised public enterprises.

It is no longer the government that achieves results; civil society organisations are crucial to the success of government policy and take over tasks previously invested in government. For example, housing associations and educational institutions are playing an active role in an ever-wider field in society. The tasks of housing corporations have been broadened from the rental of affordable housing for lower income groups to neighbourhood management and community organisation.⁹⁷ Schools have seen their tasks implicitly broadened from knowledge transfer and teaching skills, to providing parenting support and unofficial gatekeeper of youth care.

The intermediate government level resulted from its position between two levels of government and its spatially oriented tasks, in an obvious external orientation towards cooperation with other authorities like water boards, private organisations and the agrarian sector. The process of land consolidation is an example of long-term cooperation between government and the agrarian sector. Since nature and infrastructure – water, green spaces and roads – escape the logic of the territorial division into three tiers in the Netherlands, the intermediate level government, including any designated water boards as a functional government, traditionally focused on coordination and collaboration with other organisations with a task in the spatial domain.

The decentralisation trend is not over yet. The municipalities' tasks are to be taken further with proposed decentralisations in the fields of employment, youth care service and counselling,

94 Wagenaar et.al. 2011, pp 227-228

95 Brandsen et.al 2006 describes hybrid organisations as organisations that operate at the intersection of the state, markets and society and unite in their performance aspects various social domains.

96 Pierre and Peters 2000, p. 89

97 Following the grossing up operation in public housing, the direct financial relationship between central government and the housing corporation has been severed. Housing corporations became social enterprises. Housing corporations are increasingly less locally based and have evolved into regionally operating companies.

and daytime activities.⁹⁸ Provinces have broader tasks in the field of spatial planning, nature conservation and regional economic policy. These decentralisations reinforce the need to achieve policy-making and implementation at the local level in cooperation with civil society and with the private sector.

In recent decades, 'Europe' has developed itself as an extra layer of administration. The European Union is an active legislator whose decisions often have a direct effect at the level of an individual municipality. The influence of supra-national regulations on decentralised governance has thus increased, partly by moving powers from central government to the European level.

In summary, on the one hand there is an expansion of tasks for authorities, on the other there is a shift of responsibilities to the public market, to social institutions and local governments. At the same time, this creates an additional administrative layer, which influences both the national and local level.

4.3 The development of the network society

Van Poelje describes at the beginning of the twentieth century the term, 'collaborative decentralisation' as the strong increase in cooperation between the government and non-governmental organisations.⁹⁹ Municipalities and private organisations, poor relief agencies, religious communities and housing corporations, which were traditionally active in health care and housing, came together in areas where public and private sectors both had a job to do. This interrelation was, among others, reflected in personal ties: it was not uncommon for a council member to have a role in the governance of a local housing corporation. Pillarization played an important connecting role here. The administrators of civil society organisations and local governments often came across each other via this pillarisation and, it is through this that they managed to find a consensus. These structures together with depillarization and individualization, and developments that were deployed in the 1960's were lost, but cooperation between governments and social institutions remained intact.

Cooperation at the local and regional level had become more or less commonplace but in the early 1980's these relationships changed under pressure from interventions at the national level. Central government was no longer able to meet the increasingly complex demands and needs of society.¹⁰⁰ This led to privatization and decentralisation of tasks to the intermediate level and to municipalities.

During this period the guiding philosophy 'New Public Management' also had wide acceptance in the Netherlands: governments and civil society organisations sought a more efficient organisation

98 Lower Chamber, meeting year 2010-2011, 32 417, no. 14, Coalition Agreement VVD and CDA, *Vrijheid en verantwoordelijkheid* (Freedom and responsibility)

99 Van Poelje 1953, p. 56

100 Pierre and Peters 2000, p.79; Balkenende 2003, p. 261, Minderman 2008, p. 25

of their business processes and applied organisational principles from the business sector. Contract management, benchmarking, ISO certification, output control and quality charters were common terms in the public sector.¹⁰¹ The aim was to show the government's achievement in performance and to make the public sector measurable, transparent and accountable.¹⁰² An illustration of this is the introduction of the VAT compensation fund in 2003. The explicit purpose was to remove barriers preventing local authorities from outsourcing tasks, making it (financially) more attractive to outsource tasks to private entrepreneurs instead of maintaining execution services within their own organisation.

The depillarised civil society organisations underwent a process of upscaling (focussing first on business organisational considerations such as specialization and professionalization). This had implications for the ties with the local government. Because of upscaling the education authorities, housing associations and health care institutions surpassed in many cases the scale of local government. The relationship between local government and civil society became looser and more businesslike.

The discontinuation of the derived social order and the decentralisations and privatizations during the pillarisation period in the 1980's, led to upscaling and commercialization and created a new relationship between governments and their environment. Relations were more equal; governments could not simply rely on a higher hierarchical position in society, but had to accept their role on an equal footing alongside other parties. In achieving their policy goals, government organisations managed to remain dependent on other parties operating in horizontal networks.

Many publications describe the development of the network society as one of *government to governance*.¹⁰³ This development means that:¹⁰⁴

- *Government is not an entity but a conglomerate of actors;*
- *Government is not the only actor that attempts to influence societal developments, and*
- *Government interventions are interventions in policy networks, in which power, resource dependency, and strategic behaviours are vital elements.*

Governance development has a diverse background and this is also the case in its interpretation.¹⁰⁵ The main awareness is that in order for governments to achieve their policy goals, they are increasingly dependent on their partners in their environment.¹⁰⁶ This environment consists of co-governments, civil society which, in the Dutch context, is traditionally quite considerable,

101 Hood 1991, pp 6-9

102 Pollitt and Bouckaert 200, pp 272-273

103 Rhodes 2000, p. 56; Franzke 2007, p.21

104 Bekkers et.al. 2007, p. 4

105 Rhodes 2000

106 Pierre and Peters (2000 p. 49; Frederickson and Smith 2003, p. 207-227

businesses and forms of cooperation with local residents. These parties are all involved in some way in achieving social goals and, at the same time, focussing towards governments and themselves. This creates horizontal connections between the various parties through which they collectively endeavour to reach their goals.

Unlike the types of cooperation that existed at the beginning of the twentieth century whereby organisations were held accountable within their own structures, the new element in this development is organisations incorporate their available sources and then relinquish these into a temporary structure in order to collectively achieve a societal objective. Accountability then not only takes place within their own structure but also in the organisation's environment.

