INSTITUTE OF SOCIAL STUDIES

DECENTRALIZATION, LOCAL GOVERNMENTS AND MARKETS: A COMPARITIVE STUDY OF RECENT TRENDS IN SELECTED COUNTRIES

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INTRODUCTION

Decentralization is a complex issue that has to do not only with delegation, deconcentration or devolution of responsibilities from the central to the local level of government, but in a broader sense, it includes a rebalance between governments and markets. The purpose of this research is to analyse the process of decentralization from this perspective and to discuss, based on information of eight countries, the variety of changes and/or their possible common grounds. The paper is organized as follows:

Chapter One presents the theoretical framework that includes: fiscal federalism, intergovernmental relations, institutional arrangements to provide public services and, Bennett's model of resource and power allocation. Chapter Two analyses the process of decentralization from the central to the local government. The main topics for this chapter include: the degrees of decentralization both in industrialized and in developing countries; the factors that explain the different roles of the local layer of government; the economic roles of the local and central governments under different decentralization schemes; and the factors that explain the local government fiscal imbalances between its own revenues and its expenditure responsibilities. Additionally, Chapter Two presents a closer look at the local government finances analysing the composition of revenues and expenditures, the importance of central government grants on the overall local resources, and the local government expenditure priorities. A central component of this chapter is a discussion of the factors that explain the poor capacity of local governments to rely on their own tax-base, the weak link between economic fluctuation and local taxes, local governments financial autonomy, decentralization of social expenditures, and a comparison of social allocation ratios between the different layers of government.

Chapter Three analyses the redefinition of the balance between the government and the market, quasi-markets and non-governmental organizations. The aim of this chapter is to show that in order to improve economic efficiency and responsiveness to the customer there are several institutional arrangements that require more or less governmental intervention. To illustrate this issue, I first made an analysis of the balance between governments and markets and, second, I referred to concrete innovative experiences on the provision of public services both in industrialized and in developing countries. Additionally, Chapter Three presents a unifying approach to the process of decentralization to the local governments and to the markets. The objective here is to analyse the variety of responses (and their common characteristics) to the problems of economic efficiency and responsiveness to the customers that are associated with the decentralization processes.

Finally, Chapter Four is a discussion of some policy considerations that are associated with decentralization. Based on the results of previous chapters, I show that the redefinition of the balances between governments and markets, on one side, and central and local governments on the other side, have common characteristics: the increased concern about economic efficiency on the provision of public services, the search for innovative arrangements that better respond to customer preferences, greater local government efficacy and, better representation of peoples' interest. The research concludes with a reflection about a future research agenda and a summary of the main results. In both cases, the aim is to discuss issues that are relevant to developing countries.

Finally, it is important to highlight that this paper has three main limitations: (1) it is not intended to be a policy discussion but an empirical research of the decentralization processes, (2) it arrives at generalizations that must be taken as a departure point for future researches that deal with a bigger sample and, (3) due to data limitations the analysis of the process of decentralization to the markets is based on proxy variables and illustrating experiences rather than in direct indicators.

1. THEORETICAL FRAMEWORK

1.1 Definition of Decentralization

There are many reforms which fall under the banner of decentralization. It is therefore useful to make it clear that the process of decentralization is chiefly concerned with two dimensions: (1) intergovernmental relations, and (2) the balance between government and markets. Within the first dimension we can distinguish three possible systems (UNDP 1993):

Deconcentration. In this system some administrative responsibilities are transferred to the lower levels of government. It involves the spatial reallocation of decision-making.

Delegation. In this system the managerial responsibility for specific functions is transferred to public organizations that are outside the normal bureaucratic structure of the Central Government (CG). It involves the assignment of specific decision-making authority to Local Governments (LGs) or parastatals.

Devolution. The responsibilities for governing are assigned to local authorities. It involves the creation or strengthening of subnational units of governments, whose activities are outside the direct control of the CG.

The second dimension of decentralization, namely towards the market, includes different institutional arrangements for public service delivery: contracts, franchise systems, vouchers, voluntary services, self delivery and, market provision. These arrangements will be analysed later.

1.2 Fiscal Federalism

1.2.1 The nature of goods and services

To understand the government involvement in the process of satisfying people's needs we require to look first at the different types of goods and services. To do this we will use two classifying concepts: non-rival consumption and exclusion.

'Non-rival consumption occurs when a certain good or service can be provided to additional consumers or users at no extra cost. The supply of a good or service is (within a certain range) indivisible' (Helmsing 1994: 5) since it is not possible to isolate the actual consumption or use by an individual and calculate its specific costs. However, even if it is possible to estimate the individual costs, there is no possibility of avoiding potential consumer/users from having access without paying for it (i.e. 'free riding').

'Goods and services have the characteristic of exclusion if the potential user can be denied the goods or excluded from their use unless he meets the conditions set by the potential supplier. In other words, the goods can change hands only if the buyer and the seller agree on the terms' (Savas 1982: 30).

Using both concepts it is possible to classify the different goods and services into four groups:

Group 1. Private goods. These goods or services are consumed individually and cannot be obtained by the user without the consent of the supplier, which is usually obtained by making payment. Private goods pose no conceptual problem of supply since the market place is supposed to provide them. Collective action with respect to private goods for the most part is confined to assuring their safety (e.g. of food, buildings), honest reporting (e.g. of weights and measures, labels) and quality (Savas 1982).

Group 2. Toll goods. These are pure jointly consumed goods for which exclusion is completely feasible (e.g. cable TV, water supply). Many toll goods are natural monopolies so collective action may be required to assure that they are created (or granted) and regulated.

<u>Group 3. Common pool goods.</u> These are pure individually consumed goods for which exclusion is complete-
ly unfeasible but their quantity is limited within a given period and their consumption is rival (e.g. minerals
in the ocean, communal grazing). Collective action is required to avoid the danger of depletion and to
safeguard these goods.

<u>Group 4. Collective or public goods.</u> These are pure jointly consumed goods for which exclusion is complete-
ly unfeasible (e.g. broadcast TV, air pollution controls). The market place is unable to supply such goods
because they are used simultaneously by many people and no one can be excluded from enjoying them.
Therefore, collective action (i.e. tax contributions) have to be obtained in order to ensure their supply.

Groups 1 and 4 are clear illustrations of private and public goods. Groups 2 and 3 are intermediate ones. In
relation to this last set Helmsing (1994: 6) argues that, 'in cases where consumption is rival and exclusion is
technically difficult, the provision tends to be public. On the other hand, if the cost of exclusion is low then
private provision is possible even though consumption is not-rival'.

1.2.2   The economic roles of the different layers of government

Musgrave and Musgrave (1984) identify three economic roles of government: stabilization, distribution and allo-
cation. They also discuss the economic reasons why certain fiscal functions should be operated in a more central-
ized level while others should be decentralized.

<u>Stabilization</u>
This function includes measures to be taken by the government to obtain a high rate of economic growth and
to address major economic imbalances (e.g. reduce fiscal deficit).
    The responsibility of the stabilization policy has to be at the national level because (Musgrave & Musgrave
1984, Helmsing 1994):

(1)   The attempts of the LG to apply its own fiscal stabilization policy will be restricted by the openness
      of the LG economy (i.e. if a high proportion of the public expenditure multiplier leaks away, the LG's
      fiscal policy is not very effective);
(2)   The fiscal stabilization policy requires a periodic finance of deficits or surpluses with the corresponding
      borrowing and debt repayments. These create a serious problem for LGs because they have no easy ac-
      cess to the capital markets and they have no control over a supporting monetary policy;
(3)   Decentralized monetary policies would be ineffective due to the openness of the local economy;
(4)   The central banking functions, like the power to print money, are a national responsibility; and, finally,
(5)   The stabilization measures require a certain degree of coordination between LGs and CG (e.g. revenue
      sharing and grants). This coordination is a CG responsibility.

<u>Distribution</u>
It is possible to distinguish between: (1) distribution among individuals and (2) distribution among jurisdictions.
In relation with the first aspect, LG distribution policies cannot be effective because there is free mobility of eco-
nomic factors between jurisdictions.
    On the other hand, the responsibility for the distribution among jurisdictions has to be at the national level
because (Musgrave & Musgrave 1984):

(1)   National policies may cause fiscal burdens to fall upon particular jurisdictions and, therefore, some form
      of compensation is required.
(2)   Fiscal capacities among LGs differ because low and high income individuals tend to separate in distinct
      communities. Thus, some LGs have low tax base and high fiscal need while others have high tax base
      and low fiscal need. A national system of transfers between these jurisdictions might then serve to
      reduce these differences;
(3)   Grants made to poor jurisdictions will provide public service benefits to low-income people and,
      therefore, individual disparities will be reduced.

Allocation function

This 'concerns the process by which total resource use in an economy is divided between the private and public sectors, and by which the mix of public goods is chosen not only sectorally, but also socially and even spatially' (Helmsing 1994: 10).

To establish the extent to which the LGs should be involved in this function, we have to consider the following aspects (Helmsing 1994):

(1) *Market imperfections.* In general, government intervention in the allocation of resources is required if the market is not competitive. On the contrary, under non-competitive markets, LG intervention is not always required because local monopolies are protected almost exclusively by transportation costs and these are only a small part of the overall cost of a good or service.

(2) *Externalities.* 'An externality arises when the production or consumption activities of one party enter directly as an argument into the production or utility function of another party' (Brown & Jackson 1994: 38).

   The presence of externalities is another argument for government intervention in the market. Furthermore, since externalities are often localized, LGs have a role to play in their generation (if they are positive) or in their control (if they are negative).

(3) *Merit goods.* The concept of merit goods is frequently used to justify government intervention in the allocation of resources. The provision of these goods requires LG intervention because: either an individual's information set is incomplete or distorted because of misleading advertising (e.g. cigarettes) (Brown & Jackson 1994); purchasers may not be able to afford these goods (e.g. low income housing); or purchasers are not the final consumers (e.g. basic education) (Helmsing 1994).

(4) *Impure public goods.* In theory there are few cases of pure public goods. In practice, there are several factors that restrict access to them as congestion, spatial barriers, functional barriers and, socio-cultural limitations.

   The provision of impure public goods by the different layers of government can be justified on the bases of their spatial extent. In fact, it is possible to make a hierarchy of public goods based on their spatially declining benefits (spatial barriers) and use this hierarchy to determine the level of government at which to organize their provision. The advantages of such a system are two: the intended beneficiary group is in a better position to express their preferences and; they are expected to contribute to the costs of providing the service (Helmsing 1994).

   The disadvantages are three: the most efficient scale of production/provision (i.e. least cost technology) may not coincide with the government jurisdiction; neither the costs nor the benefits of a public good is limited to the residents of a district (there are 'spill-over' effects) and; the kinds of public goods needed and the level at which they are required change over time (Helmsing 1994).

Even though these arguments are very important, we can't infer from them that the central provision of impure public goods will be a satisfactory alternative. Instead, these arguments pose a problem of intergovernmental fiscal coordination (e.g. tax-sharing or transfers). This topic will be analysed in detail under the section 'Intergovernmental Relations'.

1.2.3   The layer cake model of government

The Tiebout-Musgrave layer cake model of the public sector provides a solution to the problem of assigning economic roles to the different layers of government. According to this model the stabilization and distribution functions should be discharged by the CG while LGs should engage in allocation activities since they are better in reflecting customers' preferences (Brown, Jackson. 1994).

1.2.4   The Tiebout model

The economic roles of LGs under a decentralized system can also be discussed using a pseudo-market mechanism for preference revelation. In his formulation Tiebout imagined an economy which is characterized by local public goods, i.e. public goods whose benefits are confined to a specific region in the sense that there are no inter regional spill-overs or costs. Individuals are then assumed to 'vote with their feet', allocating themselves between

localities according to their preferences for public goods and the associated tax rates. This proposal gives an apparent mechanism for individuals to reveal their preferences and a solution to the public goods optimality problem. However, this solution has two limits: (1) it does not consider the important economies of association to be gained when a number of persons share the financing of a public good and; (2) since each individual has his/ her own preferences there would need to be a very large number of potential local jurisdictions to move to (Brown & Jackson 1994, Oates 1990, Musgrave & Musgrave 1984).

1.3 Intergovernmental Relationships

While the fiscal federalist framework is most frequently used in the analysis of administrative reforms and decentralization – its main question is 'which level of government should take care of financing and delivering a particular public service?' (Prud'Homme cited by Helmsing 1995: np) – the intergovernmental view not only separates expenditures and revenue responsibilities, but also assumes coordination between the different levels of government and deals with the conditions under which functions and sectors can be most fruitfully decentralized. In this section we will take a closer look at this approach.

1.3.1 Localized, centralized and mixed forms of government

Before discussing in detail the apportionment of expenditure and revenue responsibilities between the different levels of government it is important to distinguish between three governmental forms: the localized, centralized and mixed ones (Bennett 1980).

The localized government
A localized government is the one where LG is responsible for all but a few public functions. The arguments in favour of this type of government are (Bennett 1980): (1) its capacity to promote local unity, sense of community, neighbourhood and self-reliance; (2) its ability to adjust more closely to geographical variations of local needs and preferences; (3) its promotion of freedom, democracy and responsibility (LGs are much more easy to control and to participate in); (4) its encouragement of innovation and experimentation with new government organizations, or public finance provision; (5) its contribution to political stability through the diffusion of power between a multiplicity of jurisdictions; (6) its promotion of national unity and security through a greater harmony of interests at local level and the fostering of collective action; and, finally, (7) its capacity to reduce the load of higher levels of government.

On the other hand, the shortcomings of this form of government are that: '(1) it can generate extreme inequity in service standards and fiscal burdens; (2) it results in inefficient economic organizations (i.e. duplication of services); (3) it fosters local autocratic rule; (4) it breeds narrow parochialism and sectionalistic competition and; (5) it produces inertia and rigidity' (Bennett 1980: 281).

Centralized governments
Centralized governments retain all powers within a single unitary structure. The advantages of this system of government are (Bennett 1980): (1) its ability to act as an external force to limit local fiscal disparity, (2) its capacity to promote economic and technical efficiency and, (3) its role in stimulating and maintaining national unity.

Extreme centralization has also its shortcomings (Bennett 1980): (1) it facilitates totalitarian dominance; (2) it leads to congestion to central work-loads and the inability to be sensitive to local needs and geographical variations; (3) it imposed uniformity and, therefore, it leads to inefficiency in the face of geographically variable needs and demands and, finally, (4) it can weaken democracy and national unity.

Mixed patterns of government
In practice, both centralized and localized governments present important advantages and disadvantages. Based on this fact, Bennett (1980) argues that the primary issue for any country must be to reach certain degree of governmental balance. Additionally, he proposes that the economic roles of government cannot be reserved exclusively to one level of government since they require coordination between all levels of decision-making.

1.3.2   The apportionment of revenue responsibilities between LGs and CGs

There are two main questions in relation to the allocation of revenue responsibilities. First, how should the revenue responsibilities be distributed? and, second, how should revenue responsibilities be apportioned between different revenue sources? (Bennett 1980).

<u>Separation of revenue sources</u>
. If we apply the Benefit Principle of apportioning tax burdens then local benefits are paid for by local revenue and national benefits by national revenue. The advantages of this system (tax-separation) are that: (1) it reinforces local autonomy and accountability, (2) it avoids tax competition between levels of government, (3) it avoids overlapping and multiple taxation and, (4) it can be easily administered and assessed (Bennett 1980).

The separation theory can, however, be objected to on a number of grounds. Bennett (1980) identifies six possible disadvantages: (1) tax overlapping and multiple taxation can be overcome by other means rather than separation (i.e. tax deductions and credits); (2) the claims of easier administration, identity of clearer consensus of interest and, better assessment depend on the methods of organization adopted at each governmental level; (3) separation can lead to administrative duplication in each local jurisdiction; (4) the revenue sources most likely to be assigned at local level are usually not adequate to finance all local needs and hence some dependence on other levels of government is required; (5) total independence and autonomy is never achievable since there is always a need for intergovernmental transfers to overcome fiscal imbalances and to achieve fiscal equalization; and finally; (6) complete separation of revenues is impossible since there is a continually changing pattern of needs at national and local level, and the yields of different taxes at different levels change with economic conditions.