Since this phenomenon occurs widely across society, the functioning society can thus be characterised as a network society: actors are involved together in networks in many places and this happens repeatedly and simultaneously, in constantly varying compositions, where actors also take on different roles, depending on the profession the participants have within the network. Focus on network cooperation thus leads to a greater or lesser degree, to the replacement of the hierarchically higher-level (central) government, "instead of a one-dimensional, hierarchical and vertical legitimacy process, public organisations are responsible for their achievements to their environment, including their supply chain partners."¹⁰⁷

This implies changes in administrative relations; the use of the power of determination (in Dutch "*doorzetmacht*") to solve social problems or to reach policy goals has become fragmented. This places different demands on governments, for example, concerning its control instruments, the Council for Public Administration concludes: "Hierarchical authority relations have been replaced by a complicated set of networks in which people, social institutions and business can embark on an equal footing. Authority and its influence must be acquired by dedication, knowledge, money or control of the game which in networks is largely based on unwritten rules."¹⁰⁸

4.4 The functioning of governments in the network society

The governance theory teaches that increasingly the government's role has become that of an entity that creates conditions and no longer acts as a hierarchical authoritarian government.¹⁰⁹

To achieve policy goals collectively with other parties requires a matching type of horizontal management. Social horizontalisation should thus have consequences for the operations repertoire of governments: traditional policy instruments such as authority, financial, organisational and

¹⁰⁷ Minderman 2008, pp 44-45

¹⁰⁸ Council for Public Administration 2010a, p. 34

¹⁰⁹ Pierre and Peters 2007, p. 234-235

information tools are no longer sufficient for adequate government actions.¹¹⁰ In horizontal governance mutual behaviour influence primarily occurs through negotiation.¹¹¹

Research by Blom and Schillemans clearly shows that central government still prefers to use vertical policy instruments. They investigated the instruments of government in five different policy fields in the past years and came to the conclusion that the uses of vertical and unilateral interventions such as legislation and regulation, levying taxes and requesting contributions, providing information and centralization still have the advantage over means like a covenant, subsidy and guarantee mechanism, information transfer and decentralisation. Blom and Schillemans concluded that “The story of horizontalisation governance says more about the normative preferences of policy makers and analysts than about actual government steering”.¹¹²

There is a different picture at a decentralised level. Here two types of steering appear at the same time; on the one hand government authorities use network cooperation instruments that imply certain equivalence between the collaborating organisations.¹¹³ On the other hand their actions are based on formal powers. Powers alone are no longer sufficient; persuasion and negotiation skills, information and communication have gained importance.

Government actions at a local level are therefore both vertical and horizontal: horizontal governance has gained importance, but legitimate government action is often based on a form of vertical governance. Based on allotted tasks and powers or arising from their own autonomous responsibilities, a government is confronted with a social problem (inconveniences, debt, school disengagement, environmental pollution, decreased biodiversity, flooding risks etc.), whereby through participation in a network (horizontal governance) they contribute to solving this problem. Legitimacy for this action comes from a vertically received task or competence.

In order for a network to function, a number of requirements must be met. For example, it is important that the actors involved are in a position to help build the network. Participants in the network must also be willing to share their resources with other members. These sources include formal authority, legal authority, legitimacy, knowledge, experience, innovative ideas, political competences, organisational skills, but also resources. Financial resources are not always decisive, but in many cases act as an efficient ‘lubricant’. This is all based on trust as a factor to increase the stakes; the greater confidence parties have in each other, the greater their investment in the network.¹¹⁴ This is why in addition to administrative and/or financial relations, social and even personal relationships are important.

110 Howlett and Ramesh 2003, p. 24

111 De Bruijn and Ten Heuvelhof 1991, p. 3, p. 14

112 Blom and Schillemans 2010, p 341-354

113 Bovens, 't Hart, Van Twist 2007, p. 355

114 Sørensen and Torfing 2007, pp 98-100

There is a contrasting response to the question of whether there is horizontalisation. Relationships in society are undeniably horizontal. Public administration is also part of these new horizontal relationships and is committed to adapting to this new reality. As a result, there is obviously a question of exogenous horizontalisation. We see endogenous horizontalisation in local government, but very little in central government. Politics and governance operate at that level as though society is still built up in vertical, hierarchical relations.¹¹⁵ The consequences for the decentralisations are that ‘The Hague’ does not always respect a more indirect form of power over decentralised tasks.

Local governments are aware of their mutual (horizontal) dependence and they largely determine the way they, for example, organise their processes concerning policy preparation and implementation. This change in culture is a change in administrative relations and affects the financial relationships in different ways. Before this is elaborated in detail it is important to reflect on a development that marks the next phase in the relationship and responsibilities between government and society – resocialisation.

4.5 Resocialisation

“It is the municipality’s task to organise what, in its opinion, is considered to be important and guided in questions like: “Is this in the citizen’s interest?”, “Can the citizen also do this himself/herself?”, “Do we help the more vulnerable members of society enough?” or “Is there any other authority or public party who is better equipped to carry out this activity?” It is about these tasks, if we ask ourselves: are we doing the right things?”¹¹⁶

These are the main questions in a future vision of local government posed by the Commission VNG Talent! This committee no longer assumes to have a prerogative from the municipalities for tasks in society; problem and municipality are no longer seen as a dual unit. Other parties, citizens and institutes are also held accountable for their actions allowing local government to take a step back. Questions about the division of labour between government and society not only play a role in local government, but are a current topic of discourse at all levels of national and international governance.¹¹⁷ It is about a different view of the role of government in society, the main characteristics of which are limiting its size and its function.

Cost savings, cutbacks and financial alertness will contribute to a withdrawal of authorities participating in various social initiatives, especially when they are not directly part of their ‘own’ policy objectives.

115 See also Council for Public Administration 2010a, p. 36

116 VNG-Commission Talent! 2010 (Association of Netherlands Municipalities Commission) p. 21

117 The Dutch coalition agreement speaks about the concept “compact government” whereas the British government uses the term “Big Society”.

These government withdrawals are already visible. Due to the horizontalisation of society and the decentralisation of (parts of) public tasks towards civil society, this has brought about a shift in the public domain's tasks and responsibilities to other domains. In the last ten years, a subsequent decentralisation has taken place; that of a 'progressive decentralisation' towards the individual citizen. Legislation such as the Social Support Act (*Wet maatschappelijke ondersteuning, Wmo*), the Social Assistance Act (*Wet werk en bijstand WWB*) and debt relief emphasise the individual responsibility and organisational ability of the citizen. It is only when self-help does not lead to the desired result – that a request for assistance can be channelled through the social safety nets covered in these laws.

This 'progressive decentralisation' occurred together with an increase in initiatives from (groups of) citizens and private partnerships willing to take responsibility for matters related to a social dimension. It is too ambitious to analyze the causality of these (seemingly?) complementary movements; however it can be observed that in time, this development will affect administrative and financial relations. For example, as a result of assuming that there is personal responsibility and self-reliance, the importance of public safety nets for those who cannot manage for themselves has increased. These safety nets operate on a local level, so the financial consequences are also borne by municipalities. Examples include debt relief and special assistance.

As previously described, in the Dutch context citizens have always had an active attitude towards social issues. For many decades, all kinds of types of active citizenship, social initiative or shared responsibility are known types of cooperation between (groups of) citizens and governments. These types of cooperation were in many cases supported by subsidies.

It was for a long time, and often still is, the government's reflex to be first in line as "pre-eminently being in the best position" to finding solutions for social problems. This attitude was satisfactory in times when society also preferred to turn to the government as soon as there was a problem: "what is the minister/delegate/councillor going to do about it?"

This often caused the government and those concerned in society's public sectors to ignore the question as to whether society could do the job well itself, or whether it could do it better and then preferably also cheaper. In the meantime, it is clear that more often and in increasingly more areas, changes have taken place. The foremost objective is for those involved to take their own responsibility and to undertake their own actions concerning an issue or social ambition. This is often prompted by financial motives. Facilities have become unaffordable or in many cases the government is often not the most efficiently operating party to resolve the issue at hand, reason enough to look for an alternative.

One of the reasons for this approach lies with citizens themselves; citizens of today are no longer the same as citizens of a few decades ago. Today they are not only individualistic but also set on customization and they are also more well educated. Access to Internet provides them with unlimited knowledge and information and communications and collaboration can be organised virtually for free. This is the empowerment of the individual and is the reason that the success rate for private initiatives is greater than ever before.

However, there is a demand for modern types of (fit for the job) (self)qualifying authorities; besides the role of guaranteeing the protection of the more vulnerable and the quality of the rule of law, there are still many social issues where government has a role or task to play.

The Council uses, for the time being, the above-mentioned term 'resocialisation' to describe the mechanism for a withdrawing government and a (presumed) more active role of the citizen. This is (still) a diffuse concept¹¹⁸ to indicate the development of solutions to social issues. It can be seen as a prerogative of governments for a long-term task and subject to private initiative and/or entrepreneurship, with or without co-production with a government.

That does not mean that, under the denominator of resocialisation, governments can rapidly disregard numerous social issues. In accordance with the ratio of the network society, governments are without question still involved, but are no longer in financial terms the obvious facilitator. This is the 'new' aspect of the trends which are grouped under the umbrella of resocialisation; only the use of the instruments has changed.

The government no longer has the dominant role of subsidy or grants provider. If resocialisation is the new role of governments then this should also include helping and encouraging social initiatives, with instruments such as legislation, organisational ability, knowledge and power throughput and, if possible, including funding.

Resocialisation is not a specific Dutch development. There are also descriptions of initiatives in the United States and the United Kingdom where citizens have collaborated with one another by combining the available cash flows for common goals, such as for nature conservation, housing, access to a region or to a district to achieve changes in their environment.¹¹⁹ The Netherlands has a wide variety of initiatives on themes of sustainability and 'new' energy¹²⁰. There are also examples from the cultural sector and higher education¹²¹.

In order to adequately anticipate the resocialisation trend GreenWish¹²² has developed an overview of new business models with which it has gained experience in recent years.

118 Also terms like deregulation 'onstatelijking' and 'privatization' are often used in this context but are not applied here because of the multiple meanings of these terms.

119 Berlin, Hesselink, 2011

120 www.GreenWish.nl

121 The Concertgebouw (Concert Building) in Amsterdam has an extensive programme for acquisition funding. The Concertgebouw Fund is an almost entirely privately funded cultural institution and which issues depositary receipts for shares in 'musical dividends'. (www.concertgebouw.nl). These initiatives are not always successful. Leiden University recently launched the Belvédère cultural fund. Individuals could invest in bonds with university heritage as collateral (www.alumni.leidenuniv.nl). The project has since been terminated due to the lack of interest.

122 Greenwish 2011

Innovations in financing

1 Crowd funding

Concept description: “Many small things make something big”. By asking people to individually invest (or donate) a small amount through their own network, (part of) the required investment can be brought together. Participants receive a formalised certificate or contract stating what period and under what conditions the money or interest will be paid, etc. Due to the rise of Internet and (other) social media, larger networks can be built and deployed much faster. Also there are now websites specifically developed to support this type of financing.

2 Cooperation model

Concept description: A group of people form a cooperative association to take advantage of economies of scale in investments. The risk and investment is spread over the many participants to create large demonstrable public support. Depending on the concept chosen, the money earned remains (entirely) within the association for reinvestment and/or to be used for other social goals or flows (in part) back to the members, who originally invested money.

3 Alternative economy

Concept description: The basic assumption is that the original purpose of money as a means for barter has reached far beyond its original function. Thus new systems have been developed to not only allow direct service exchange (mesh working), but also (often regional) networks as alternative mediums of exchange to be used to exchange services and products within the whole network. Sometimes this system is extended to include credit facilities.

4 Revolving fund

Concept description: A revolving fund is a fund that grants loans from a social objective. The loans are repaid, after which the money is lent out again. The fund’s assets are not consumed. Revolving funds can be launched by government (energy pot¹²³ Utrecht), from capital funds (Start¹²⁴ with flexible loans) or can develop from private lending circles (Union Solidarity¹²⁵).

5 Donations under ‘new’ conditions, focused on “entrepreneurs”

Concept description: some funds change the criteria under which they provide donations. Entrepreneurs are no longer excluded from receiving donations and appropriate types of assistance are sought such as: combinations give-loan money, guarantees, and flexible terms of conditions. The distinction lies in customization and in the financier who puts a great amount of commitment (substance and process systematic) in assisting the beneficiary entrepreneur.

123 Energy pot Utrecht

124 Start

125 Vereniging Solidair

6 Participation

Description concept: a group of participants finance part of the entrepreneur's budget and, in exchange, receive revenue from the company (in cash or in kind). In some cases (Pergola and Sleipnir), the participants also get control of the company.

7 Private/Loan groups

Concept description: it is sometimes difficult, especially for those starting a business, to obtain the necessary investment funds. The 'loan group concept,' uses a starting entrepreneur's social network so that his/her plans are more widely discussed and the required funds are raised. Because of the social factors involved, it is also evident that the more socially and environmentally friendly entrepreneurs are, the more successful they are than those who are only interested in profit. Loan groups are (usually) temporary, participants know each other and are strongly dependent on individuals.

8 Partnerships growth model

In practice, people who set up an initiative or an enterprise rarely start with one model. During the launch and growth of the company they enter into various partnerships with different purposes. There are substantive partnerships, and financial partnerships.

Substantive partnerships comprise of service exchanges to improve the product and its scope. It is through these substantive partnerships that the financial partners operate by delivering 'traditional' material contributions (advertising or sponsors), but also through substantive sponsorship (providing additional activities for the company) or sponsoring 'in kind' (e.g. PR campaign, hereby reducing the budget). This kind of model combines elements of previous ones.

The above summary illustrates the vast diversity of the types of funding with which governments are now, or in the near future will be, confronted with and about new questions which will arise about risk and responsibility. Resocialisation has not only implications for the relations between governments and other sectors in society, but also affects the system of financial relations. For example, as a result of participation in new forms of enterprise which generate profits, what are the consequences for local initiatives with a high-risk profile or long-term substantial income from local governments?

Resocialisation can be seen as a development that follows after horizontalisation. Dividing tasks with social institutions is followed by 'progressive decentralisation' of formerly public tasks, sometimes up to the individual level. This implies a different kind of role for governments; from subsidy provider and grant provider the emphasis will now be shifted towards promoter and facilitator.

Resocialisation implies a more limited financial role for governments and leads to innovative forms of financing and/or an intensification of the use of hitherto less commonly-used business models.

This trend also confronts governments with new risks and accountability issues. It is vital that governments are well-equipped for these new challenges.