In practice, therefore, most countries have evolved a mixture of separate, shared and overlapping revenue sources. Additionally, it is important to highlight that some revenue responsibilities are better administered at one level of government than at other. Specifically: '(1) certain taxes must be reserved to CG, at least for administrative purposes; these usually include corporate income tax, redistributive elements of personal income tax, gift tax, and any heavy burdens placed on sales tax; (2) the most appropriate local taxes are usually property tax, user charges, severance tax (where possible), with limited use also of personal income, sales and estate taxes' (Bennett 1980: 293), and (3) policy attempts to achieve redistribution through taxation must be based on CG revenue sources.

1.3.3   The apportionment of expenditure responsibilities

Various theoretical approaches to the determination of the most appropriate allocation of functions among the different levels of government have evolved. Bennett (1980) identifies five of them:

<u>Sense of community</u>. People have often a 'sense of community' and look for ways and means to improve the well-being of the community as a whole. This can provide a good base to organize government responsibilities.

<u>Technical efficiency (X-efficiency)</u>. It involves the determination of the level of government at which the output of services can be produced at least cost. The calculations involved in this approach are only an indicator for the allocation of expenditure functions since: (1) there are important spill-overs and externalities associated with the provision of some public goods, and (2) technical efficiency changes with time modifying the economies of scale and distribution.

<u>Economic efficiency</u>. The economic efficiency approach involves technical efficiency and three subsidiary features: (1) the practicalities involved in the assignment of economic roles to the different levels of government, (2) the extent of externalities and spill-overs and, (3) the price elasticity of demand for goods.

The first aspect has already been discussed in section 1.2.4 (Tiebout-Musgrave Theorem). However, in relation to it, Bennett (1980) emphasizes that in federal countries, local services and fiscal functions are more related to local preferences and, as a consequence, a considerable degree of variation in tax rates, distribution polices and growth incentives can be found at the local level of government.

The second aspect was also previously discussed and we arrived at the conclusion that economic efficiency criterion gives rise to a hierarchical allocation of public goods according to their degree of externality (spatial range).

Finally, the elasticity of demand as a criterion to allocate function to the different levels of government indicates that: (1) inelastic goods should be provided publicly, (2) completely inelastic goods should be provided at the national or international level as merit good and, (3) mixed or impure goods should be publicly or privately provided. In the last case, public regulation is required (Helmsing 1994).

Decision-making or 'calculus of consent' approach. This approach refers to two aspects (Helmsing 1994). First, that the costs of collective action to access a public service decline as the beneficiary group increases and, second, that the decision costs to agree and to run these collective actions rise with the group size. As a consequence, by adding the two costs curves the optimal group size with minimum costs may be determined and therefore, an optimal pattern of government. The problem associated with this criterion is its inconsistency with technical and economic efficiency considerations.

Administrative constraints. This criterion is less theoretical. It says that as a government structure evolves over time, its existing organization poses constraints to the reallocation of expenditure functions.

1.3.4   Changes to fiscal structure

'Under the influence of changing demands, innovations and technology, and shifts in the values and cultural identity of society, various adjustments to government structure and its fiscal responsibility can be undertaken'. Several options are open (Bennett 1980: 305):

Changes in government structure. These changes usually involve: (1) consolidation of government (e.g. increased centralism, changes to boundaries); (2) decentralization of government; (3) Multi-tier government; and (4) marketplace government (e.g. creation of ad-hoc bodies or special purpose governments as in the case of marketing boards).

Changes in fiscal responsibility. These changes include: (1) the reassignment of revenue responsibilities or sources; (2) reassignment of expenditure responsibilities and, finally, (3) the adjustment of intergovernmental transfers and coordination.

1.4   Decentralization, Local Governments and Markets

1.4.1   Diversity and common ground

Decentralization is a term that can have a variety of uses: in some cases it refers purely to intergovernmental relations and in others, its emphasis is on shifting responsibilities between the governmental and non-governmental sectors. A single term, therefore, describes a variety of situations (i.e. Thatcher and Reagan reforms) that often have a common ground and seek similar outcomes.

The common concern of decentralization policies is a search of a reorientation of governmental response to questions of need for services, demand, and customer preferences (take-up of collective goods and services). This reorientation implies that 'public-service approach is only one of a number of ways of seeking to deal with the field in which collective goods can be delivered. Voluntary, non-profit organizations, as well as regulated market responses are some of the other possibilities' (Bennett 1990: 2).

1.4.2   Intergovernmental relations and the legacy of welfarism

Decentralization is a key issue to understanding the changes in the role of the government that is taking place both in industrial and developing countries. However, decentralization can only be understood with respect to what were the previous government roles under the welfarist paradigm.[1]

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[1]   Welfarism was the dominant paradigm since the 1940s to the 1970s.

The dominant aspect of welfarism was an 'institutionalization of the responsibility of the government to ensure high and stable employment, to provide income support for the poor, to provide health care, education and housing, and to plan effective provision. Government planning and rationality become by-words of a wide range of processes' (Bennett 1990: 4). The basis of these developments was manipulation of the economy as proposed by Keynes.

The result was that the market mechanisms were supplanted by a normal acceptance of welfare state in which people and places (and hence LGs) have claims for welfare against society as a matter of rights and justice. Additionally, the rapidly growing economy allowed an expansion of the concept of 'needs' and, therefore, the emergence of new and rising expectations. These rising expectations induced an expansion of the governmental sector and a flow of welfare responsibilities to the LGs.

From the financial point of view, the consequence of these developments were: (1) that LGs had to undertake growing expenditure responsibilities on a static and, sometimes, narrowing revenue base (most revenue taxes remained a CG responsibility) and, (2) that the imbalances of resources and requirements between levels of government had to be solved by a growing CG involvement on the finance of local services (e.g. use of grants). As Bennett (1990: 6) says 'the result has been a steady erosion of the linkage of local decisions from their financial consequences with regard to such questions as provision, assessment of needs and management'.

1.4.3   Models to approach the variety of responses

There are important differences between countries specially in the formal acquisition of legal responsibilities, the political and financial aspects involved in the provision of public services, and the form and extent of delegation of powers. The major aspects of these differences can be captured using two classifying criteria: their level of central and localized power (decentralization to the government) and, the extent to which resource allocation is dominantly market controlled or determined by the government (decentralization to the market). On the bases of these criterion, Bennett (1990) proposes the following theoretical models (refer to Graph 1.1.):

Centralized public sector model. This model is close to the form of many developing countries today. It allocates resources through the government and is power centralized.

Localized public sector model. This model is used by the Scandinavian countries. It is characterized by the allocation of a high proportion of resources through the government and a high degree of decentralization to the state/local level.

Localized market model. This is Tiebout and the public-choice theorists' model. It allocates resources through the market and it is power localized.

Centralized market model. It is power centralized and assigns resources through the interaction of supply and demand.

Mixed model. It is a complex mix of central/federal and state/local powers but with a greater emphasis than in the past on market allocation processes. This hybrid model (also called a 'post-welfare' model) is particularly applicable to industrial countries.

1.4.4   Is there any evolutionary structure?

For mass service provision it is possible to identify two possible common trends:

In industrialized countries there is a tendency to move from a welfarist approach to a post-welfare model whose focus is on (Bennett: 1990): (1) greater governmental responsiveness to the customers, (2) the introduction of innovative arrangements in the organization of service delivery, (3) managerial reforms (internal accountability), (4) reinterpretation of representation and external accountability and, (5) shifts in the 'boundary' of government.

In developing countries the tendencies are less clear since they have yet to develop a 'full welfare state'. According to Bennett (1990: 12) 'they are having to develop intergovernmental decentralization first, in order to provide a set of agencies to allow future development. They may be following the North European historical

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Graph 1.1 Decentralization Models[*]

MARKET RESOURCE ALLOCATION

Decentralization to the Markets

PURE MARKET ECONOMIES

CENTRALIZED MARKET MODEL

LOCALIZED MARKET MODEL

MIXED MODELS

CENTRALIZED PUBLIC SECTOR MODEL

LOCALIZED PUBLIC SECTOR MODEL

GOVERN-MENTAL RESOURCE ALLOCATION

PLANNED ECONOMIES

POWER CENTRALIZED

Decentralization to the Governments

POWER LOCALIZED
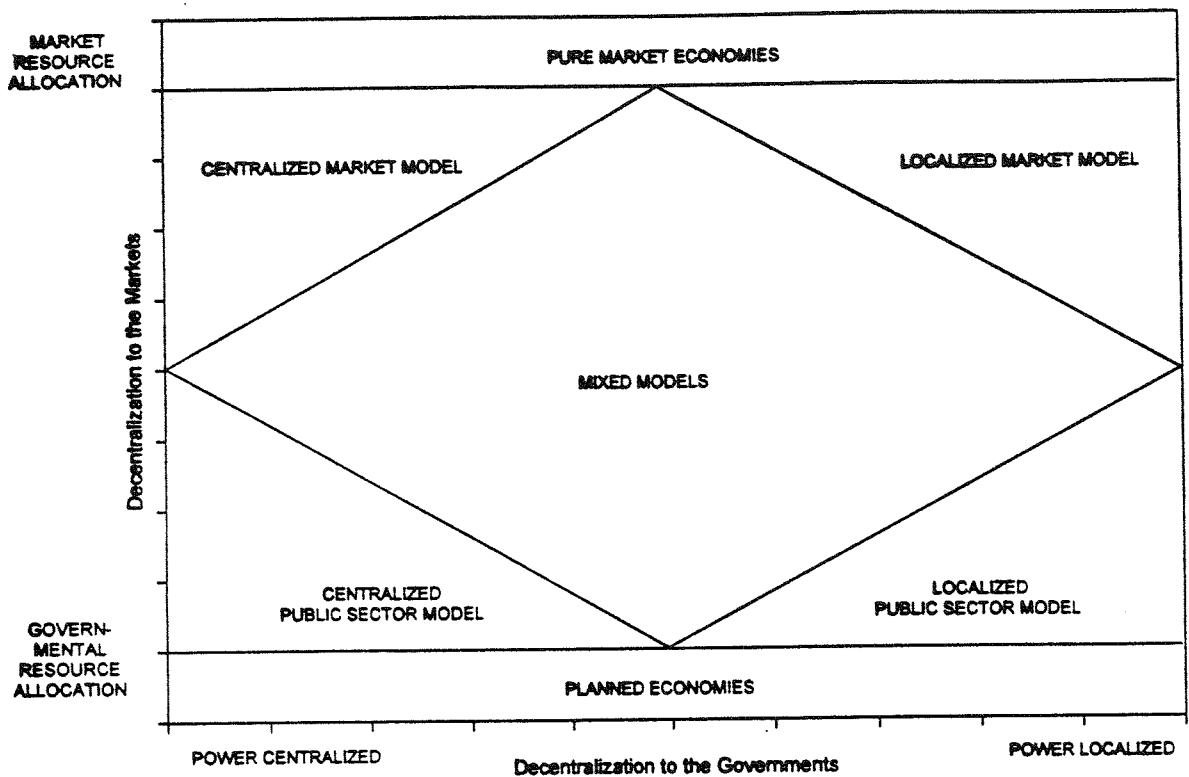
* Categorization of intergovernmental relations by the character of their dominant method of resource allocation (govemmental or market) and level at which government action is dominantly exercised (federal/central or local).

path, but more rapidly. They are also likely to bypass many of the historical precedents by moving directly towards para-state and market approaches to services'.

In all countries the tendency is to downsize the government and to concentrate most of its efforts not in direct provision of services but in creating an environment (i.e. through the use of regulatory and taxing authority) that induces efficiency gains, a greater responsiveness to customers and, promotes a higher level of economic activity.

1.5   Alternative Institutional Arrangements to Provide Goods and Services

As we previously discussed the provision of public goods does not necessarily have to be done by the public sector. In fact, the recent tendency to downsize the economic role of the government (decentralization to the market) has been associated with a discussion of alternative ways to provide goods and services. In this section we treat these alternatives.

Table 1.1 Institutional Arrangements for Providing Public Services

Service arrangement	Arranges service	Produces service	Pays producer
Government service	Government	Government	n.a.
Intergovernmental agreement or contract	Government (1)	Government (2)	Government (1)
Contract	Government	Private firm	Government
Franchise	Government	Private firm	Consumer
Grant	Government & consumer	Private firm	Government & consumer
Voucher	Consumer	Private firm	Government & consumer
Market	Consumer	Private firm	Government & consumer
Voluntary	Voluntary association	Voluntary association	n.a.
Self-service	Consumer	Consumer	n.a.

Source: Savas 1982: 73.

1.5.1 Consumers, producers and service organizers (arrangers)[2]

Before discussing the different arrangements for public good and services provision an important distinction must be made between consumers, producers and service arrangers (Savas 1982).

The consumers are individuals and households that directly obtain or receive the good or service. 'The producer is the agent that actually and directly performs the work or delivers the goods and services to the consumers. A producer can be a unit of government (local, county, state or federal), a multipurpose or unifunctional special district, a voluntary association, a private firm, a non-profit agency, or in certain instances, the consumer himself' (Savas 1982: 56).

The arranger is the agent who assigns the producer to the consumer. The arranger may be the LG in which the consumer is located, the state/province/federal government, a voluntary association or the service consumer himself.

To illustrate these three concepts lets suppose that a LG hires a paving contractor to resurface a street with asphalt. In this case, the municipality is the arranger, the firm is the producer, and the public in general is the consumer. Using these three concepts we can now discuss the alternative ways to provide collective goods and services (see Table 1.1).

1.5.2 Institutional arrangements for providing public goods

According to Savas (1982) it is possible to identify nine arrangements to deliver collective goods. These alternatives are:

(1) Government good or service. 'It denotes the delivery of a good or service by a government agency using its own resources (employees); that is, the same government unit acts as both the service arranger and the producer' (Savas 1982: 58) (e.g. municipal provision of primary education).

(2) Intergovernmental agreements. The term intergovernmental agreements denote that one government is the producer but another is the service arranger (e.g. the LG purchase of fire protection services from a specialized government unit). Goods and Services commonly provided under intergovernmental transfers include water supply, jails, sewage treatment, policy communications, libraries, resource recovery plants and, public health services.

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[2] In a recent paper Helmsing distinguish between service delivery and service provision (Helmsing, 1995). However, in this section I follow the approach proposed by Savas since it is more appropiate for my analytical purposes.

(3) Contract or purchase of goods and services. Contracting out can be defined as public financing of private production. Alternatively, the public agency can retain responsibility for the good or service but arrange for private management (management contracts). At the LG level, some of the goods and services usually delivered under this arrangement are refuse collection, ambulance service, street paving and, traffic-light maintenance.

(4) Franchise. 'An exclusive franchise is an award of monopoly privileges to a private firm to supply a particular good or service, usually with price regulation by a government agency. Non-exclusive or multiple franchises can also be awarded, as in the case of taxis. In franchise service, the government is the arranger, a private organization is the producer and, the consumer purchases the service directly from the producer' (Savas 1982: 66). Common utilities such as electric power, gas and water distribution, are usually provided under franchise contracts.

(5) Subsidies (or grants to private producers). Under this system a subsidy is given by the government to the producer typically under the form of grants or tax-exemptions. Examples of this arrangements are government induced provision of low-cost housing by the private real state industry, grants to universities and, subsidies to mass transportation companies. Under a grant arrangement the producer is the private firm, both government and consumers are the arrangers and, usually, both government and the consumer make payments to the producer.

(6) Vouchers. The voucher system is also designed to encourage the consumption of particular goods and services. The vouchers are subsidies to the consumer and permit them to exercise relatively free choice in the marketplace. In a voucher system, the producer is a private firm (authorized by the government), both government and consumer pay the producer but, only the consumer selects the deliverer (e.g. rent and school vouchers).

(7) Free market. This system is used to provide private and toll goods. 'The consumer himself arranges for services and selects the producer, which is a private firm. Government is not involved in the transaction in any significant way, although it may establish service standards' (Savas 1982: 70).

(8) Voluntary services. 'In this arrangement, a voluntary mutual-aid association acts as service arranger and either produces the service directly, using its members as workers, or hires and pays a private firm to do the work' (Savas 1982: 70). Examples of this system are recreation facilities, street cleaning, protective patrol and free protection.

(9) Self services. In this system the arranger and the producer is the consumer. The government encourages individuals or groups such as neighbourhoods associations, to undertake for their own benefit, activities that the government has previously undertaken. This results in a reduction in government activity that otherwise would be required. An example of this arrangement is household care of street and sidewalk sweeping (Hatry 1973).

Combined arrangements

While a particular service is generally provided through one arrangement, it is also important to highlight that some collective goods may be provided under several systems. For example, refuse collection could be delivered by a combination of public agencies and private firms.