Presently, it is not possible to determine what kind of impact this will have on the system. The Council predicts that there will be an increase in the demand for more expertise on new business models and the associated opportunities, risks and accountability issues. This also applies to the extension and design of social safety nets resulting from legislation which focuses on the proposed empowerment of citizens. This will become a very topical theme with the enforcement of the Work according to Ability Act (*Wet Werken naar vermogen*). This is why the Council has planned room in its research agenda for further exploration into alternative business models and the design of social safety nets.

4.6 Significance of the horizontalisation for financial relations

To gain insight into the significance of horizontalisation for financial relations, the Council combined a literature review and an extensive consultation with experts in a series of expert meetings involving social actors. The results regarding the horizontalisation themes are discussed in this section.

1. *Vertical financial relations did not prevent horizontalisation*

Apart from the limited local taxation area of municipalities, financial relationships are dominated by a vertical division of resources. Insofar as this concerns the general resources, the (municipal and provincial funds) general grant and tax revenues, local governments are free to use these at their sole discretion. They are not accountable to central government for these.

The Council notes that the vertical character of the system of financial relations has not prevented the emergence of more equal relationships at the local level. The Council attributes this to, for instance, a decades-old tradition of cooperation with civil society and business, but also to the system of financial relations itself. In particular, the freedom of discretion to use the general allowance in conjunction with the regional/local responsibility facilitated anticipation of a horizontal reality. It also shows that governments are increasingly successful in their experience of using network cooperation for the new challenges they face. An example is the municipalities' experience with the Dutch Social Support Act (*WMO*) commitment which they will use for their future child welfare tasks.

2. *Reaffirming allocative efficiency*

Besides one of the principles of administrative relations and thus that of financial relations, the Council also sees the reaffirmation of allocative efficiency. Granting administrative and financial responsibilities to local governments is based on the notion of allocative efficiency; the assumption that in many areas where governments have social issues, local authorities are in a better position to coordinate the allocation of financial resources (careful weighing of costs and benefits) than other involved parties and thus making provisions that do justice to specific (local/regional) conditions. This role is gaining importance in a society characterised by interdependence and equality of parties.

3. Co-production and co-financing requires clarity of role

Depending on the circumstances and own considerations, provinces and municipalities increasingly choose for joint implementation services, the relocation of their organisation or collaboration with other civil society organisations, governments and/or companies. An example is the manner in which municipalities have used integration resources. Policy was shaped by various forms of cooperation with a wide variety of parties. Local governments chose to distance themselves from implementation by outsourcing work through a subsidy and/or entering into a client-contractor relationship with a community organisation. Social responsibility develops due to the financial interdependence between municipality or province and the social organisation. A government can steer towards the desired self-perception of a social enterprise through regulations and funding flows.

Just like municipalities and provinces, civil society organisations are also more or less dependent on money transfers from central government in order to achieve their task. At the same time, civil society organisations, together with municipalities and/or provinces, are jointly responsible for the realization of a public task, they are “co-producers”. Local authorities and civil society organisations are part of a chain in which each has (only) a part of the responsibility. Whereas civil society organisations are organised around a social task, local governments are required to apply an integrated policy. They are bound to a broad balance of interests in various policy areas. Their choices are also the result of many decision-making opportunities and considerations. Coordination with third parties in parallel processes was an important part of this procedure. The interconnectedness and interdependence of governments with their environment invokes a complex and completely opaque image but it is a fact: the complexity of society precisely determines that this is the way social objectives can be achieved.

Co-financing is an expression of a shared responsibility. The responsibility of the individual partners' contributions in types of co-financing is often difficult because funds contributed by individual governments are difficult to trace. Local authorities are often responsible to a higher tier authority to account for the resources used to achieve the social goal. The combination of co-financing and vertical accountability leads to task complexities for government.

Another disadvantage of co-financing must be acknowledged: co-financing can lead to disorder of power and responsibilities and therefore a suboptimal balance of resources and benefits, leading to all kinds of inefficiencies such as the Council described in its view on the Provinces Funds.¹²⁶ It is therefore important for the clarity of roles to be transparent about which parties are responsible for contributing to achieving social goals. This must be the case for both the vertical relations between the authorities as well as for the horizontal relations between governments and civil society organisations.

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4. Horizontalisation requires new accountability measures

Among others, the allocation of funds to municipalities has provided them with administrative opportunities to carry out an overall steering function. The same applies to provinces in the spatial-economic domain. The municipal/provincial governance role – usually carried out by initiating or facilitating networks – can only be successfully met if these governments are capable of addressing local/regional challenges in a comprehensive and coherent manner. This requires a large amount of substantial broad responsibility from the municipality and the provincial administration, a responsibility that will only increase with forthcoming large decentralisations. Central government will have to restrict itself to globally formulating *what* from the position of national responsibility are the social goals and not concern itself with the question of *how* local governments and civil society are going to achieve these goals together.

The Council understands the continuing and even increasing need of central government, as system controller, but also in its role as fund manager, to have access to quantitative information about the local use of resources, but sees this as a vertical response to a development that comes from the horizontal reality. The expenses for participation in a chain are not a suitable indicator for the costs used decentrally for a social task: within local networks roles and tasks are divided along lines that do not have to match the task allocation which is the basis of the allocation model of the general funds. For example, part of a neighbourhood approach could consist of a housing corporation providing services to take care of parks and green spaces and the municipality paying for a caretaker, without this explicitly being traceable from expenditures. At the national level this should lead to the question as to whether the socially desired outcome, the ‘what’ was achieved. The road leading to the ‘how’ is not a national matter but a local responsibility that also extends to the question as to whether the available resources have been optimally utilised. However, the accountability in this regard should be primarily decentralised. Confidence in the system will increasingly be achieved by a global distribution of resources, using outcome criteria to assess the realization of social issues in combination with horizontal accountability.

Because this is a relatively new approach, the Council finds it advisable to further investigate new insights into policy implementation. These insights can then be used as indicators for a sustainable future allocation model for the general funds.

It is important that the financial system does not discourage network cooperation but does the opposite and facilitates it, thereby promoting clarity about tasks and role divisions between the different actors. For this reason, it is desirable to preserve freely disposable resources and a local government tax area in addition to a pooling of cash flows, as well as an accountability system that fits in with the logic of network cooperation. In principle, the Council considers that accountability must take place in the local/regional environment: this not only applies to local authorities in relation to their democratically elected forums, but the Council believes this should be developed more widely. In this respect, the Council considers it realistic for a school board or housing corporation, which is closely involved in achieving policy objectives in networks with governments, to be collectively accountable for these objectives with these authorities, both to their own administration and to the municipal councils concerned. This also meets with the conditions

that only in very exceptional cases, tasks and responsibilities can be organised by one authority or organisation from civil society. Social complexity indicates that multiple parties can only achieve success through social cooperation. Mutual accountability is a logical consequence of cooperation.

4.7 Points of interest

The followed reorientation process has prompted the Council to focus attention on some important issues so that the system can in due course also continue to perform its duties.

1. Network approach complicates assessment of policy implementation

There is an indisputable tension in the practice, on the one hand, of carrying out a task at a local level together with social partners in a co-production, and on the other, the need for central government as the party responsible for the system, to know whether the objectives are being achieved at reasonable costs or whether there is a question of under or over-production. Due to the increase in the number of decentralised tasks in conjunction with the network approach to social issues, this tension is likely to continue to increase. Indeed, the local assessment of achieved objectives may differ from what central government as the determiner of 'what' had in mind.

2 The use of public funds is less traceable

The resources used in co-productions cannot be attributed, or at least only to a very limited extent, to an individual party as costs or expenses. The same goes for network collaboration whereby the parties involved are only responsible for part of a task and for their costs, as far as their contribution can be expressed in money at all. This means that up to now, the quantitative insight into the costs incurred (cost orientation) on the basis of distributed resources has an increasingly limited resonance. Network collaboration thus leads to a decreasing traceability of the use of public funds. The Council anticipates that this decreasing traceability/resonance in the long-term may pose a threat to the trust in the distribution of funds from the general grants. It is doubtful whether intensifying central government's demand for information regarding the costs incurred in local partnerships is the answer. Further research is needed into alternative indicators in order to ensure confidence in the system.

3 Review of current measurement units

This also applies to the use of the current measurement units: the use of the administrative unit "municipality" when it concerns the collection of expenditures from joint collaborations or regions does not justify the cost structures involved in such relationships. The key issue for government steering policy can no longer be based solely on expenditures, but should primarily be based on determining the extent to which social issues are achieved.

4 Parallel financing flows lead to a risk in over-financing

Another question that looms is whether the vertically designed distribution systems sufficiently take into account the fact that local governments often solve social problems in conjunction with social enterprises. Housing associations, schools and care and health institutions are dependent on other sources than local authorities for their resources. This results in parallel vertical funding flows which

meet at the local/regional level. This means that some primary schools receive part of their money for students who need extra care but municipalities also receive compensation for this target group from the Educational Disadvantage Policy. This also applies on the one hand to the assortment of care that citizens can receive under the General Exceptional Medical Expenses insurance (Awbzpot) whereas, on the other hand, they have to rely on the facilities that the municipality pays for from the Social Support Act (WMO). There is a risk that this will give rise to tasks becoming too diffuse, policy orders becoming broad and vague or 'chain responsibilities' established by law leading to under or over funding. This is why it is necessary to gain thorough knowledge of the extent, coherence and impact of parallel financing. Local governments will benefit from insight into the possibilities and impossibilities of integration and coordination between the various funding flows that locally diverge. Central government is responsible for the best possible distribution of scarce public resources and for preventing under or over financing. The Council believes it is necessary to not only carry out a systematic analysis of policy areas, but also to survey all public and private financial flows.

5 Chain responsibility leads to the risk of shifting responsibilities

Another aspect of supply chain responsibility is the risk that the actors involved either consciously or unconsciously, pass on or shift part of their responsibility to others in the chain. For example, the municipalities pay the costs of preventive health care but the potential benefits are for others. This passing on of costs can be avoided by limiting the number of chain partners.

By putting one party in charge of the assessment, the burden of the preventive deployment of resources can be weighed against the additional charges. Another option is to incorporate a financial incentive which prevents any passing on. It is important to recognise the positive effects of chains, but this must not stand in the way of a commitment to efficiency. It is in this way that municipalities' debt assistance helps to prevent rent arrears and further degradation of living standards. Much would be gained if the involved chain parties acknowledge the shared responsibility and reflect this in the organisation of their processes.

6 Resocialisation makes new demands on governments

Resocialisation involves a more limited financial role of authorities and leads to innovative forms of financing. This trend also confronts authorities with new risks and accountability issues. It is important that authorities are well-equipped for these new challenges. The Council considers it necessary to gather know-how about new business models and their associated opportunities, risks and accountability issues and to give attention to the size and design of social safety nets.

For the benefit of legitimacy, the Council sees a role for central government to design the system in such a way so as to be able to anticipate the possibility of meeting the above-mentioned challenges. The general funds, which can be freely used and for which no accountability to central government is required, are considered by the Council as essential elements of a sustainable system for the future. The specific naming of management and development tasks for the distribution of the general grant from the provincial funds is understandable for an optimal allocation of resources from central governments viewpoint, but it can be counterproductive for the efficient use of resources.

It is up to those local governments with a broader task area and a wider range of governance tools to work towards a public administration that exemplifies ingenuity and adaptability, but also one of persuasion. These are the skills that authorities should have if they are to adequately respond to the wishes and demands they face from society.

4.8 Conclusion and research agenda

In recent years, horizontal relationships have intensified to a high degree in mutual interdependencies between governments and civil society organisations. In addition, decision-making and organisation methods have been created to match this horizontal reality. The Council anticipates further developments due to the large decentralisations which are taking place in the provinces and municipalities.

At the same time the Council notes that where the financial relationships are concerned, the political and administrative dealings are largely dominated by forms of vertical control. This seems contradictory but as previously described, both types of management work at the same time without any problems. Also in this case the Council sees that verticality does not need to be an obstacle for horizontal reality in which provinces and municipalities operate, provided certain conditions are met.

These conditions are:

- **Clarity of Role:** Especially in a complex society where governments are involved in many social issues, there should be a clear division of tasks and accountability. It must be clear what the level of authority is of each of the parties involved, what this responsibility involves and to whom they are accountable. This means that central government must always be sure where it wants to steer towards beforehand. The guiding principle should be that central government restricts itself to the question 'what' and does concern itself with 'how'.
- **Freedom of expenditure:** As a result, the financial system should be in line with the tasks for which local governments are responsible. Local governments are largely dependent on central government for their funding. When these refer to specific-purpose transfers, the accountability rules can pose an obstacle to obtaining the envisaged result via civil society actors. This emphasises the importance of the freedom of expenditure.
- **Accountability:** Also social organisations entrusted with the implementation of a public task may be expected to justify themselves. Not only towards their clients and the administration, but also towards municipal councils and/or the provincial councils, in whose authorisation they carry out public tasks or with whom they collaborate in combating a social problem. It is important for local authorities to keep an eye on the sustainability and quality of social companies whom they deal with.

For the time being, the conclusion seems to be justified partly on the basis of the expert meetings and various interviews held with stakeholders, that although there are substantial changes ahead for the system, this does not in fact call for a major reorganisation/redesign of the financial relations but instead the carrying out of fundamental groundwork in order to make the financial relations system robust for the twenty-first century.

The Council notes based on the past reorientation process that the reality of the horizontal society does not call for a radical redesign itself. However, it is increasingly important for the assessment of the distribution of tasks, powers, responsibilities and resources, to involve the relations between local governments and social organisations in a policy making area. It is not enough just to look at the vertical relations between on the one hand, the government and civil society or between the central government and local governments on the other. For the efficient use of resources it is important to have insight into the mutual relationships and the resources available to the parties wanting to use them.