2. DECENTRALIZATION TO THE LOCAL GOVERNMENTS

2.1 Initial Considerations

This form of decentralization can be basically assessed in relation to three criteria: (1) the importance of local expenditures in relation to the general government expenditures, (2) the importance of local revenues relative to the general government revenues and, (3) LGs' financial autonomy.

In this section I will use these criteria in order to answer the following questions: what is the degree of decentralization in both industrialized and developing countries?; what are the factors that explain the different roles of the local layer of government?; which are the economic roles of the local and central governments under different decentralization schemes? and, what are the factors that explain the local fiscal imbalances?.

From the methodological point of view the analysis will try to cover two approaches: a static comparison between countries based on indicators that resume their behaviour during the last twenty years (specially averages) and; a dynamic perspective based on long-term tendencies.

The data comes from the International Monetary Fund, *Governmental Finance Statistics* (several issues), and has the following characteristics:

(1) Chronologically it covers the period 1975 to 1994. However, in cases with data constraints the time-span could be shorter (e.g. Colombia),

(2) Geographically it covers countries from Europe (Denmark, The Netherlands and the United Kingdom); Latin America (Chile and Colombia); Africa (Kenya); Asia (Thailand) and Australia (Australia).

(3) Economically it covers industrial and developing countries.

(4) Politically it includes unitary and federal countries with two and three layers of government.[3]

In order to provide consistency and comparability to the analysis the term 'local' will refer to the non-central component of the government sector. This is particularly important in three cases: Colombia where the data covers the second and the third layer of government (Departments and Municipalities), Australia where the decentralization process is specially important for the second layer of government (States) and, The Netherlands, where the available information covers Provinces and Local Governments without differentiating them. In all other cases, the non-central component of the governmental sector refers exclusively to the local level of government.[4]

2.2 Decentralization and Economic Development

Graph 2.1a illustrates the relationship between per capita income and degree of decentralization. From this graph we can see that industrialized countries have a higher decentralization ratio than developing ones (in average 41.7 per cent and 13.64 per cent respectively).[5] The explanation for this situation has to do with two aspects: (1) the aggregate resources of the economy and, (2) the efficiency in the provision of services.

Bennett (1994: 19) explains quite clearly the first aspect: 'The level of economic development of a country or region determines the aggregate resources that are available for development of governmental and other services. Generally, the higher the level of economic development the higher is the level of services that can be provided. Indeed, there is a strong, but approximate, relationship between these two factors.

The outcome of this relationship has to be a recognition that the scale of government action will generally be less in aggregate with lower levels of GDP. We would expect, therefore, that the extent, form and complexity of government structures will be less developed with lower levels of GDP'. In other words, the level of economic activity is important to explain the increasing demand for services (both private and public) and, the complexity of the governmental structure.

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[3] Formally Chile has a four tier system of government. However, its Provincial Government has only nominal functions.

[4] An initial effort was made to differentiate the lower layer of the government from the other levels; however, in order to avoid inconsistencies, I decided to adopt an operational definition of LG as the 'non-central' component of government.
   As a result of an initial analytical effort I arrived to the conclusion that the results of this research are, in some cases, very sensitive to the definition of 'local'. This issue is particularly relevant for countries with decentralization processes to the second layer of government and not to the lowest one as in the case of Australia.

[5] The regression line between per capita income and degree of decentralization shows a positive relation but a relatively poor adjustment. The interesting aspect of the regression is that the t-test shows that income is an explanatory variable for decentralization. In order to arrive to generalizations the regression should be repeated with a bigger sample.

Graph 2.1a Decentralization and Economic Development
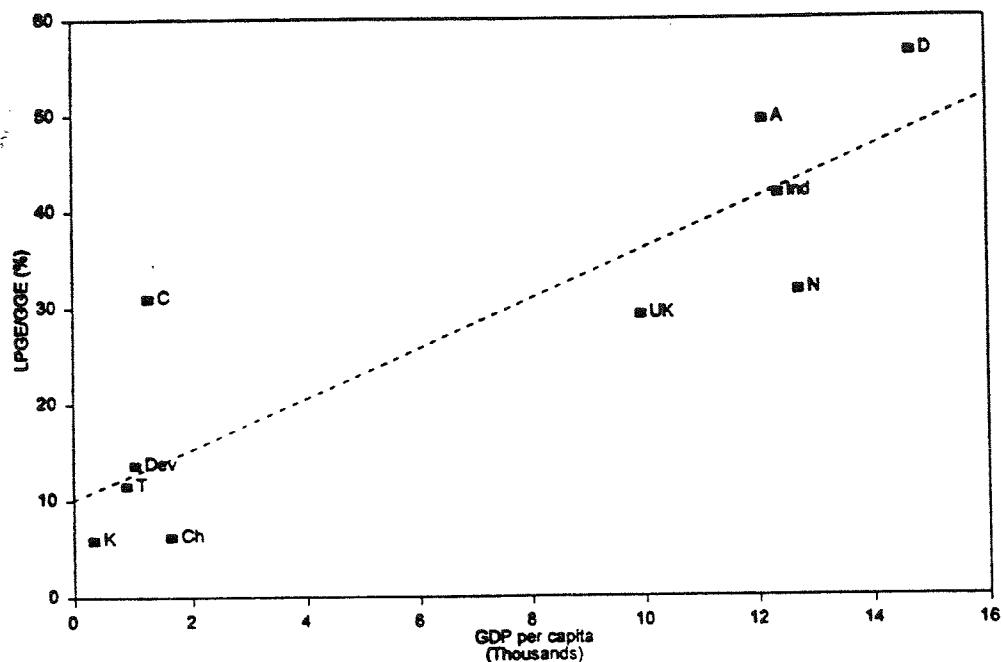
Graph 2.1b Trends on Decentralization and Economic Development
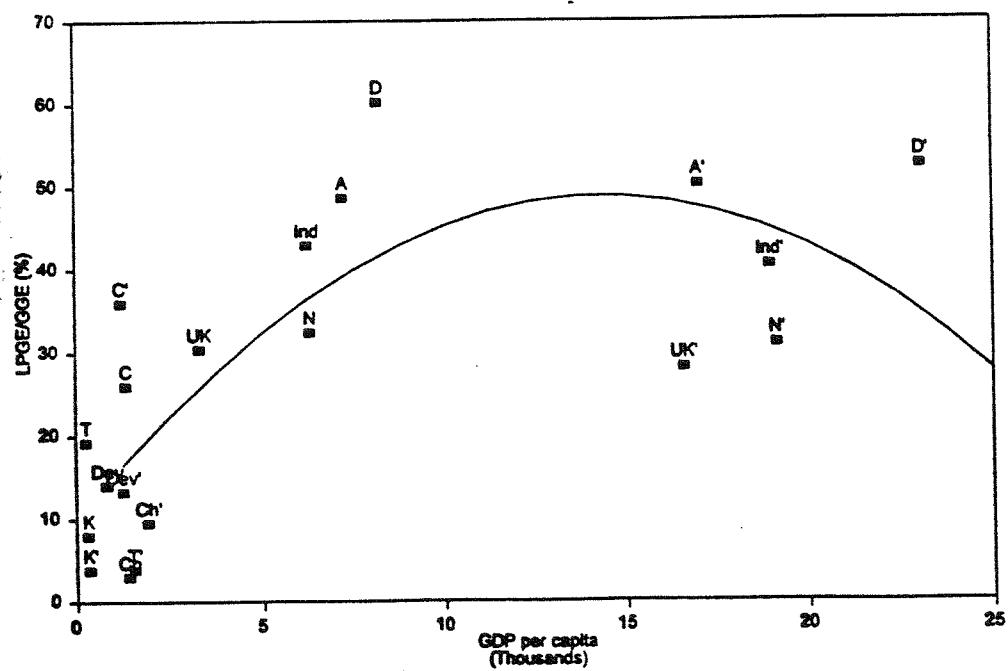
LPGE: Local and Provincial Government Expenditure.
GGE: General Government Expenditure.
(X): Initial position; (X'): Final position.

Source: Own elaboration based on IMF Government Finance Statistics.

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In relation with the second aspect, efficiency considerations in the provision of services are important to explain why countries with low levels of GDP tend to have highly centralized governments. In fact, with very low levels of resources any 'welfare state' service will suffer from problems of attaining economies of scale and a critical mass of consumers.[6]

Graph 2.1b shows the relationship between decentralization and per capita income in a time-span of 20 years. In general, there are two aspects that have to be highlighted: (1) the relative stability of the decentralization ratios at different levels of income (especially in industrial countries) and, (2) the lack of a common trend among developing countries.[7]

2.3   Degree of Decentralization of Expenditures and Revenues

2.3.1   Indicators of decentralization

The indicators used to study the degree of decentralization are the following (UNDP 1993):

(1)   The expenditure decentralization ratio, defined as the percentage of total government expenditure spent by LGs.

(2)   The modified expenditure decentralization ratio, which is similar to the former but it takes into account that some governmental expenditures cannot be decentralized (especially defense and debt servicing).

(3)   The revenue decentralization ratio, which assesses the significance of local taxation. It is defined as the percentage of local government revenue in total government revenue.

(4)   The financial autonomy ratio, which gives an indication of local government's independence from central government's fundings. It is the percentage of locally raised revenue in total local expenditure.

Of course, these indicators have to be treated with caution and complemented with additional information since: (1) it is possible that a country decentralizes its expenditures but keeps a tight control over standards and priorities, so such financial delegation may be meaningless; (2) it is difficult to estimate and quantify the contributions people make to self-help projects and, (3) the degree of decentralization depends also on several factors as the size of the country, population, area, income, and others (Oates 1972).

2.3.2   Degree of decentralization of expenditures and revenues

Tables 2.1 and 2.2 show several indicators of central-local government relationship. From these tables we can see that, in general, the degree of decentralization of expenditures (LPGE/GGE) is higher than the degree of decentralization of revenues (LPR/GGR)[8] and that, as a consequence, LGs are usually dependent on the CG financial support to balance their budgets.

The explanation for this situation has to do with policy concerns about the economic roles of the government. In fact, a system of government that, with national differences, decentralizes expenditures and only part of revenues has the following effects (Prud'Homme, R. 1990)

(1)   positive on stabilization because CG keeps some control over the amount of taxes raised and, because it thus has a fair degree of control over expenditures through grants and subsidies;

(2)   positive allocative implications because it is assumed that expenditures decided at the local level are more responsive to local need and realities, and therefore, they are more efficient; and,

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6   Oates identifies an additional argument. He says that the decentralization of a public activity is a costly enterprise so that a country must be relative affluent to addopt a decentralized from of government. Oates goes even further on this argument based on a regression analysis that shows that centralization decreases with economic growth (Oates, 1972).

7   The best regression curve for this data is a non linear model. Even though the model does not shows a very good adjustment, it shows that Oates' findings must be taken with caution.

8   The exception is Kenya where, on average, the expenditure decentralization ratio is 5.86 while the revenue decentralization ratio is 6.35.

Table 2.1 Fiscal Indicators of Intergovernmental Relations

	(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth			Trend (Regression)	
						(2)-(1)	(3)-(2)	(4)-(3)	Initial	Final
LGR/GGR (%)										
Australia	5.04	5.32	5.59	5.61	5.37	5.64	5.11	0.38	4.95	5.78
Chile	1.77	5.16	5.62		4.08	191.47	8.89		1.47	6.68
Colombia	4.76	6.18	5.78		5.46	29.99	-6.51		4.61	6.31
Denmark	30.98	31.11	29.87	31.22	30.77	0.42	-3.99	4.51	30.93	30.62
Thailand	6.72	5.61	5.27	4.96	5.68	-16.49	-6.04	-5.83	6.73	4.63
Kenya	7.93	6.47	5.38	5.05	6.35	-18.46	-16.79	-6.22	8.20	4.50
Netherlands	4.48	5.52	6.93	8.64	6.27	23.21	25.56	24.72	3.71	8.84
United Kingdom	16.91	16.36	15.44	9.70	15.15	-3.25	-5.59	-37.22	16.44	11.85
LPGR/GGR (%)										
Australia	24.81	24.96	26.10	29.37	25.97	0.60	4.60	12.52	23.52	28.42
Chile	1.77	5.16	5.62		4.08	191.47	8.89		1.47	6.68
Colombia	16.17	19.79	17.00		17.69	22.42	-14.10		16.04	19.35
Denmark	30.98	31.11	29.87	31.22	30.77	0.42	-3.99	4.51	30.93	30.62
Thailand	6.72	5.61	5.27	4.96	5.68	-16.49	-6.04	-5.83	6.73	4.63
Kenya	7.93	6.47	5.38	5.05	6.35	-18.46	-16.79	-6.22	8.20	4.50
Netherlands	4.48	5.52	6.93	8.64	6.27	23.21	25.56	24.72	3.71	8.84
United Kingdom	16.91	16.36	15.44	9.70	15.15	-3.25	-5.59	-37.22	16.44	11.85
LGE/GGE (%)										
Australia	6.02	6.54	6.61	6.67	6.43	8.66	1.11	0.84	6.04	6.83
Chile	3.45	7.45	8.12		6.21	116.22	9.01		2.96	9.47
Colombia	7.00	8.63	8.24		7.82	23.26	-4.60		6.95	8.69
Denmark	60.88	57.01	54.86	54.03	56.36	-6.37	-3.77	-1.51	60.23	52.49
Thailand	19.53	9.90	7.19	8.12	11.52	-49.31	-27.41	13.00	19.19	3.86
Kenya	7.91	5.78	4.76	4.79	5.86	-26.91	-17.63	0.60	7.92	3.80
Netherlands	32.21	31.21	32.53	30.64	31.70	-3.10	4.24	-5.82	32.37	31.03
United Kingdom	31.10	28.13	28.32	29.70	29.27	-9.54	0.68	4.86	30.36	28.18
LPGE/GGE (%)										
Australia	48.98	49.60	48.99	50.79	49.46	1.25	-1.22	3.66	48.69	50.22
Chile	3.45	7.45	8.12		6.21	116.22	9.01		2.96	9.47
Colombia	27.88	33.06	35.01		30.97	18.59	5.90		25.99	35.95
Denmark	60.88	57.01	54.86	54.03	56.36	-6.37	-3.77	-1.51	60.23	52.49
Thailand	19.53	9.90	7.19	8.12	11.52	-49.31	-27.41	13.00	19.19	3.86
Kenya	7.91	5.78	4.76	4.79	5.86	-26.91	-17.63	0.60	7.92	3.80
Netherlands	32.21	31.21	32.53	30.64	31.70	-3.10	4.24	-5.82	32.37	31.03
United Kingdom	31.10	28.13	28.32	29.70	29.27	-9.54	0.68	4.86	30.36	28.18
LGE-Mod/GGE (%)										
Australia	6.42	7.02	7.06	7.07	6.87	9.32	0.65	0.11	6.47	7.28
Chile	3.95	8.43	9.01		7.00	113.48	6.86		3.47	10.52
Colombia		9.09	8.89		9.01		-2.17		9.20	8.81
Denmark	63.62	59.49	56.89	56.35	59.03	-6.49	-4.38	-0.95	63.32	54.74
Thailand	23.99	12.31	8.72	9.67	14.12	-48.71	-29.13	10.90	23.65	4.58
Kenya	8.82	6.61	5.26	5.20	6.54	-25.00	-20.44	-1.16	8.91	4.17
Netherlands	34.12	32.84	34.18	32.06	33.36	-3.75	4.09	-6.19	34.30	32.42
United Kingdom	34.90	31.50	31.73	33.00	32.76	-9.74	0.73	4.00	34.08	31.44

Table 2.1 Fiscal Indicators of Intergovernmental Relations (continued)