This fact, the obvious influence of social reality on financial relationships, has led the Council to review the classical definition of financial relations. Financial relations involves *the set of rules dealing with the allocation of power over revenue to governments between which there is an administrative interest and over relations involving a transfer of revenue from one government to another or to a social organisation in order to implement policy objectives arising from a public task.*

The developments planned for the system ahead present a task for those involved to investigate various areas so as to achieve a sustainable system that beyond any doubt will function well in the future. With regard to the subject matter described in this chapter, the Council suggests a number of research themes as follows:

- New insights into policy implementation and designing indicators for a sustainable allocation model of the general fund for the future;
- The effects of parallel financing, the convergence of public and private resources within one policy area;
- The design of financial incentives to prevent shifting of responsibilities;
- An effective organisation of the financing of chains;
- The opportunities and risks for local authorities in new business models;
- The scope and design of social safety nets.

5. Findings and conclusions

5.1 Introduction

This report is the result of the reorientation project that the Council organised in order to give in-depth consideration to the foundations of the current financial relations system. Such a process fits within the main objective of the Council, which is to strive for a balanced distribution of resources to conform with the distribution of tasks, responsibilities and powers, in order that these can contribute to the efficient functioning of government as a whole.

The immediate reason for this reorientation of the financial relations is the evaluation¹²⁷ of the Council by an independent evaluation committee headed by Mr. A. Docters van Leeuwen. This follows an earlier finding by the Council that due to successive adjustments to the system of financial relations, the Council did not always seem to connect to its original philosophy.

There were three main leading questions in this process:

- a. What scientific discussions are being conducted within the framework of “fiscal federalism” and, what does this mean for the premise that decentralised financial considerations should be encouraged as much as possible?
- b. Is there any reason for Goedhart’s normative character of the third level of aspiration, as defined in the Financial Relations Act, to be reconsidered or to be reformulated?
- c. What conclusions should be drawn from the observation that local and regional authorities increasingly operate in horizontal networks, whereby (according to the committee) their tasks can no longer be restricted to giving technical advice on formal vertical funding flows?

The process was divided into several subprojects. The Council compiled an explicit norms framework, carried out a literature review and, consulted a large number of (financial) experts. This also involved social actors outside the immediate working area of financial relationships. During an ‘administration consultation round’ discussions were held with a substantial number of those involved in the administration environment in which financial relations (and the Rfv) operate.

These activities led to the findings and conclusions reviewed in this chapter. The Council explicitly uses both terms because they are an essential part of the results of this project, which consists of observations that require further investigation and therefore are not appropriate for conclusions. That is why the Council has formulated a research agenda (Section 5.5).

Section 5.2 discusses the findings and conclusions following the assessment framework. Section 5.3 covers the significance of fiscal federalism in a Dutch context and the topicality of the third level of

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aspiration. Section 5.4 deals with both the findings and conclusions regarding horizontalisation and resocialisation. In section 5.5, the Council gives its views on safeguards for the system, inter alia with a research agenda.

5.2 Findings and conclusions as a result of the assessment framework

The Council presents its explicit assessment framework in Chapter 2 of this report. It is a reflection of the present complexity in which the Council makes its assessments and, provides the opportunity to assess (proposed) policy regarding the implications for an efficient and effective functioning of financial relations. The assessment framework aims thereby to contribute to the adequate funding of tasks, responsibilities and powers being given to (local) governments and perhaps confirms its use beyond the scope of the advice given by the Council.

While some stability of norms contributes to the trust and transparency in the functioning of the system, the Council accedes that new developments, theoretical insights and discussions, such as those to be conducted in the near future within the framework of re-evaluation of the municipalities, may lead to changing perceptions. The Council sees its explicit assessment framework as a permanent progressive development of the system and has therefore opted for an appropriate framework.

The Council believes that a dialogue with all parties involved in the system to be of great value to the continuous development and future sustainability of its assessment framework and will also periodically enter into talks with all of the parties involved in the system.

5.3 The significance of fiscal federalism in a Dutch context; the third level of aspiration

Fiscal federalism

Transferring fiscal federalism¹²⁸ to a decentralised unitary state like the Netherlands does not present a workable perspective because of the relatively small differences between the relevant authorities (i.e. municipalities).

In the case of the Netherlands, it also means that decentralisation is expected to contribute to a more effective and efficient appraisal of costs and benefits. The Council shares the view that decentralisation promotes policy innovation, strengthens citizen involvement and, fosters policy competitiveness. The assessment framework (Chapter 2) shows a more nuanced view on the allocation of tasks and resources to local governments than the evaluation commission's fiscal federalism approach. In the Council's opinion, the decentralised allocation of tasks and resources contributes to an effective and efficient use of resources. However, there are also disadvantages to

¹²⁸ The study into the distribution of the power over financial resources between local governments

decentralisation. Therefore, decentralisation is not always appropriate. In each case, the advantages must be weighed against the disadvantages.

The third level of aspiration

The third level of aspiration means that each municipality/province with the same tax burden should be able to deliver the same level of services. The Council stresses that the third level of aspiration is a normative basis for distributive justice. The effect being that there is too much emphasis on the 'presumed' equality. A less extensive and detailed equalisation of costs and revenue capacity would be more reasonable. Financial relations should accommodate enterprising municipalities/provinces to ensure that in the distribution of resources they are not sanctioned, but actively encouraged. The Council considers that a reformulation (specification and differentiation) of the third level of aspiration is required, in which the differences in the costs of equalisation of income capacity is taken into account allowing each municipality/province to be able to provide its citizens with an equivalent package of local and regional facilities. In terms of structural characteristics this leads to similar types of municipal/provinces with a global comparable tax rate being in a position to provide the same service capacity.

5.4 Findings and conclusions concerning horizontalisation and resocialisation

In order to achieve their policy, governments largely have to rely on cooperation with or implementation by civil society or the private sector. This development is referred to as horizontalisation. In so doing, hierarchical and centric relationships have been replaced with equality and reciprocity. In answer to the question to what extent should horizontalisation of intergovernmental relations be reflected in the design of financial relations, the Council notes in particular, that local public administration has become part of these new horizontal relations and has adapted to this new reality. The awareness of mutual (horizontal) dependence largely determines how local authorities organise their processes, for example, concerning policy preparation and implementation. This change in "culture" is a change in administrative relations and works in different ways through financial relationships.

At the same time the Council notes that as far as financial relationships are concerned, political and administrative dealings are largely dominated by vertical forms of governance, without this constituting a barrier for the horizontal reality in which provinces and municipalities operate, providing certain conditions are met.

The conditions are *clarity of role, freedom of expenditure of the general grant resources and a wide horizontal accountability.*

The network society requires horizontal connections to be made at a local level. Administrative and organisational ability is needed to carry out this responsibility. In the first instance, this involves an administrative and organisational problem and is only a secondary issue for financial relations.

The Council concludes that although there are plans to change the system, this fact does not call for a major reorganisation/redesign of the financial relations but requires fundamental groundwork to be carried out. These are:

- the network approach complicates judgement on policy implementation;
- the use of public funds is less traceable;
- current measurement/distribution units should be reconsidered;
- parallel financing flows induce risk of over-financing;
- chains of responsibility bear the risk of shifting on responsibilities;
- resocialisation makes new demands on governments concerning risk and responsibility.

It is not enough just to look at the vertical relations between central government and civil society or relations between central government and local governments. For efficient use of resources it is important to have an insight into the relationships and resources that are available to parties.

Role for central government

The Council sees a role for central government to organise the legitimacy of the system in such a way that it anticipates as far as possible the above-mentioned developments. It is important that the financial system does not obstruct network cooperation but facilitates it. This will promote clarity about the system regarding task and role division between the different actors. The general funds, which are freely expendable and for which no central government accountability for their use is required, are viewed by the Council as essential elements of a sustainable system. The specific naming of management and development tasks for the distribution of the general grant from the provincial funds is understandable for an optimal allocation of resources from a central government viewpoint, but it can be counterproductive for the efficient use of resources.

Role for local governments

The municipal/provincial overall steering role – which is usually carried out by initiating or facilitating networks – can only be successfully carried out if these authorities are capable of addressing local/regional problems in a comprehensive and coherent manner. This requires the municipal and provincial government to take on a substantial amount of [new] responsibility. At a national level the question is whether the socially desired outcome – that is, the what – has been achieved. The road leading to the ‘how’, is not a national matter but a decentralised responsibility that also includes determining whether the available resources have been optimally utilised. In this regard, accountability should primarily be local. Confidence in the system will increasingly be gained through starting with a global distribution of resources, using outcome criteria to assess the realization of social goals in combination with an accountability system that fits in with the logic of the network society.

It is up to those local governments with a broader task area and a wider range of governance tools to work towards a public administration that exemplifies ingenuity and adaptability, but also one of persuasion. These are the skills that authorities should have if they are to adequately respond to the wishes and demands they face from society.

New definition of financial relations

The obvious influence of the social reality on financial relations is an opportunity for the Council to review the classical definition¹²⁹ of financial relations. *Financial relationships involve the set of rules dealing with the allocation of power over revenue to governments between which there is an administrative interest and over relations involving a transfer of revenue from one government to another or to a social organisation in order to implement policy objectives arising from a public task.*

By reformulating the definition of financial relations, the Council hopes that the social reality is better reflected in political and administrative discourse.

5.5 Safeguards for the system: research agenda

The responsibility for the system of administrative and financial relations lies with central government. An effective system is a shared responsibility of all concerned authorities and benefits from checks and balances that create a basis for mutual trust. The Council considers that a number of developments such as the outcomes of the reorientation process, the reassessment of the distribution of the Municipality Funds, the establishment of the redistribution of the provincial funds as well as the proposed large decentralisations, demonstrate a continuing need for safeguards in the system. In doing so, this will not only particularly equip the fund managers but also the local authorities to adequately resolve the financial relations issues in the near and distant future. These issues are diverse, but are all linked to timely and adequately anticipated support for and confidence in the system, ensuring that scarce resources are optimally channelled to local governments for complex social tasks.

These safeguards consist both of basic expertise concerning distribution issues as well as a general authoritative supervision of the implementation of the Financial Relations Act. Financial relations are more than just the distribution of provincial and municipal funds.

In the present situation, the ministries that manage the general funds are also in charge of the maintenance and policy of the funds. In addition, the financial relations are shaped by the allocation of duties, powers and resources of the various individual ministries, which are coordinated by the Minister of the Interior. However carefully they perform these tasks, if a number of functions concerning the funds and the other state grants are incorporated in a “neutral place”, it will reinforce the legitimacy of the way central government implements these tasks.

As a result of decentralisation, the size of the Municipal Funds is anticipated to surpass the amount of 25 billion euros in the future making it the second budget item on the central government’s budget. As a result, the importance of safeguarding the system will increase. This is not only about large amounts of money – it is important to minimise any wastage due to suboptimal distribution. It is also about transparency and legitimacy of the distribution.

129 This classical definition is: the set of rules dealing with the allocation of the power of resources to authorities between which there is an administrative relation.

Horizontal reality and the trend towards resocialisation are both the result of a decreasing traceability of the use of public funds at the local level. Due to parallel financing, the intertwining of local level financial flows is a new issue in financial relations. These are just some examples of issues requiring further exploration on the functioning of the system.

In addition, there is a constant need for attention on the one hand from the authorities concerned and, on the other the acceptance of differences by the same players. The balance between the needs and opportunities in relation to the costs involved in providing a good understanding of the situation is the subject of an ongoing dialogue between the authorities concerned.

If the financial relations system is to be able to continue to function in the future, if only from the perspective of safeguarding the system's maintenance, quality and legitimacy, it will require an objective observer to safeguard the distribution according to the politically adopted decisions. But it will also concern insight into the (financial) consequences of the division between the 'what' and the 'how' in the (proposed) legislation. In addition, intrinsic questions such as, 'are the facts correct' and, 'have the fund managers used the right figures' will need to be addressed. Further observations such as, due to decentralisations or new methods, data no longer being able to be obtained in the traditional way and measurement units (e.g. municipalities) being outdated, as perhaps in the case of the formation of regions, will need to be looked into. Financial relations can no longer be viewed as before and research is required to rapidly go beyond purely collecting technical data to maintain the system or to make an evaluation of the proposed decentralisation and its financing.

According to the constitution no financial authority is above the checks and balances of the Lower Chamber. This is where the authority to exercise control lies. Transparency and accountability actively contribute to confidence in politics and public administration. The necessity of these factors increases especially in times of scarcity, when sobriety and efficiency become fundamental issues. An entity that on the one hand, takes care of the system's security and, on the other, takes care of the enhancement and development of knowledge about financial relations, is according to the Council a logical response to the direction in which financial relations are now developing.

The reorientation process shows that even now, there are still many unanswered questions about financial relations. These sometimes concern questions about knowledge ("What about? What are the facts on?") or relate to unexplored territory (the relationship between new forms of financing and the financial risks municipalities encounter). It is also about the perception of social, legal or economic trends that affect financial relations.

From this it follows that financial relationships should be considered in a broad context; the distribution of scarce resources should be so arranged that they contribute to the efficiency of central government as a whole and justify the risks the tasks entail.

The Council can therefore envisage that relevant parties cooperate with one another to offset their different needs in financial relations and, it sees the advantages of building a structure in which these issues can be resolved and where expertise and sustainable quality management is built up.

The Council does not take any position on the organisational aspects, but limits itself to identifying roles and tasks of such an entity. This could include roles/tasks in the areas of:

- research;
- (technical) advice;
- maintenance of the system;
- quality guarantee;
- arbitration;
- education/training.

The Council advocates the establishment of an entity that is able to not only meet the needs of central government and parliament but also those of local governments and community organisations. Such an entity is an efficient and simple way of guaranteeing the financial relations system so as to structurally improve the quality of public administration. The Council would like to contribute to the further development of this initiative and would like to take this task upon itself. It also proposes to further elaborate on the issue regarding safeguards.

Contributing to knowledge and understanding of financial relations is important for confidence in the functioning of the system. The research agenda set by the Council based on the outcomes of the reorientation process illustrates the need for structural attention to financial relations issues.

Research agenda

The outcomes of the reorientation process not only provide answers to three main questions and a number of findings, but also include a series of research topics. They are all incorporated in this section. In the Council's opinion, these research topics illustrate a long-term desire for more knowledge about different aspects of financial relations, and also about new developments in the short and long-term that will affect financial relations. The Council has incorporated these research topics into its program for the coming period and will, where possible, seek cooperation with other councils and research institutes for joint analysis and advice.