	(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth			Trend (Regression)	
						(2)-(1)	(3)-(2)	(4)-(3)	Initial	Final
LPGE-Mod/GGE (%)										
Australia	52.27	53.25	52.35	53.88	52.83	1.87	-1.68	2.92	52.18	53.49
Chile	3.95	8.43	9.01		7.00	113.48	6.86		3.47	10.52
Colombia		34.52	37.80		35.83		9.51		33.65	38.02
Denmark	63.62	59.49	56.89	56.35	59.03	-6.49	-4.38	-0.95	63.32	54.74
Thailand	23.99	12.31	8.72	9.67	14.12	-48.71	-29.13	10.90	23.65	4.58
Kenya	8.82	6.61	5.26	5.20	6.54	-25.00	-20.44	-1.16	8.91	4.17
Netherlands	34.12	32.84	34.18	32.06	33.36	-3.75	4.09	-6.19	34.30	32.42
United Kingdom	34.90	31.50	31.73	33.00	32.76	-9.74	0.73	4.00	34.08	31.44
CGG/LGR (%)										
Australia	22.76	22.65	20.36	18.11	21.29	-0.48	-10.10	-11.09	24.07	18.50
Chile	45.43	20.23	32.49		32.73	-55.46	60.56		41.27	24.20
Colombia	39.29	39.18	42.67		39.77	-0.29	8.92		37.96	41.58
Denmark	49.85	50.52	43.21	43.21	46.88	1.33	-14.47	0.01	51.96	41.80
Thailand	72.41	52.16	36.60	28.75	48.47	-27.96	-29.82	-21.46	76.20	20.73
Kenya	18.91	5.02	1.40		7.28	-73.47	-72.03		19.27	-4.71
Netherlands	86.23	83.73	78.22	72.33	80.54	-2.90	-6.58	-7.53	89.17	71.91
United Kingdom	48.67	45.66	45.56	68.45	50.27	-6.18	-0.23	50.26	43.02	57.51
CGG/LPGR (%)										
Australia	53.21	51.94	47.47	41.13	49.25	-2.37	-8.62	-13.36	56.03	42.47
Chile	45.43	20.23	32.49		32.73	-55.46	60.56		41.27	24.20
Colombia	47.72	53.65	56.88		51.41	12.43	6.02		44.88	57.93
Denmark	49.85	50.52	43.21	43.21	46.88	1.33	-14.47	0.01	51.96	41.80
Thailand	72.41	52.16	36.60	28.75	48.47	-27.96	-29.82	-21.46	76.20	20.73
Kenya	18.91	5.02	1.40		7.28	-73.47	-72.03		19.27	-4.71
Netherlands	86.23	83.73	78.22	72.33	80.54	-2.90	-6.58	-7.53	89.17	71.91
United Kingdom	48.67	45.66	45.56	68.45	50.27	-6.18	-0.23	50.26	43.02	57.51
LG Financial Autonomy (%)										
Australia	77.24	77.35	79.64	81.89	78.71	0.14	2.96	2.84	75.93	81.50
Chile	54.57	79.77	67.51		67.27	46.17	-15.36		58.73	75.80
Colombia	60.71	60.82	57.33		60.23	0.19	-5.74		62.04	58.42
Denmark	50.15	49.48	56.79	56.79	53.12	-1.33	14.78	0.00	48.04	58.20
Thailand	27.59	47.84	63.40	71.25	51.53	73.38	32.52	12.39	23.80	79.27
Kenya	81.09	94.98	98.60		92.72	17.14	3.80		78.42	110.66
Netherlands	13.77	16.27	21.78	27.67	19.46	18.18	33.86	27.06	10.83	28.09
United Kingdom	51.33	54.34	54.44	31.55	49.73	5.85	0.19	-42.06	56.98	42.49
LPG Financial Autonomy (%)										
Australia	46.79	48.06	52.53	58.87	50.75	2.70	9.31	12.07	43.97	57.53
Chile	54.57	79.77	67.51		67.27	46.17	-15.36		58.73	75.80
Colombia	52.28	46.35	43.12		48.59	-11.35	-6.96		55.12	42.07
Denmark	50.15	49.48	56.79	56.79	53.12	-1.33	14.78	0.00	48.04	58.20
Thailand	27.59	47.84	63.40	71.25	51.53	73.38	32.52	12.39	23.80	79.27
Kenya	81.09	94.98	98.60		92.72	17.14	3.80		78.42	110.66
Netherlands	13.77	16.27	21.78	27.67	19.46	18.18	33.86	27.06	10.83	28.09
United Kingdom	51.33	54.34	54.44	31.55	49.73	5.85	0.19	-42.06	56.98	42.49

Table 2.2 Fiscal Indicators of Intergovernmental Relations

	(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth			Trend (Regression)	
						(2)-(1)	(3)-(2)	(4)-(3)	Initial	Final
LGR/GGR (%)										
Industrial Countries	14.35	14.58	14.46	13.79	14.39	1.57	-0.81	-4.61	14.51	14.27
Developing Countries	5.29	5.85	5.51		5.39	10.60	-5.84		5.25	5.53
LPGR/GGR (%)										
Industrial Countries	19.29	19.49	19.59	19.73	19.54	1.00	0.52	0.74	19.15	19.93
Developing Countries	8.15	9.26	8.32		8.45	13.63	-10.15		8.11	8.79
LGE/GGE (%)										
Industrial Countries	32.55	30.72	30.58	30.26	30.94	-5.62	-0.46	-1.06	32.25	29.63
Developing Countries	9.47	7.94	7.08		7.86	-16.17	-10.89		9.26	6.45
LPGE/GGE (%)										
Industrial Countries	43.29	41.49	41.17	41.29	41.70	-4.18	-0.75	0.27	42.91	40.48
Developing Countries	14.69	14.05	13.77		13.64	-4.38	-1.98		14.02	13.27
LGE-Mod/GGE (%)										
Industrial Countries	34.76	32.71	32.47	32.12	33.01	-5.91	-0.75	-1.06	34.54	31.47
Developing Countries		9.11	7.97		9.17		-12.50		11.31	7.02
LPGE-Mod/GGE (%)										
Industrial Countries	46.23	44.27	43.79	43.82	44.50	-4.24	-1.09	0.08	45.31	43.02
Developing Countries		15.47	15.20		15.87		-1.74		17.42	14.32
CGG/LGR (%)										
Industrial Countries	51.88	50.64	46.84	50.53	49.74	-2.38	-7.51	7.87	52.06	47.43
Developing Countries	44.01	29.15	28.29		32.06	-33.77	-2.94		43.67	20.45
CGG/LPGR (%)										
Industrial Countries	59.49	57.96	53.61	56.28	56.73	-2.57	-7.50	4.97	60.05	53.42
Developing Countries	46.12	32.76	31.84		34.97	-28.95	-2.81		45.40	24.54
LG Financial Autonomy (%)										
Industrial Countries	48.12	49.36	53.16	49.47	50.26	2.57	7.70	-6.94	47.94	52.57
Developing Countries	55.99	70.85	71.71		67.94	26.54	1.21		55.75	81.04
LPG Financial Autonomy (%)										
Industrial Countries	40.51	42.04	46.39	43.72	43.27	3.77	10.35	-5.75	39.95	46.58
Developing Countries	53.88	67.24	68.16		65.03	24.78	1.37		54.02	76.95

(3)   positive redistributive effects because central transfers, if properly designed, can reduce regional and personal disparities.

2.3.3   Trends on the degree of decentralization of expenditures and revenues

In order to compare the trends of decentralization in different countries we can place them in a graph that measures the degree of decentralization of expenditures in the x-axis and the degree of decentralization of expenditures in the y-axis. This graph (refer to Graph 2.2) allow us to use four theoretical models: (Prud'Homme R. 1990):

Model A is 'defined by complete centralization of taxes and of expenditures. In this model, there is hardly any LG, and there is, of course, no intergovernmental subsidies' (Prud'Homme R. 1990: 117). This model has positive implications from the point of view of the stabilization and redistributive functions of the government. The allocative implications are less clear since Model A can (or can not) induce greater economic efficiency.

Graph 2.2 Decentralization Models
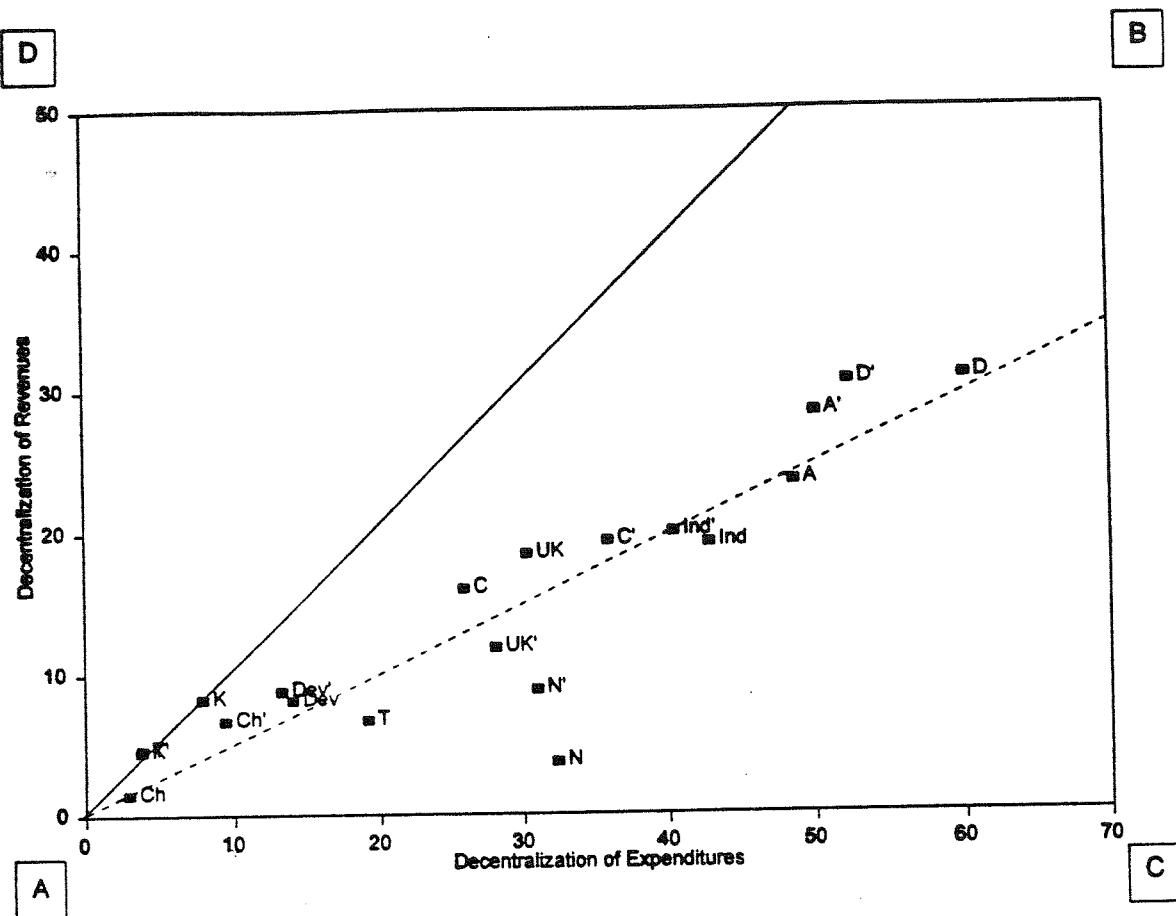
(X): Initial position; (X'): Final position

Source: Own elaboration based on IMF Government Finance Statistics.

Models of Centralization/Decentralization and their Implications

	Stabilization implications	Allocative implications	Redistributive implications
Model A: Centralization of taxes & expenditures	Good	Unclear	Good
Model B: Decentralization of taxes & expenditures	Bad	Unclear	Bad
Model C: Centralization of taxes & Decentralization of expenditures	Rather good	Not too bad	Potentially good
Model D: Decentralization of taxes & Centralization of expenditures	Poor	Bad	Probably bad

Model B is defined by complete decentralization of taxes and expenditures. In this case, there are also no subsidies/transfers and practically no CG. This model has negative stabilization and redistributive implications. Its allocative implications are not clear.

Model C is defined by decentralization of taxes and decentralization of expenditures. In this model, all taxes are raised by the CG, given to LGs in the form of subsidies, and spent by LGs. The implications of this model are rather good on stabilization and potentially good on the redistributive role of the government. It can contribute to a greater economic efficiency.

Model D is defined by decentralization of taxes and centralization of expenditures. In this purely theoretical case, taxes are raised by LGs, given to the CG in the form of subsidies, and spent by it. This is a model with negative implication on the economic roles of the government.

The scatterplot shows that in general developing countries are very close to model A. However, each country has its own experience and trend:

Chile. In this country the degree of decentralization is still very small in comparison with most industrial countries. However, the Chilean tendency during the last twenty years is towards a greater size of its LGs and a relatively limited financial imbalance between LG revenues and expenditures.

Thailand. Thailand shows a clear tendency towards a higher degree of centralization (it is moving even further towards model A). In fact, the expenditure decentralization ratio dropped from 19.5 per cent in the mid-seventies to 8.1 per cent in the early nineties while, in the same period, the revenue decentralization ratio decreased from 6.7 per cent to 5 per cent. The reason for these changes have to do with the stabilization and distributive advantages of model A.

Colombia. It is not only the country with the highest degree of decentralization within our developing countries but it is also the one that shows the highest dynamism in redefining its intergovernmental relations (see initial value C and final one C' in Graph 2.2). From the graph it is evident that Colombia is decentralizing without closing the local fiscal imbalance between its own revenues and expenditures.

Kenya. It shows the same tendency as Thailand but with a higher degree of centralization (this country is also moving towards model A). It is interesting to note that in Kenya LGs do not have a significant fiscal imbalance. Industrialized countries, on the other hand, are not only more decentralized than developing ones but, according to the graph, they have also higher local fiscal imbalances.

Denmark. It is the country with the highest degree of decentralization of expenditures and revenues. Its main tendency is to reduce the local government fiscal gap through a greater centralization of expenditures. From the point of view of Prud'Homme's models, Denmark is moving towards a mixed model in between the triangle ABC. This means that Denmark's model of decentralization balances the advantages and disadvantages of models A, B and C.

The Netherlands. Its tendency is to keep a high degree of decentralization of expenditures but, at the same time, reduce the local financial dependency through a higher capacity to collect local revenues (compare N and N'). This country is also moving towards a mixed model.

United Kingdom. Contrary to the Netherlands its tendency is towards a greater centralization of revenues. In fact, the UK fiscal reforms were directed to keep the allocative functions of its LGs while increasing the CG revenue functions.

Australia. It is a highly decentralized country that is moving towards a greater financial autonomy of its States and LGs. Its tendency is towards a mixed model as in the case of Denmark.

On the bases of the national experiences we can say that: (1) all countries (no matter their level of economic development) are undergoing changes in the distribution of responsibilities between the different levels of government; (2) on average, LGs in both industrial and developing countries are trying to reduce their financial imbalances (refer to Graph 2.2); (3) within developing countries, Kenya and Thailand are moving towards a more centralized system of government; (4) highly decentralized countries are also the ones with the highest fiscal imbalances and; (5) countries with high decentralization ratios are moving towards a model of intergovernmental relations that takes the advantages of models A, B and C.

2.4   Resources for Decentralization

2.4.1   An overview

Table 2.3 shows the composition of local revenues in industrial and developing countries. From this table it is possible to see some basic facts:

(1)   On average, taxes represent a higher percentage of the local revenue in developing countries than in industrial ones (39.4 per cent and 26.6 per cent respectively). In both cases, LGs have a restricted capacity to rely on their own resources.

(2)   Countries with a high degree of decentralization are more dependent on central grants than those in which the roles of the government are more centralized (grants from the CG are 57 per cent of all local revenues in industrial countries while they represent only 34.9 per cent in developing ones). In practice, this substantially reduces the decision-making capabilities of LGs.

(3)   Local non-tax revenues are relatively more important in developing than in industrial countries (25.8 per cent against 14.1 per cent). This item includes fees, user charges and, other revenues that are paid according to the related benefits.

(4)   In all countries the capital revenue is only a very small fraction of the total.

The composition of local revenues shows also important changes during the period 1975–94. These long-term trends can be summarized as follows (Table 2.3):

(1)   While in most industrialized countries the tax revenue shows a decreasing tendency (especially in the period 1984–94) in developing countries, the same item shows the opposite tendency.

(2)   Both in developing and industrial countries the non-tax component shows a tendency to increase its contribution to the total local government revenue.

(3)   On average the contribution of grants to the overall LG revenue tends to decrease in industrial and developing countries. This indicates that LGs are moving towards higher levels of local financial autonomy. In industrialized countries grants were 59.6 per cent of all local revenues during the early 1970s while now they are about 56.3 per cent. In developing countries, the importance of grants in the overall local revenue dropped from 46 per cent to 31.8 per cent in the period 1975 to 1989.[9]

(4)   The percentage contribution of the capital revenue to the total local revenue is increasing in industrialized countries while it is much more unstable in developing ones.