- New insights into policy implementation and design of indicators for a sustainable distribution model for the general funds
- The growing influence of financial obligations arising out of (mandatory) regional cooperation
- The effects of parallel financing, the convergence of public and private resources within a policy
- The design of financial incentives to prevent passing on or shifting tasks
- An effective organisation of the financing of chains
- The opportunities for and risks of new business models for local authorities.

With the elaboration of these recommendations, conducting research and by broadening and deepening its advice over the full spectrum of financial relations, the Council hopes to contribute to making the system sustainable for the twenty first century. In the Council's view, this should be preceded by a fundamental debate with the legislator.

Annex 1

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Annex 2

List of people and organisations interviewed during the reorientation project

Mr Aalderink	Municipality of Bronckhorst, (P10 – partnership between 10 largest rural municipalities in the Netherlands)
Ms Arends	Municipality of Bronckhorst, (P10 – partnership between 10 largest rural municipalities in the Netherlands)
Mr Beimers	Ministry of Finance
Mr Beukema	Interprovinciaal Overleg
Mr Budding	Zijlstra Center/ VU University Amsterdam
Mr Boerboom	Ministry of the Interior and Kingdom Relations (BZK)
Ms Boel	Ministry of the Interior and Kingdom Relations (BZK)
Mr Bordewijk	publicist
Mr Bos	Netherlands Bureau for Economic Policy Analysis (CPB)
Mr De Groot	University of Twente
Ms De Sonnaville	Netherlands Court of Audit
Mr Etty	Andersson Effers Felix
Mr Fleurke	VU University Amsterdam
Mr Frederiksz	inter provincial consultation (<i>Interprovinciaal Overleg</i>)
Mr Gieskes	Council for Real Estate Assessment (Waarderingskamer)
Mr Geluk	ROC Midden Nederland
Mr Van der Heiden	Municipality of Liesveld/De Waard Werkt
Ms Hoeben	University of Groningen
Mr Holtslag	Scientific Council for Government Policy (<i>Wetenschappelijke Raad voor het Regeringsbeleid WRR</i>)
Mr Homan	Dutch Healthcare Authority (Nederlandse Zorgautoriteit NZA)
Mr Houtman	Municipality of Rotterdam
Ms Hugenholtz-Sasse	Greenwish
Mr Huigsloot	Cebeon
Mr Huisman	Province of Zuid-Holland
Ms Insinger	Erasmus MC
Mr Jacobs	Association of Netherlands Municipalities (VNG <i>Vereniging van Nederlandse Gemeenten</i>)
Mr Jans	Haute Equipe
Mr Janssen	Municipality of Arnhem
Mr De Kam	Radboud University Nijmegen
Mr Kerssemakers	Municipality of Weert
Mr Klaassen	Erasmus University Rotterdam
Mr Kromwijk	Representative for Social Regeneration (<i>Ambassadeur Sociale duurzaamheid</i>)

Ms Lautenbach	Ministry of the Interior and Kingdom Relations (<i>Ministerie van Binnenlandse Zaken en Koninkrijksrelaties BZK</i>)
Mr Van Leeuwen	Tilburg University
Ms Linden	Community Health Services Utrecht (<i>Gemeenschappelijke Gezondheidsdiens; GGD</i>)
Mr Van de Lustgraaf	Andersson Elffers Felix
Mr Minderman	Zijlstra Center, VU University Amsterdam
Mr Moor	(former director of Finances) Amsterdam
Mr Muijt	Province of Gelderland
Mr Mul	The Netherlands Institute of Chartered Accountants (<i>Nederlandse Organisatie voor Beroepsaccountants NBA</i>)
Ms Nijenhuis	Dutch Ministry of the Interior and Kingdom Relations (<i>Ministerie van Binnenlandse Zaken en Koninkrijksrelaties BZK</i>)
Mr Oosterhuis	Dutch Ministry of Finance
Mr Oskam	Vereniging van Nederlandse Gemeenten
Mr Putter	Erasmus Universiteit Rotterdam
Mr Rijke	Platform medium-sized municipalities (<i>Platform middelgrote gemeenten; PMG</i>)
Mr Schaap	Tilburg University
Mr Scheerman	Bestuursacademie Nederland
Mr Schilder	BMC Consultancy and Management
Mr Schillemans	Utrecht University
Mr Schulz	Tilburg University
Mr Smit	Municipality of Nijmegen
Mr Spigt	Municipality of Dordrecht
Mr Steiner	Bruno Steiner advies
Mr Stoof	Autonomous Municipality Cooperation (<i>Samenwerkingsverband Autonome Gemeenten; SVAG</i>)
Mr Timmers	Province of Noord-Holland
Mr Tollenaar	Autonomous Municipality Cooperation (<i>Samenwerkingsverband Autonome Gemeenten; SVAG</i>)
Mr Van Erk	Autonomous Municipality Cooperation (<i>Samenwerkingsverband Autonome Gemeenten; SVAG</i>)
Mr Van de Donk	Province of Noord-Brabant
Mr Van Dijken	Netherlands Institute for City Innovation Studies NICIS
Mr Van Genderen	Province of Zuid-Holland
Mr Van Hout	P10 – partnership between 10 largest rural municipalities in the Netherlands
Mr Van Koesveld	Dutch Ministry of Finance
Mr Van Veller	Association of Dutch Municipalities (<i>Vereniging van Nederlandse Gemeenten VNG</i>)
Mr Verhagen	Municipality of Den Haag
Mr Vos	Bestuursacademie Nederland
Mr Wilms	Ape, Research & Consultancy

Association of Netherlands Municipalities (*VNG Vereniging van Nederlandse Gemeenten*)

Platform medium-sized municipalities (*Platform middelgrote gemeenten: PMG*)

P10 – partnership between 10 largest rural municipalities in the Netherlands

Financiële werkgroep G33/G4

Ambtenaren financiën 100.000+ steden

Dutch City Managers Association (*Vereniging van gemeentesecretarissen VGS*)

BOAG ambtelijk overleg financiën IPO

Autonomous Municipality Cooperation (*Samenwerkingsverband Autonome Gemeenten; SVAG*)

Annex 3

Members of the Financial Relations Council

Chairman

Mr M.A.P. van Haersma Buma, LL.M

Dike warden of Delfland and also acting member of the Council for Public Administration

Deputy chairman

Ms H. van Rijnbach-de Groot,

Mayor of the Municipality of Etten-Leur

Members

Prof. M.A. Allers

Professor of Economics of Sub-National Government at the University of Groningen

Ms *drs.* L.E.J. Engering-Aarts

Former alderman for Finances and Culture at the Municipality of The Hague

Mr F.A.G. Hol

Former alderman for Finances at the Municipality of Heerlen

Temporary members

Mr Th. A.J. Peters

Former member of the provincial council Gelderland

Prof. Th.A.J. Toonen

Professor of Public Administration at the University of Leiden and Delft University of Technology