2.4.2   Current revenues

In this section we are going to answer two questions: (1) what are the factors that explain the poor capacity of LGs to rely on their own tax-base, and (2) if local taxes are pro-cyclical or anti-cyclical.

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[9]   Unfortunately, more recent data is not available for all developing countries.

Table 2.3 Revenue Composition (percentage of total revenues and grants)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1980-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
TOTAL REVENUE									
Australia	Cent. govt	100.0	100.0	100.0	100.0	100.0	0.0	0.0	0.0
	State, prov. govt	42.5	43.6	48.1	55.2	47.3	2.5	10.3	14.6
	Local govt.	77.2	77.3	79.6	81.9	79.0	0.1	3.0	2.8
	Local state govt	46.8	48.1	52.5	58.9	50.6	2.7	9.3	12.1
Chile	Cent. govt	94.9	97.9	100.0	100.0	98.2	3.1	2.2	0.0
	Local govt	54.9	79.8	67.5		67.4	45.4	-15.4	
Colombia	Cent. govt.	97.0	99.9	99.0		98.6	3.0	-0.9	
	State, prov. govt.	49.5	41.9	38.3		43.2	-15.3	-8.6	
	Local govt	60.7	60.8	57.3		59.6	0.2	-5.7	
	Local state govt	52.3	46.4	43.1		48.6	-11.3	-7.0	
Denmark	Cent. govt	93.6	96.8	98.5	98.7	96.9	3.3	1.8	0.2
	Local govt	50.1	49.5	56.8	56.8	53.3	-1.3	14.8	0.0
Thailand	Cent. govt.	98.3	97.6	97.4	99.0	98.1	-0.7	-0.2	1.6
	Local govt	27.6	47.8	63.4	71.3	52.5	73.4	32.5	12.4
Kenya	Cent. govt	97.0	97.5	95.3	89.6	94.9	0.5	-2.2	-6.0
	Local govt.	81.1	95.0	98.7	100.0	93.7	17.1	4.0	1.3
Netherlands	Cent. govt	99.6	99.6	99.5	99.9	99.7	-0.1	-0.1	0.4
	Local, prov. govt	13.8	16.3	21.8	27.7	19.9	18.2	33.9	27.1
United Kingdom	Cent. govt.	99.8	99.1	99.5	99.2	99.4	-0.8	0.4	-0.3
	Local govt.	51.3	54.3	54.4	31.5	47.9	5.9	0.2	-42.1
Indust. countries	Cent. govt	98.3	98.8	99.4	99.5	99.0	0.6	0.5	0.1
	Local govt	40.5	42.0	46.4	43.7	43.0	3.8	10.3	-5.7
Devel. countries	Cent. govt	96.8	98.2	97.9		97.4	1.4	-0.3	
	Local govt.	54.0	67.2	68.2		65.5	24.6	1.4	
Total average	Cent. govt	97.5	98.5	98.7		98.2	1.0	0.1	
	Local govt.	47.2	54.6	57.3		54.3	15.7	4.9	
CURRENT REVENUE									
Australia	Cent. govt.	99.8	99.7	99.6	99.8	99.7	-0.1	-0.2	0.2
	State, prov. govt.	41.8	42.7	46.4	53.1	46.0	2.2	8.7	14.5
	Local govt	70.4	70.6	70.4	73.6	71.2	0.2	-0.3	4.5
	Local state govt.	45.3	46.8	51.2	56.5	49.3	3.4	9.4	10.4
Chile	Cent. govt.	92.3	96.2	97.4	94.2	95.0	4.2	1.2	-3.2
	Local govt.	54.3	78.5	66.1		66.3	44.6	-15.1	
Colombia	Cent. govt.	97.0	99.9	98.7		98.5	3.0	-1.1	
	State, prov. govt.	49.2	41.8	38.3		43.1	-15.0	-8.4	
	Local govt.	60.0	59.6	57.1		58.9	-0.7	-4.1	
	Local state govt.	51.9	46.0	43.1		48.2	-11.4	-6.3	
Denmark	Cent. govt	93.1	96.1	98.1	97.8	96.3	3.2	2.1	-0.3
	Local govt.	47.7	48.1	55.2	55.4	51.6	1.0	14.7	0.4
Thailand	Cent. govt.	98.0	97.6	97.4	98.6	97.9	-0.4	-0.2	1.2
	Local govt.	27.6	47.8	63.4	71.3	52.5	73.4	32.5	12.4
Kenya	Cent. govt.	97.0	97.5	95.3	89.6	94.8	0.5	-2.2	-6.0
	Local govt.	56.8	94.5	78.7	99.9	82.5	66.4	-16.7	26.9
Netherlands	Cent. govt.	99.5	99.5	99.3	99.8	99.5	0.0	-0.1	0.5
	Local, prov. govt.	13.4	15.9	21.4	24.2	18.7	18.2	34.7	13.3
United Kingdom	Cent. govt.	96.3	99.5	100.5	99.0	98.8	3.3	1.0	-1.5
	Local govt.	50.3	49.5	47.9	26.8	43.6	-1.6	-3.2	-44.0
Indust. countries	Cent. govt.	97.2	98.7	99.4	99.1	98.6	1.6	0.7	-0.3
	Local govt.	39.2	40.1	43.9	40.8	40.8	2.3	9.6	-7.2
Devel. countries	Cent. govt.	96.1	97.8	97.2		96.6	1.8	-0.6	
	Local govt.	47.6	66.7	62.8		62.4	40.0	-5.8	
Total average	Cent. govt	96.6	98.2	98.3		97.6	1.7	0.0	
	Local govt.	43.4	53.4	53.4		51.6	23.0	0.0	

Table 2.3 Revenue Composition (continued)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
TAX									
Australia	Cent. govt.	89.6	89.9	89.2	89.6	89.6	0.3	-0.7	0.5
	State, prov. govt	29.3	28.8	30.0	32.2	30.1	-1.8	4.5	7.3
	Local govt.	53.4	47.0	40.5	42.2	45.8	-12.0	-13.8	4.1
	Local state govt.	32.3	31.1	31.5	33.6	32.0	-3.5	1.3	6.6
Chile	Cent. govt.	71.5	77.1	77.0	81.6	76.8	7.8	-0.2	6.0
	Local govt.	37.5	36.2	32.5		35.4	-3.5	-10.1	
Colombia	Cent. govt	90.2	82.9	88.1		87.1	-8.0	6.2	
	State, prov. govt	42.3	32.6	32.2		35.7	-23.0	-1.2	
	Local govt.	48.9	47.4	46.7		47.7	-3.1	-1.4	
	Local state govt.	44.0	36.1	35.9		39.7	-17.9	-0.6	
Denmark	Cent. govt	84.7	83.9	85.3	82.8	84.2	-0.9	1.7	-2.9
	Local govt.	39.8	40.1	46.7	46.8	43.4	1.0	16.3	0.3
Thailand	Cent. govt.	88.9	88.5	88.1	89.9	88.8	-0.5	-0.5	2.0
	Local govt.	22.5	39.7	53.1	60.9	44.1	76.3	33.9	14.5
Kenya	Cent. govt	85.0	86.8	85.0	80.3	84.3	2.1	-2.1	-5.5
	Local govt.	33.2	43.5	44.8	32.2	38.4	31.1	2.9	-28.1
Netherlands	Cent. govt	90.4	86.9	87.8	91.3	89.1	-4.0	1.1	4.0
	Local, prov. govt	1.9	3.2	7.8	8.7	5.4	67.3	142.4	11.7
United Kingdom	Cent. govt.	87.2	86.9	89.0	90.4	88.4	-0.4	2.4	1.6
	Local govt	26.6	30.2	32.5	13.1	25.6	13.3	7.8	-59.7
Indust. countries	Cent. govt	88.0	86.9	87.8	88.5	87.8	-1.3	1.1	0.8
	Local govt	25.1	26.2	29.6	25.5	26.6	4.1	13.2	-13.7
Devel. countries	Cent. govt.	83.9	83.8	84.5		84.2	-0.1	0.8	
	Local govt.	34.3	38.9	41.6		39.4	13.4	7.0	
Total average	Cent. govt.	85.9	85.4	86.2		86.0	-0.7	1.0	
	Local govt	29.7	32.5	35.6		33.0	9.4	9.5	
NON-TAX									
Australia	Cent. govt.	10.2	9.9	10.4	10.2	10.2	-3.3	5.2	-1.7
	State, prov. govt.	12.5	14.0	16.4	20.9	15.9	11.5	17.5	27.6
	Local govt.	17.0	23.6	29.9	31.4	25.5	38.9	26.8	5.1
	Local state govt.	13.1	15.3	18.3	22.4	16.7	16.9	20.0	22.2
Chile	Cent. govt.	20.8	19.1	20.4	12.6	18.2	-8.2	6.8	-38.1
	Local govt.	16.8	42.3	34.1		31.1	151.9	-19.4	
Colombia	Cent. govt.	6.8	16.9	10.6		11.4	150.0	-37.1	
	State, prov. govt.	6.8	9.2	6.1		7.4	34.7	-34.2	
	Local govt.	11.1	12.2	10.4		11.2	9.7	-14.4	
	Local state govt.	7.9	9.9	7.2		8.6	24.9	-27.4	
Denmark	Cent. govt.	8.5	12.2	12.8	14.9	12.1	44.7	4.8	16.6
	Local govt.	7.9	8.0	8.5	8.6	8.3	1.1	6.7	0.9
Thailand	Cent. govt.	9.1	9.1	9.3	8.7	9.0	0.3	2.4	-6.6
	Local govt.	5.1	8.1	10.3	10.4	8.5	60.4	25.9	1.3
Kenya	Cent. govt.	12.0	10.6	10.3	9.3	10.6	-11.2	-3.3	-9.4
	Local govt.	47.2	51.0	53.6	67.7	54.9	8.0	5.2	26.2
Netherlands	Cent. govt.	9.1	12.6	11.5	8.6	10.4	39.3	-8.5	-25.9
	Local, prov. govt.	11.5	12.7	13.6	15.6	13.4	10.1	7.5	14.2
United Kingdom	Cent. govt.	9.1	12.6	11.5	8.6	10.5	39.3	-8.5	-25.1
	Local govt.	23.7	19.3	15.4	13.7	18.0	-18.3	-20.2	-11.0
Indust. countries	Cent. govt.	9.2	11.8	11.6	10.6	10.8	28.7	-2.2	-8.5
	Local govt.	14.0	13.8	14.0	15.1	14.1	-1.6	1.1	7.8
Devel. countries	Cent. govt.	12.2	13.9	12.7		12.3	14.7	-9.1	
	Local govt	19.3	27.8	26.3		25.8	44.6	-5.5	
Total average	Cent. govt.	10.7	12.9	12.1		11.6	20.7	-8.0	

Table 2.3 Revenue Composition (continued)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
CAPITAL REVENUE									
Australia	Cent govt	0.2	0.3	0.4	0.2	0.3	27.3	57.8	-53.1
	State. prov. govt	0.7	0.9	1.6	2.1	1.3	19.4	86.6	25.7
	Local govt.	6.8	6.8	9.2	8.3	7.8	-1.0	36.5	-10.2
	Local state govt.	1.5	1.7	2.7	2.9	33.6	12.3	62.5	7.5
Chile	Cent govt	2.7	1.7	0.9	0.6	1.5	-37.3	-46.3	-28.6
	Local govt.	0.5	1.2	0.9		0.9	128.0	-29.4	
Colombia	Cent govt	0.0	0.0	0.3		0.1	-0.5	591.2	
	State. prov. govt	0.3	0.1	0.0		0.1	-66.1	-79.2	
	Local govt.	0.7	1.3	0.2		0.7	72.0	-85.6	
	Local state govt.	0.4	0.4	0.1		0.3	-7.9	-83.7	
Denmark	Cent govt.	0.5	0.6	0.4	0.9	0.6	23.7	-36.1	122.1
	Local govt.	2.5	1.3	1.6	1.3	1.7	-46.2	17.5	-14.2
Thailand	Cent govt.	0.3	0.0	0.0	0.4	0.2	-96.5	3.0	4636.6
	Local govt	0.0	0.0	0.0	0.0	0.0			
Kenya	Cent govt.	0.0	0.0	0.0	0.0	0.0	314.0	-48.7	-17.5
	Local govt	0.0	0.4	0.3	0.1	0.2		-27.9	-71.8
Netherlands	Cent govt	0.1	0.1	0.1	0.1	0.1	-46.2	74.0	-35.4
	Local, prov. govt.	0.3	0.4	0.4	3.4	1.1	16.5	0.5	797.9
United Kingdom	Cent govt	0.2	0.3	0.4	0.2	0.3	68.5	19.0	-42.4
	Local govt	1.1	4.9	6.5	4.7	4.3	358.8	34.4	-27.5
Indust countries	Cent govt.	0.3	0.3	0.3	0.4	0.3	23.3	3.7	3.8
	Local govt	1.3	2.1	2.8	3.1	2.3	54.1	35.8	11.1
Devel countries	Cent govt.	0.7	0.4	0.3		0.4	-40.7	-32.1	
	Local govt	0.2	0.5	0.3		0.4	113.8	-39.3	
Total average	Cent govt	0.5	0.4	0.3		0.4	-23.5	-16.6	
	Local govt	0.8	1.3	1.6		5.3	63.1	21.0	
GRANTS & TRANSFERS									
Australia	Cent govt.	0.0	0.0	0.0	0.0	0.0			
	State. prov. govt	57.5	56.4	51.9	44.8	52.7	-1.8	-7.9	-13.7
	Local govt	22.8	22.7	20.4	18.1	21.0	-0.5	-10.1	-11.1
	Local state govt.	53.2	51.9	47.5	41.1	49.2	-2.4	-8.6	-13.4
Chile	Cent govt.	5.1	2.1	0.0	0.0	1.8	-57.7	-100.0	137.0
	Local govt.	45.1	20.2	32.5		32.6	-55.2	60.6	
Colombia	Cent govt	3.0	0.1	1.0		1.4	-96.3	822.4	
	State. prov. govt	50.5	58.1	61.7		56.8	15.0	6.2	
	Local govt.	39.3	39.2	42.7		40.4	-0.3	8.9	
	Local state govt.	47.7	53.6	56.9		51.4	12.4	6.0	
Denmark	Cent. govt.	6.4	3.2	1.5	1.3	3.1	-49.2	-54.2	-11.0
	Local govt.	49.9	50.5	43.2	43.2	46.7	1.3	-14.5	0.0
Thailand	Cent. govt.	1.7	2.4	2.6	1.0	1.9	38.4	7.3	-61.8
	Local govt.	72.4	52.2	36.6	28.7	47.5	-28.0	-29.8	-21.5
Kenya	Cent. govt	3.0	2.5	4.7	10.4	5.1	-16.0	87.5	121.3
	Local govt	18.9	5.0	1.3	0.0	6.3	-73.5	-74.8	
Netherlands	Cent. govt.	0.4	0.4	0.5	0.1	0.3	24.4	16.4	-84.5
	Local, prov. govt.	86.2	83.7	78.2	72.3	80.1	-2.9	-6.6	-7.5
United Kingdom	Cent. govt.	0.2	0.9	0.5	0.8	0.6	429.4	-45.9	52.4
	Local govt.	48.7	45.7	45.6	68.5	52.1	-6.2	-0.2	50.3
Indust. countries	Cent. govt.	1.7	1.2	0.6	0.5	1.0	-33.2	-45.7	-13.2
	Local govt.	59.5	58.0	53.6	56.3	57.0	-2.6	-7.5	5.0
Devel countries	Cent. govt.	3.2	1.8	2.1		2.6	-44.0	15.9	
	Local govt.	46.0	32.8	31.8		34.5	-28.8	-2.9	
Total average	Cent. govt	2.5	1.5	1.3		1.8	-40.2	-6.2	

Table 2.3 Revenue Composition (continued)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
OVERALL DEFICIT									
Australia	Cent. govt	-14.9	-7.4	-2.8	0.4	-6.2	-50.6	-62.5	-115.3
	State, prov govt	-7.9	-4.6	-4.2	-5.0	-5.4	-41.8	-7.3	17.7
	Local govt	-7.7	-4.5	1.0	0.5	-2.7	-41.0	-122.6	-51.6
	Local state govt	-7.8	-4.5	-3.5	-4.2	-5.1	-42.1	-23.0	21.4
Chile	Cent govt	3.0	0.1	-0.4	7.3	2.5	-95.0	-396.3	-1744.3
	Local govt	2.1	-12.1	0.1		-3.3	-678.7	-101.1	
Colombia	Cent govt	-3.6	-31.7	-11.8		-15.7	771.5	-62.3	
	State, prov. govt	0.0	6.5	-3.3		1.1	-36831.0	-150.4	
	Local govt	0.0	-6.0	7.2		0.4	11927.6	-219.6	
	Local state govt	0.1	3.8	0.0		1.5	4605.9	-100.3	
Denmark	Cent govt	-2.5	-14.8	5.2	-3.4	-3.9	501.9	-135.4	-165.9
	Local govt	-0.3	0.6	-0.9	-1.3	-0.5	-306.1	-255.3	44.3
Thailand	Cent govt	-25.7	-29.1	-10.7	19.0	-11.6	13.1	-63.3	-277.8
	Local govt	2.7	3.8	7.2	6.4	5.0	40.8	89.8	-11.3
Kenya	Cent govt	-23.6	-26.1	-25.2	-11.0	-21.5	10.9	-3.7	-56.4
	Local govt	3.4	-2.9	-2.1	1.4	0.0	-184.3	-27.6	-169.6
Netherlands	Cent govt	-6.6	-13.2	-7.6	-6.1	-8.4	99.7	-42.4	-19.6
	Local, prov. govt	-5.4	-4.9	-10.2	-0.7	-5.3	-8.5	106.5	-93.3
United Kingdom	Cent govt	-16.2	-11.1	-1.5	-4.8	-8.4	-31.5	-86.7	228.6
	Local govt	-9.9	-3.0	-1.3	0.1	-3.5	-69.4	-57.7	-110.0
Indust countries	Cent. govt	-10.0	-11.6	-1.6	-3.5	-6.7	15.5	-85.8	111.8
	Local govt	-5.9	-3.0	-4.0	-1.5	-3.6	-49.1	33.2	-61.5
Devel countries	Cent. govt	-12.5	-21.7	-12.1		-11.6	73.7	-44.4	
	Local govt	2.1	-1.8	1.3		0.8	-188.5	-171.8	
Total average	Cent govt	-11.3	-16.6	-6.8		-9.1	47.8	-58.8	

2.4.2.1 The poor capacity of LGs to rely on their own tax-base

In general, LGs have a restricted capacity to rely on their own resources (taxes are on average only 33 per cent of all local revenues) because they have limited tax possibilities. This is the direct consequence of the CGs' tendency to reserve for themselves the most buoyant and lucrative tax revenues.

The above proposition can be demonstrated by simply looking at the tax responsibilities of CG and LGs.[10] From Table 2.4. we see that LGs rely mainly on: (1) property taxes, (2) domestic taxes on goods and services and, (3) other taxes like the ones on vehicles, entertainment, and licenses.[11] On the contrary, the CG tax responsibilities include the most lucrative sources as: (1) taxes on personal income, profits and capital gains, (2) domestic taxes on goods and services (including value added tax) and, (3) taxes on international transactions and trade.

Once again the analysis dividing the sample between developing and industrialized countries allows us to see that LGs in advanced countries are, in general, less dependent on property taxes than their counterparts in the Third World. The reason is that they have additional tax responsibilities like the income taxes in Denmark or the poll taxes in the United Kingdom.

From a theoretical point of view the distribution of tax responsibilities between the different layers of government can be explained using the 'principles of good taxation'. According to these principles: (1) since mobility places limits on variations between the taxation policies of different LGs, taxes that are highly mobile -

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[10] For Colombia and Australia, both with three layers of government, the information refers to the lowest level of government.

[11] It is interesting that in Kenya and Denmark LGs have access to income taxes while in Colombia LGs receive 10% of their revenues from 'Social Security'.

Table 2.4 Sources of Tax Revenues for Central and Local Governments

	Income Tax	Social Security	Tax on Wages	Tax on Property	Domestic Taxes on GGs & SSs	International Trade Taxes	Other Taxes	Total
Australia								
Central	72.1		1.6		22.3	3.9		100.0
Local				100.0				100.0
Chile								
Central	28.4	7.3		0.5	45.3	12.0	6.5	100.0
Local				56.0	44.0			100.0
Colombia								
Central	25.1	12.1	4.8	0.3	32.1	22.2	3.4	100.0
Local		10.0		40.1			49.9	100.0
Denmark								
Central	45.0	4.6	1.6	2.5	45.5	0.1	0.8	100.0
Local	92.1			7.8			0.1	100.0
Kenya								
Central	92.1			7.8			0.1	100.0
Local	30.7			51.0	17.3		1.0	100.0
Netherlands								
Central	33.5	40.1		2.5	22.9		1.0	100.0
Local				38.8	4.1		57.1	100.0
United Kingdom								
Central	38.6	17.9		8.4	35.1	0.1		100.0
Local				1.1			98.9	100.0
Thailand								
Central	31.0	1.3		2.6	44.2	20.2	0.8	100.0
Local				16.5			83.5	100.0

Source: Own elaboration based on IMF Government Finance Statistics.

like corporate and personal income taxes- are more appropriately taxed by a higher level of government; (2) tax bases which are unevenly distributed between localities -such as those on international trade- are inappropriate candidates for decentralization, because of their negative repercussions on equity, (3) taxes that are calculated using local data systems should be decentralized (e.g. property taxes) and, (4) taxes should be paid at the level in which they are more correlated with their benefits (as in the case of licenses paid to the local government) (UNDP 1993).

2.4.2.2 Lack of dynamism of local taxes

Another characteristics of LGs is that they rely on taxes that do not change with the economic activity and prices. In other words, local taxes are neutral or anti-cyclical in relation to the fluctuations of prices and income.

In order to demonstrate this proposition we can use a correlation analysis that should give us the following results:

(1) $\rho(\Delta CT, \Delta Y) > \rho(\Delta LT, \Delta Y) > \rho(\Delta LPT, \Delta Y)$

(2) $\rho(\Delta CT, \Delta P) > \rho(\Delta LT, \Delta P) > \rho(\Delta LPT, \Delta P)$

where:

ρ	:	Linear correlation
ΔCT	:	Percentage change of central government tax revenue
ΔLT	:	Percentage change of local government tax revenue
ΔLPT	:	Percentage change of local government property tax
ΔY	:	Percentage change of the Gross Domestic Product (GDP)
ΔP	:	Percentage change of the Consumer Price Index (CPI)

From (1) we expect to show that CG taxes are more correlated with the general economic activity (in this case GDP) than local taxes and, that local taxes should have a higher correlation coefficient than property taxes.

Proposition (2) is intended to demonstrate the same as (1) but using the rate of inflation instead of the percentage change of GDP.

Table 2.5 shows the results of the calculations. The data is in line with our expectations since, in general, local taxes (especially property taxes) do not always change with economic activity and prices.

Additionally, the results show that LGs in industrialized countries have a higher capacity than developing ones to adjust their taxes (including property tax) to the economic fluctuations of prices and GDP.[12] The factor that explain this last issue seems to be associated with the higher institutional capacity of their LGs.

As expected the differences between countries are also important (Table 2.5). The factors that account for these differences are: (1) that some countries have a system of property tax valuation that is less sensitive to economic and prices fluctuations than others; (2) that the indexation procedures to adjust local taxes are not always based on enough information and, therefore, they can underestimate the actual economic fluctuations (as in the case of inflation) and; (3) that local political influences can play an important role to delay or avoid revaluation of the tax-base. For example, in Colombia, although important changes were made to reevaluate property taxes on the basis of the price index, political factors were important to keep the rate of indexation below the rate of inflation (UNDP 1993).

2.4.3   Central transfers and financial autonomy

It follows from our discussion in section 2.4.2.1 that, as a consequence of the limited capacity of LGs to rely on their own tax-base, intergovernmental transfers play a critical role in local finance. Here we are going to examine the contribution of these transfers to the total local government revenues and, their tendencies during the last twenty years.

2.4.3.1 Contribution of central transfers to local government revenues

The available data about the contribution of the central transfers to local government revenues shows that, on the average, grants stands for a very important part of local inflows (Table 2.3). In fact, CG transfers account for about 60 per cent and 35 per cent of LG revenues in industrialized and developing countries respectively. Additionally, if we recall that advanced countries tend to have a higher degree of decentralization than developing ones, we could deduce that the proportion of grants over the total revenue tends to be higher in decentralized countries than in more centralized ones. The main reason for this situation is that decentralization usually implies additional expenditure responsibilities for LGs but not always a redistribution of revenue responsibilities (we already discussed this issue).

Of course, all generalizations must be taken with caution because there is a wide range of national experiences. For example, in developing countries the contribution of grants to the local revenue is: 32.6 per cent in Chile, 51.4 per cent in Colombia, 47.5 per cent in Thailand and 6.3 per cent in Kenya. On the other hand, in industrialized countries LGs show the following levels of financial dependency from central grants: 80.1 per cent in The Netherlands, 52.1 per cent in United Kingdom, 46.7 per cent in Denmark and, 49.2 per cent in Australia.

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[12] Chile is the only country in the second group with very high correlation coefficients. This shows the relatively high efficacy of its property tax revaluation system.

Table 2.5 Local Taxes and Economic Fluctuations: Correlation Coefficients

	CT,Y	LT,Y	LPT,Y	CT,P	LT,P	LPT,P	CT~,Y~	LT~,Y~	LPT~,Y~	CT~,P~	LT~,P~	LPT~,P~
Australia	0.996	0.996	0.996	0.995	0.993	0.993	0.678	0.209	0.209	0.796	0.709	0.709
Chile	0.996	0.994	0.983	0.965	0.905	0.962	0.984	0.895	n.a.	0.925	0.905	n.a.
Colombia	0.996	0.990	0.985	0.988	0.994	0.996	0.442	-0.137	-0.111	-0.023	0.025	0.044
Denmark	0.995	0.996	0.938	0.986	0.988	0.916	0.847	0.895	-0.113	0.567	0.700	-0.133
Thailand	0.996	0.996	0.949	0.905	0.905	0.936	0.778	0.895	0.143	0.427	0.237	0.143
Kenya	0.997	0.960	0.957	0.984	0.927	0.905	-0.142	0.406	0.119	0.055	0.177	-0.009
Netherlands	0.996	0.939	0.985	0.984	0.884	0.978	0.631	-0.284	0.002	0.563	-0.176	0.746
United Kingdom	0.996	0.621	0.138	0.993	0.603	0.124	0.595	0.666	0.264	0.623	0.279	0.264
Industrial countries	0.996	0.888	0.764	0.984	0.867	0.753	0.688	0.322	0.066	0.887	0.378	0.397
Developing countries	0.997	0.985	0.968	0.956	0.933	0.950	0.516	0.465	0.036	0.356	0.336	0.045
Total	0.996	0.937	0.866	0.970	0.900	0.851	0.602	0.393	0.062	0.522	0.357	0.221

Where: CT: Central government taxes
LT: Local government taxes
LPT: Local and provincial taxes
Y: Income
P: Prices
~: Percentual variation

Source: Own elaboration based on IMF Government Finance Statistics.

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2.4.3.2 Trend over the last twenty years

On average, there is a tendency to reduce the local government dependency on central grants both in industrialized and in developing countries (Table 2.3). However, if we refer to the disaggregated data we can see the variety of national experiences. For example, among industrialized countries Australia, Denmark and The Netherlands are reducing their financial dependency on central grants, while the United Kingdom shows the opposite tendency (specially during the period 1985–94). On the other hand, within developing countries the differences are also evident: in Colombia LGs are continuously increasing their dependency on the CG; Chile has a tendency to downsize the importance of grants on LG revenues; Thailand shows a reduction of the contribution of grants to its LGs and; finally, in Kenya local authorities are practically financially independent of their CG.

Of course, in each case the implications for LGs are totally different. Countries with low degrees of financial autonomy show a greater involvement of central authorities in the establishment of standards and norms for service delivery and, therefore, they usually show a weak linkage between local government decisions and people's needs. As Rondinelli says (cited by UNDP 1993: 33) the lack of financial autonomy in these countries 'reduces the burden, but increases the dependence of local authorities, who generally neither impose taxes nor have to justify to local population how money is spent'.

Additionally, countries where central grants are an important component of local revenues can achieve several objectives as: (1) the reduction of vertical and horizontal fiscal imbalances; (2) reductions in differences in fiscal capacity between LGs resulting from different resource endowments and economic structures; (3) ensuring a similar pattern in the provision of services in each locality and; (4) internalizing externalities (compensation principle).

On the other hand, countries with a relatively high degree of local financial autonomy show a greater independence in decision-making, can be more sensitive to both costs and local priorities but, their equity considerations are some how less important.

2.5 Decentralization of Expenditures

This section has the purpose to answer to the following questions: how LGs expenditures are composed?; what is the degree of decentralization of social expenditures?; and, if the social allocation ratio is higher at local level than at the central one.

2.5.1 Expenditures by economic type: An overview

Current expenditures account for about 80 per cent to 85 per cent of all local spendings both in developing and in industrialized countries. However, if we disaggregate this account into its main components the sample shows the following differences (Table 2.6):

(1) That LGs in developing countries spend more on goods and services than industrialized ones (67.5 per cent against 56.2 per cent respectively). The explanation for this difference has to do with the relative importance of 'wages and salaries' over the total spendings. In fact, Colombia spends 53.6 per cent of all the local budget on wages and Kenya 51.3 per cent, while the same item accounts for 35.3 per cent in The Netherlands, 37.9 per cent in Denmark and 44.1 per cent in the United Kingdom.[13]

(2) There are two components of current expenditures that, on average, are more important in industrialized than in developing countries: interest rates and subsidies. The high proportion of subsidies over the local budget is the result of a relatively well developed welfare state, while the importance of interest rates shows that LGs in industrialized countries have an easier access to the banking system and have less legal limitations to borrow than their counterparts in less developed countries.

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[13] Chile is an exception between developing countries because its local governments spend only 36.8% of their budget on salaries and wages.

Table 2.6 Expenditures Composition (percentage of total expenditures + lendings – repayments)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
TOTAL EXPENDITURES									
Australia	Cent. govt	92.4	97.6	99.5	101.6	100.0	5.6	2.0	2.1
	State, prov. govt	95.7	98.1	98.2	99.5	46.5	2.5	0.1	1.4
	Local govt	99.6	99.9	100.2	100.1	78.7	0.4	0.2	0.0
	Local state govt.	96.2	98.4	98.4	99.6	98.0	2.3	0.1	1.2
Chile	Cent. govt.	98.0	102.3	102.8	100.9	101.0	4.4	0.5	-1.8
	Local govt.	100.0	99.5	99.9		99.8	-0.5	0.4	
Colombia	Cent. govt	99.0	97.7	97.5		98.2	-1.4	-0.2	
	State, prov. govt.	100.0	99.9	99.5		99.9	0.0	-0.5	
	Local govt	100.2	100.3	99.9		100.2	0.1	-0.4	
	Local state govt.	100.0	100.0	99.7		99.9	0.0	-0.4	
Denmark	Cent. govt	98.9	99.1	99.5	99.3	98.2	0.1	0.5	-0.2
	Local govt.	99.8	99.9	99.9	100.0	99.9	0.1	0.1	0.1
Thailand	Cent. govt	98.2	99.1	97.6	99.0	98.5	0.9	-1.5	1.5
	Local govt	100.0	100.0	100.0	100.0	100.0	0.0	0.0	0.0
Kenya	Cent govt	91.0	95.0	98.1	98.4	95.4	4.4	3.2	0.3
	Local govt.	100.0	100.0	96.8	92.2	97.4	0.0	-3.2	-4.7
Netherlands	Cent govt.	97.6	97.7	102.0	100.8	99.5	0.1	4.4	-1.1
	Local, prov. govt	103.0	100.4	93.7	100.4	99.3	-2.5	-6.7	7.2
United Kingdom	Cent govt	94.8	97.3	99.2	104.0	98.2	2.6	1.9	4.9
	Local govt.	99.1	99.5	100.7	100.5	99.8	0.4	1.2	-0.2
Indust. countries	Cent. govt.	95.9	97.9	100.1	101.5	99.2	2.0	2.2	1.4
	Local govt.	99.5	99.5	98.2	100.1	99.3	0.0	-1.4	2.0
Devel. countries	Cent govt	96.6	98.5	99.0		98.3	2.0	0.5	
	Local govt.	100.0	99.9	99.1		99.3	-0.1	-0.8	
Total average	Cent. govt.	96.3	98.2	99.5		98.7	2.0	1.3	
	Local govt	99.8	99.7	98.6		99.3	-0.1	-1.1	
CURRENT EXPENDITURES									
Australia	Cent. govt	83.4	91.2	93.2	95.7	90.4	9.4	2.2	2.7
	State, prov. govt	75.3	83.2	83.7	86.0	81.6	10.5	0.6	2.7
	Local govt.	50.3	63.3	69.3	72.5	62.9	25.6	9.6	4.7
	Local state govt.	72.2	80.6	81.8	84.2	79.2	11.6	1.4	3.0
Chile	Cent. govt.	84.1	94.0	90.6	87.9	89.2	11.7	-3.6	-3.0
	Local govt	92.9	82.4	81.6		85.9	-11.4	-1.0	
Colombia	Cent. govt	65.2	78.3	80.0		73.4	20.1	2.2	
	State, prov. govt	86.2	86.8	89.8		87.0	0.8	3.5	
	Local govt.	81.3	69.1	81.5		76.6	-14.9	17.9	
	Local state govt.	84.8	82.2	87.1		84.3	-3.1	6.0	
Denmark	Cent. govt.	93.4	93.8	95.8	95.8	94.6	0.5	2.1	0.0
	Local govt.	88.5	92.7	93.7	94.8	92.7	4.7	1.1	1.2
Thailand	Cent. govt.	74.4	77.9	81.3	77.2	77.8	4.7	4.5	-5.0
	Local govt.	69.3	63.4	62.3	54.4	62.8	-8.6	-1.6	-12.7
Kenya	Cent. govt.	70.7	78.2	82.8	82.3	78.2	10.6	5.9	-0.6
	Local govt.	88.0	93.8	91.0	84.1	89.3	6.5	-2.9	-7.5
Netherlands	Cent. govt.	90.6	89.6	94.0	96.1	92.4	-1.2	4.9	2.2
	Local, prov. govt	88.0	88.6	82.9	85.2	86.2	0.6	-6.4	2.8
United Kingdom	Cent. govt.	89.5	92.9	94.0	95.5	92.7	3.8	1.2	1.6
	Local govt.	80.2	84.7	86.0	86.7	84.2	5.7	1.5	0.8
Indust. countries	Cent. govt.	89.2	91.9	94.2	95.8	92.5	3.0	2.6	1.6
	Local govt.	82.2	86.7	86.1	87.7	85.6	5.4	-0.7	1.9
Devel. countries	Cent. govt.	73.6	82.1	83.7		79.6	11.5	1.9	
	Local govt.	83.8	80.4	80.5		80.6	-4.0	0.1	
Total average	Cent. govt	81.4	87.0	89.0		86.1	6.8	2.3	
	Local govt.	83.0	83.5	83.3		83.1	0.6	-0.3	

Table 2.6 Expenditures Composition (percentage of total expenditures + lendings – repayments) (continued)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
EXPENDITURES ON GOODS & SERVICES									
Australia	Cent. govt	20.8	21.5	22.0	24.1	21.9	3.3	2.5	9.7
	State. prov. govt	58.0	62.8	61.1	61.9	60.8	8.2	-2.6	1.2
	Local govt.	42.0	53.8	60.7	64.5	54.2	27.9	12.9	6.2
	Local state govt.	56.1	61.6	61.1	62.2	60.0	9.9	-0.9	1.9
Chile	Cent. govt	40.5	34.7	28.8	28.4	33.4	-14.3	-17.1	-1.5
	Local govt.	53.1	61.5	64.3		59.3	15.7	4.6	
Colombia	Cent. govt	38.9	30.4	26.5		29.4	-21.8	-12.9	
	State. prov. govt.	65.5	73.8	62.6		68.2	12.5	-15.1	
	Local govt.	67.9	58.8	55.5		62.5	-13.4	-5.6	
	Local state govt	66.1	69.8	66.5		66.7	5.7	-4.7	
Denmark	Cent. govt.	24.9	20.2	20.4	20.1	21.5	-19.1	1.2	-1.5
	Local govt	51.1	55.7	56.3	55.7	55.1	9.0	1.2	-1.1
Thailand	Cent. govt.	51.7	59.4	58.2	59.3	56.9	14.9	-2.1	1.9
	Local govt		58.3			58.3			
Kenya	Cent. govt.	51.2	53.3	50.6	49.2	51.1	4.0	-5.0	-2.7
	Local govt.	55.7	90.9	85.8	81.3	85.7	63.2	-5.7	-5.2
Netherlands	Cent. govt.	16.1	14.6	15.1	14.6	15.1	-9.5	3.6	-3.4
	Local, prov govt	52.2	45.8	40.5	44.7	45.9	-12.3	-11.5	10.3
United Kingdom	Cent. govt	29.7	30.5	30.4	31.2	30.4	2.7	-0.1	2.6
	Local govt.	60.9	64.2	65.3	66.6	64.0	5.4	1.7	2.0
Indust. countries	Cent. govt	22.9	21.7	22.0	22.5	22.2	-5.3	1.4	2.4
	Local govt	55.1	56.8	55.8	57.3	56.2	3.2	-1.8	2.7
Devel. countries	Cent. govt	45.6	44.5	41.0		42.7	-2.5	-7.8	
	Local govt.		70.1			67.5			
Total average	Cent. govt.	34.2	33.1	31.5		32.4	-3.4	-4.7	
	Local govt.		63.5			61.9			
WAGES & SALARIES & EMPLOYERS' CONT.									
Australia	Cent. govt.								
	State. prov. govt.								
	Local govt.								
	Local state govt								
Chile	Cent. govt	29.8	24.3	17.9	18.2	22.8	-18.6	-26.2	1.6
	Local govt.	30.0	39.1	42.5		36.8	30.1	8.8	
Colombia	Cent. govt	24.8	20.2	18.3		19.8	-18.3	-9.6	
	State. prov. govt	51.8	60.5	48.7		56.5	16.8	-19.5	
	Local govt.	54.3	44.2	44.2		45.4	-18.7	0.1	
	Local state govt	52.3	56.2	53.3		53.6	7.4	-5.1	
Denmark	Cent. govt.	16.6	12.7	12.5	11.7	13.5	-23.8	-1.4	-6.1
	Local govt.	34.5	38.2	39.0	38.6	37.9	10.7	2.1	-0.9
Thailand	Cent. govt.	22.6	27.9	30.5	33.5	28.1	23.5	9.4	9.7
	Local govt.								
Kenya	Cent. govt.	30.8	28.9	31.5	30.7	30.5	-6.1	9.1	-2.7
	Local govt.	48.1	56.4	48.8	49.5	51.3	17.2	-13.5	1.4
Netherlands	Cent. govt.	10.9	9.4	9.0	8.7	9.5	-13.9	-4.1	-3.6
	Local, prov. govt.	42.2	35.8	30.8	31.7	35.3	-15.2	-13.9	2.9
United Kingdom	Cent. govt.	13.9	12.9	12.8	12.5	13.1	-7.1	-1.4	-1.9
	Local govt.	41.2	45.0	46.1	43.9	44.1	9.1	2.4	-4.7
Indust. countries	Cent. govt.								
	Local govt.								
Devel. countries	Cent. govt.	27.0	25.3	24.6		25.3	-6.1	-3.0	
	Local govt.								
Total average	Cent. govt.								
	Local govt.								

Table 2.6 Expenditures Composition (percentage of total expenditures + lendings – repayments) (continued)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
OTHER PURCH OF GOODS & SERV									
Australia	Cent govt								
	State, prov govt								
	Local govt.								
	Local state govt.								
Chile	Cent govt	10 7	10.5	10.9	10.1	10.6	-2.4	3.8	-6.8
	Local govt.	23 1	22.4	21.8		22.5	-3.0	-2.7	
Colombia	Cent govt.	14.1	10.2	8.2		9.6	-27.9	-19.6	
	State, prov govt	13.5	13.2	13.4		13.3	-1.9	1.4	
	Local govt.	15.9	14.7	11.3		14.0	-7.6	-23.0	
	Local state govt	14.0	13.6	13.2		13.5	-2.8	-3.0	
Denmark	Cent govt	8 3	7.5	7.9	8.4	8.0	-9.7	5.5	5.8
	Local govt.	16.6	17.5	17.4	17.1	17.2	5.5	-0.9	-1.6
Thailand	Cent govt.	29.1	31.5	27.2	25.8	28.8	8.3	-13.8	-5.3
	Local govt.								
Kenya	Cent govt	20 5	24.4	19 1	18.6	20.6	19.1	-21.7	-2.8
	Local govt	35 5	34.5	36 9	31.8	34.4	-2.7	7.1	-14.0
Netherlands	Cent govt	5.2	5.2	6.1	5.9	5.6	-0.3	17.5	-3.2
	Local, prov. govt.	10.1	10.0	9.7	13.1	10.6	-0.3	-2.9	34.0
United Kingdom	Cent govt	15.7	17.5	17.7	18 7	17.3	11.3	0.8	5.9
	Local govt	19 7	19.2	19.2	22.7	19.9	-2.4	0.1	18.0
Indust countries	Cent govt								
	Local govt.								
Devel countries	Cent govt								
	Local govt								
Total average	Cent govt								
	Local govt								
INTEREST PAYMENTS									
Australia	Cent govt	5 5	6.9	9.3	6.5	7.1	25.4	34.6	-30 4
	State, prov govt.	7.4	7.7	8.8	11.1	8.5	3.4	14.7	25.2
	Local govt	6.7	7.7	7.2	7.2	7.2	14.0	-6.1	-0.5
	Local state govt.	7.4	7.7	8.6	10.5	8.3	4.5	12.0	22.4
Chile	Cent govt	7.2	2.9	7.8	8.2	6.4	-60.3	172.9	5.7
	Local govt.	0.0	0.0	0.0		0.0	6.8	-83.9	
Colombia	Cent govt	4.4	4.6	8.6		6.4	3.9	88.2	
	State, prov. govt.	0.9	0.9	1.5		1.0	5.8	70.5	
	Local govt.	1.6	1.7	2.2		1.7	4.6	32.6	
	Local state govt.	1.1	1.1	1.6		1.2	4.6	41.7	
Denmark	Cent govt	3.2	11.1	17.1	14.1	11.2	243.3	53.5	-17.5
	Local govt.	1.8	1.4	1.1	1.0	1.3	-19.6	-22.6	-6.5
Thailand	Cent govt.	7.0	10.5	15.6	8.6	10.5	50.0	47.7	-44.9
	Local govt.								
Kenya	Cent govt.	5.8	11.1	17.0	24.5	14.2	89.7	53.5	44.5
	Local govt								
Netherlands	Cent govt.	2.9	5.3	8.7	8.9	6.3	85.7	61.8	3.2
	Local, prov. govt.	13.8	14.5	12.5	11.9	13.2	5.2	-14.0	-4.7
United Kingdom	Cent govt.	8.9	10.1	10.2	7.3	9.3	13.3	1.5	-28.4
	Local govt.	13.2	11.1	8.8	7.2	10.4	-16.0	-20.3	-18.1
Indust. countries	Cent govt	7.3	7.5	7.9	8.2	7.7	3.3	4.8	4.1
	Local govt.	11.6	11.7	11.6	13.2	11.9	0.9	-0.9	14.0
Devel. countries	Cent govt.								
	Local govt.								
Total average	Cent govt.								
	Local govt								

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		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1980-94	Average	Rate of growth (2)-(1)	(3)-(2)	(4)-(3)
SUBSIDIES AND OTHER TRANSFERS									
Australia	Cent. govt.	57.1	62.8	61.9	65.1	61.4	10.0	-1.5	5.2
	State, prov. govt.	9.8	12.8	13.8	13.1	12.3	30.0	7.8	-4.9
	Local govt.	1.6	1.8	1.4	0.9	1.5	14.3	-22.7	-35.5
	Local state govt.	8.8	11.3	12.1	11.5	10.9	28.4	6.9	-5.0
Chile	Cent. govt.	36.4	56.4	54.0	51.3	49.4	54.8	-4.2	-5.1
	Local govt.	39.8	20.9	17.3		26.6	-47.5	-17.3	
Colombia	Cent. govt.	39.4	43.4	45.0		43.7	10.0	3.7	
	State, prov. govt.	19.8	12.2	26.1		17.8	-38.5	114.9	
	Local govt.	11.7	8.6	23.7		12.4	-26.6	176.1	
	Local state govt.	17.6	11.2	19.0		16.4	-36.4	69.3	
Denmark	Cent. govt	65.2	62.6	58.3	61.6	61.9	-4.1	-6.8	5.7
	Local govt.	35.7	35.6	36.2	38.0	36.4	-0.3	1.9	5.0
Thailand	Cent. govt.	14.9	7.8	7.7	8.3	9.8	-47.3	-1.6	7.6
	Local govt.		3.6			3.6			
Kenya	Cent. govt.	13.7	13.9	15.2	8.6	12.9	1.7	9.6	-43.6
	Local govt.	3.7	2.8	5.2	2.8	3.5	-24.5	84.9	-45.6
Netherlands	Cent. govt.	71.7	69.7	70.2	72.6	71.0	-2.8	0.8	3.3
	Local, prov. govt	22.0	28.3	29.9	28.6	27.1	28.5	5.6	-4.3
United Kingdom	Cent. govt	50.9	52.3	53.4	57.0	53.0	2.8	2.0	6.8
	Local govt.	6.1	9.5	11.9	12.9	9.8	54.8	25.4	8.2
Indust. countries	Cent. govt	5.1	8.4	11.3	9.2	8.5	62.9	35.2	-18.7
	Local govt.	9.0	8.7	7.8	7.7	8.3	-3.9	-10.6	-1.1
Devel. countries	Cent. govt		7.3			9.4			
	Local govt.		0.3			0.3			
Total average	Cent. govt		7.8			8.9			
	Local govt.		4.5			4.3			
CAPITAL EXPENDITURES									
Australia	Cent. govt	9.0	6.4	6.3	5.9	7.0	-29.5	-0.6	-6.8
	State, prov. govt.	20.4	14.9	14.5	13.5	16.1	-27.0	-2.9	-6.5
	Local govt.	49.2	36.7	30.8	27.6	37.0	-25.5	-15.9	-10.6
	Local state govt.	23.9	17.7	16.7	15.4	18.8	-25.9	-6.0	-7.8
Chile	Cent. govt	13.8	8.3	12.2	13.1	11.8	-39.8	47.5	6.9
	Local govt.	7.0	17.1	18.3		13.8	142.3	7.0	
Colombia	Cent. govt.	23.5	24.7	17.4		21.3	5.1	-29.5	
	State, prov. govt.	13.8	13.1	9.6		12.9	-4.8	-26.7	
	Local govt.	18.9	31.1	18.4		23.5	64.8	-41.0	
	Local state govt.	15.2	17.8	12.5		15.7	17.5	-29.7	
Denmark	Cent. govt	5.6	5.2	3.8	3.5	4.6	-8.2	-27.5	-6.6
	Local govt.	11.3	7.2	6.3	5.2	7.2	-36.4	-12.7	-16.3
Thailand	Cent. govt	23.9	21.2	16.3	21.6	20.6	-10.9	-23.4	32.8
	Local govt.	30.7	36.6	37.7	45.6	37.2	19.4	2.8	21.1
Kenya	Cent. govt	20.3	16.8	15.3	16.1	17.3	-17.0	-9.1	5.2
	Local govt	6.3	3.6	5.0	9.9	6.3	-42.4	38.3	96.6
Netherlands	Cent. govt.	6.9	8.1	8.1	4.8	7.1	16.7	-0.1	-40.6
	Local, prov. govt.	15.0	11.8	10.8	15.2	13.1	-21.1	-8.8	41.4
United Kingdom	Cent. govt.	5.4	4.4	5.1	8.5	5.6	-17.9	16.6	65.0
	Local govt.	18.9	14.7	14.7	13.8	15.7	-21.9	-0.4	-6.1
Indust. countries	Cent. govt	61.2	61.9	60.9	64.1	61.8	1.0	-1.5	5.1
	Local govt.	18.2	21.2	22.5	22.7	21.0	16.6	6.4	1.0
Devel. countries	Cent. govt	26.1	30.4	30.5		29.0	16.4	0.4	
	Local govt.	15.3	9.6	10.4		12.5	-37.0	7.6	
Total average	Cent. govt	43.7	46.1	45.7		45.4	5.6	-0.9	
	Local govt.	16.7	15.4	16.4		16.8	-7.9	6.8	

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
LENDING – REPAYMENTS									
Australia	Cent govt.	7.6	2.4	0.5	-1.6	2.6	-68.3	-81.2	-460.3
	State, prov. govt.	4.3	1.9	1.8	0.5	2.3	-56.4	-2.7	-74.0
	Local govt	0.4	0.1	-0.2	-0.1	0.1	-80.8	-290.3	-23.9
	Local state govt.	3.8	1.6	1.6	0.4	2.0	-57.2	-5.0	-74.1
Chile	Cent. govt	2.0	1.0	-2.8	-0.9	-1.0	-62.2	-388.7	-66.2
	Local govt	0.0	1.2	0.1		0.2	21803.1	-88.8	
Colombia	Cent. govt.	1.0	2.3	2.5		1.8	136.5	9.4	
	State, prov. govt.	0.0	0.1	0.5		0.1	16.4	868.0	
	Local govt	-0.2	-0.3	0.1		-0.2	63.4	-146.2	
	Local state govt	0.0	0.0	0.3		0.1	492.0	-1229.4	
Denmark	Cent. govt.	1.1	0.9	0.5	0.7	0.8	-10.1	-51.8	49.4
	Local govt	0.2	0.1	0.1	0.0	0.1	-28.1	-56.2	-147.8
Thailand	Cent. govt.	1.8	0.9	2.4	1.0	1.5	-49.1	168.9	-59.5
	Local govt								

Source: Own elaboration based on IMF Government Finance Statistics

(3) That LGs in industrialized countries spend more on capital items than developing ones. In fact, in developing countries, capital expenditure is about 12.5 per cent of the total while in industrialized ones this component accounts for about 21 per cent.

Once that we have an idea about the composition of the local expenditures by economic type it is important to identify what their recent trends are. The available data (Table 2.6) shows that:

(1) The proportion of current spendings in total local budget is increasing in most industrialized countries: in Australia this item was 72.2 per cent in the mid seventies and actually it accounts for 84.2 per cent of all spendings; in Denmark it increased from 88.5 per cent to 94.8 per cent in the same period and, in the United Kingdom it increased from 80.2 per cent to 86.7 per cent in two decades. The exception is The Netherlands where the proportion of current items on local expenditures is decreasing.

In developing countries we find the opposite tendency since LGs in Chile, Kenya and, Thailand made an effort to increase their capital spendings and, consequently to reduce the importance of their current accounts.[14] Unfortunately, there is not enough information to establish what items explain this increase, even though it remains a positive sign for local economic development.

(2) The proportion of expenditures on goods and services in the total local budget shows a relative stability in industrialized countries, particularly since the early eighties. The exception to this trend is once again The Netherlands where this component dropped from 52.5 per cent in the mid-seventies to 40.5 per cent in the late eighties and actually, it is growing again.

In developing countries there is no common trend: in Chile the importance of this account has been increasing since 1975; in Colombia the proportion of expenditures on goods and services shows a tendency to fluctuate between 65 per cent and 70 per cent, and, in Kenya since the early 80s there has been a consistent effort on the part of LGs to reduce the proportion of their spendings on goods and services.[15]

(3) The proportion of wages and salaries in total spendings does not show any common trend. In Chile and Denmark it is growing; in The Netherlands, United Kingdom and Kenya, after an increase in the mid-

[14] Once again we have an exception: Colombia. In this country both current and capital spending are much more fluctuating.

[15] There is not enough information to analyze the trends in Thailand.

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seventies, there is an evident effort of LGs to reduce their importance over total expenditures and, in Colombia it fluctuates around 54 per cent of all the aggregated local budget.

(4) The proportion of 'other purchases of goods and services' in the total local budget is decreasing in all countries except The Netherlands and the United Kingdom.

(5) In Denmark, The Netherlands and the United Kingdom the proportion of interest payments in the aggregated local budget shows a clear decreasing tendency, while the opposite is true for Australia and Colombia.

(6) In general, the importance of subsidies in the total local-budget does not show a common trend. The extreme case of subsidy reduction is Chile where it dropped from 39.8 per cent in the mid-seventies to only 17.3 per cent in the late eighties.[16] Countries with more recent experiences on local subsidies reduction are Australia, The Netherlands and Kenya.

Denmark, the United Kingdom and Colombia all show a tendency to increase the proportion of subsidies in their aggregated local budgets. Unfortunately, no information about the subsidized items is available at local level and, therefore, it is not possible to identify what the more dynamic ones are.

(7) The percentage of capital expenditures in the total local budget shows a decreasing tendency in the United Kingdom, Denmark and Australia.[17] The explanation for this situation is that in order to reduce fiscal imbalances it is more easy for LGs to delay a big project than to reduce the current expenditures (e.g. reduce the number of employees).

An opposite tendency can be found in Chile, Kenya and, Thailand where there is a significant effort of local authorities to increase the importance of their capital spendings. Obviously this is a good signal for their local economic development processes.[18]

2.5.2 Local government priorities

The task of this section is to identify what the priorities of LGs expenditures are. The emphasis will be put on social spendings since the interest is to establish: (1) what their degree of decentralization is and, (2) whether or not LGs spend more on areas of priority for human development than CGs.

.2.5.2.1 Definition of social decentralization ratios

The distribution of the local government expenditures will be analyzed through the following ratios (UNDP, 1993):

(1) The social expenditure decentralization ratio that is defined as the proportion of LGs' social spendigs in total government social spendings.

This ratio gives an indication of the extent to which social expenditures are decentralized. Since its value can change according to the definition of social spending, here we adopt two approaches: first, define social spending as composed by education, health, social security, housing and communal amenities (indicator A) and, second define social spending as to include only education and health (indicator B) (Steward, Ranis, 1994).

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[16] The reduction of subsidies was part of the economic reforms introduced by the chilean military regime that ruled Chile from 1973 to 1989.

[17] In the Netherlands local capital expenditures were reduced in the period 1975 to 1989 (15% to 10.8% of all local spending respectively). However, more recent information shows that, in the nineties, this item is regaining importance.

[18] In Colombia the trends of capital expeditures show that: this item grew till the mid eighties but it decreased afterwards.

(2)   <u>The central government social allocation ratio</u> that is defined as the percentage of the central government budget devoted to social expenditures (A').

(3)   <u>The local government social allocation ratio</u>. It is the percentage of Local Government budgets devoted to social items (B') (UNDP 1993).

Additionally, we estimated two sectoral decentralization ratios:

(4)   <u>The education decentralization ratio</u> that is defined as the proportion of general government expenditures on education spent by municipalities (Steward & Rains 1994) and,

(5)   <u>The health decentralization ratio</u> that is defined as the percentage of general government expenditures on health spent by LGs.

2.5.2.2   Social expenditure decentralization ratios

<u>Indicator A</u>
Social provision ultimately appears almost entirely at the local level in terms of clinics or schools or welfare services. So control over this could, in theory, be highly decentralized (UNDP 1993). In practice, this does not always happen since the social decentralization ratio is only 38.1 per cent in industrialized countries and, 15.3 per cent in developing ones. The reason for this situation has to do (with national differences) with the assignment of the most redistributive and equity responsibilities (of which social spending is an important component) to the CG and not to the local one.

The analysis of national data shows a wide range of experiences.[19] In developing countries Chile has the lowest social expenditure decentralization ratio (about 5 per cent), Colombia is around 33.3 per cent and, Kenya 8.1 per cent. However, while in Kenya the trend is towards an even higher centralization, in Colombia and Chile the situation is the opposite (Table 2.7).[20]

On the other hand: (1) in Australia, indicator A shows a slight decreasing tendency (it dropped from 41.4 per cent in the late seventies to 38.7 per cent in the early nineties); (2) in Denmark the expenditure decentralization ratio is similar to the social decentralization ratio (56.5 per cent and 56.36 per cent respectively); (3) The Netherlands has a social decentralization ratio of 24 per cent (lower than the average for industrialized countries) and, lower than its own expenditure decentralization ratio and, finally; (4) The United Kingdom has a social decentralization ratio that is slightly higher than its expenditure decentralization ratio.

From the above data it is possible to say that although LGs are supposed to be more efficient and effective in providing social services, in general social expenditures are still very centralized. It is only in Colombia, Kenya and the United Kingdom that the social decentralization ratio is higher than the general expenditure decentralization ratio.

<u>Indicator B</u>
Indicator B (Table 2.7). shows that in most countries LGs have more responsibilities in areas of high priority for human development (education and health) than in other social matters (as housing, social security and communal amenities). In fact, with the exception of Kenya and the Netherlands all national experiences show that education and health are an important local government concern.

For example, (1) in Australia the decentralization of expenditures on education and health is around 60 per cent against only 40 per cent for all social issues and, (2) in Denmark the relation is 68.4 per cent against 56.5 per cent.[21]

The same situation can be found in developing countries: (1) in Chile about 13 per cent of the general government expenditure on education and health is the responsibility of the local government against only 4.6

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[19]   Thailand was not included in this section due to the lack of information.

[20]   Unfortunately, in the case of Chile and Colombia the social decentralization ratio (A) can only be calculated for the period 1980-1989. It is realistic to expect that this indicator is rising under the Chilean democratic government.

[21]   This indicator can not be estimated for the United Kingdom due to the lack of information about health items.

Table 2.7 Social Expenditure Decentralization Ratios (percentage)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth (2)-(1)	(3)-(2)	(4)-(3)
SOCIAL DECENTRALIZATION RATIO (A)									
Australia		41.4	41.0	39.6	38.7	40.4	-1.0	-3.5	-2.4
Chile			4.4	4.8		4.6		9.1	
Colombia			32.9	33.9		33.3		3.1	
Denmark		56.6	55.5	57.4	56.7	56.5	-2.0	3.4	-1.2
Kenya		10.4	8.0	7.3	7.0	8.1	-22.6	-8.7	-4.2
Netherlands					24.0	24.0			
United Kingdom			32.9	31.7	30.6	31.7		-3.7	-3.5
Indust. countries					37.5	38.1			
Devel. countries			15.1	15.4		15.3		1.6	
SOCIAL DECENTRALIZATION RATIO (B)									
Australia		61.6	64.7	61.9	59.4	62.2	5.1	-4.4	-4.0
Chile			12.0	13.9		13.0		16.3	
Colombia			44.2	45.1		44.6		2.1	
Denmark		68.7	68.1	68.8	66.7	68.4	-0.9	1.1	-3.1
Kenya		7.3	6.1	3.6	3.6	5.1	-15.6	-41.0	0.2
Netherlands					18.2	18.2			
United Kingdom			51.0	48.5	44.6	48.1		-5.0	-8.0
Indust. countries					47.2	49.2			
Devel. countries			20.8	20.9		20.9		0.6	
SOCIAL ALLOCATION RATIO (A')									
Australia	Cent. govt.	47.7	45.4	46.2	51.4	47.3	-4.9	1.7	11.3
	State, prov. govt.	57.3	55.5	54.1	53.4	55.3	-3.2	-2.5	-1.4
	Local govt.	16.6	19.5	20.7	21.7	19.4	17.6	5.9	5.1
	Local, prov. state govt.	52.1	50.7	49.5	49.2	50.5	-2.8	-2.3	-0.6
	Cent. govt.	52.4	63.6	58.3	62.9	59.1	21.6	-8.3	7.8
	Local govt.		35.2	34.9		35.0		-0.9	
Colombia	Cent. govt.		47.7	52.6		49.7		10.3	
	State, prov. govt.	75.8	70.7	68.7		72.8	-6.7	-2.9	
	Local govt.	47.4	38.2	45.9		43.6	-19.2	20.0	
	Local, prov. state govt.	68.6	62.2	63.3		65.3	-9.3	1.7	
Denmark	Cent. govt.	56.6	52.9	49.8	51.5	52.9	-6.4	-5.9	3.4
	Local govt.	83.4	82.7	83.6	84.4	83.4	-0.9	1.1	1.0
Kenya	Cent. govt.	30.5	30.2	30.2	28.6	30.0	-1.1	-0.1	-4.6
	Local govt.	38.4	42.7	52.3	47.4	45.6	11.0	22.6	-9.3
Netherlands	Cent. govt.	65.1	63.6	61.6	65.2	63.8	-2.4	-3.1	5.8
	Prov., local govt.				62.4	62.4			
United Kingdom	Cent. govt.	43.6	46.4	50.8	49.1	47.4	6.4	9.4	-3.3
	Local govt.		68.0	69.2	68.3	68.6		1.7	-1.2
Indust. countries	Cent. govt.	53.3	52.1	52.1	54.3	52.8	-2.2	0.0	4.3
	Local govt.				59.2	58.4			
Devel. countries	Cent. govt.		47.2	47.0		46.3		-0.3	
	Local govt.		38.7	44.4		41.4		14.6	

Table 2.7 Social Expenditure Decentralization Ratios (percentage) (continued)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth (2)-(1)	Rate of growth (3)-(2)	Rate of growth (4)-(3)
SOCIAL ALLOCATION RATIO (B')									
Australia	Cent. govt.	37.1	36.5	37.4	42.8	37.9	-1.6	2.5	14.5
	State, prov. govt.	52.8	50.6	47.6	45.4	49.5	-4.2	-5.9	-4.6
	Local govt.	3.1	2.6	2.3	2.3	2.6	-16.4	-10.3	-0.3
	Local, prov. state govt	46.5	44.1	41.4	39.7	43.3	-5.0	-6.3	-4.0
Chile	Cent. govt.	20.6	20.7	18.8	23.5	20.8	0.4	-9.0	24.5
	Local govt.		32.3	34.8		33.5		7.7	
Colombia	Cent. govt.		25.6	29.0		26.9		13.5	
	State, prov. govt.	71.1	63.8	63.3		67.1	-10.3	-0.9	
	Local govt.	36.4	27.9	32.6		32.5	-23.3	16.8	
	Local, prov. state govt.	62.3	54.4	56.0		58.3	-12.6	2.9	
Denmark	Cent. govt.	13.0	11.1	10.3	10.8	11.4	-14.3	-7.7	5.4
	Local govt.	32.2	29.8	28.3	27.1	29.8	-7.5	-5.1	-4.0
Kenya	Cent. govt.	29.1	27.4	26.9	25.7	27.5	-6.0	-1.6	-4.6
	Local govt.	25.3	29.2	22.0	21.2	24.5	15.5	-24.6	-3.8
Netherlands	Cent. govt.	26.1	23.3	21.5	23.7	23.6	-10.6	-7.8	10.2
	Prov., local govt.				16.1	16.1			
United Kingdom	Cent. govt.	15.4	15.2	16.8	17.4	16.2	-1.0	10.0	3.7
	Local govt.		35.1	34.6	34.0	34.6		-1.6	-1.5
Indust. countries	Cent. govt.	22.9	21.5	21.5	23.7	22.3	-5.9	-0.3	10.2
	Local govt.				19.9	20.8			
Devel. countries	Cent. govt.		24.5	24.9		25.1		1.5	
	Local govt.		29.8	29.8		30.2		0.0	
EDUCATIONAL DECENTRAL. RATIOS									
Australia		68.5	70.5	70.3	71.0	70.0	3.0	-0.3	1.0
Chile			15.9	18.7		17.3		17.7	
Colombia			42.6	39.4		41.3		-7.5	
Denmark		55.1	52.9	52.3	48.7	52.9	-4.1	-1.0	-7.0
Kenya		6.3	5.3	2.1	2.1	5.7	-14.8	-60.5	-1.1
Netherlands					20.1	20.1			
United Kingdom			84.2	80.1	76.5	80.3		-4.9	-4.4
Industrial countries					54.1	55.8			
Developing countries			21.3	20.1		21.4		-5.7	
HEALTH DECENTRALIZATION RATIOS									
Australia		52.3	56.8	52.3	47.9	52.8	8.5	-8.0	-8.4
Chile			2.1	2.6		2.4		25.2	
Colombia			51.0	63.3		55.9		24.2	
Denmark		87.0	90.7	91.4	92.1	90.0	4.3	0.8	0.7
Kenya		9.7	8.2	8.7	8.8	8.8	-15.2	5.7	1.8
Netherlands					16.6	16.6			
United Kingdom		na	na	na	na	na	na	na	na
Industrial countries					52.2	53.1			
Developing countries			20.4	24.8		22.3		21.7	

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per cent if we make the calculations including all social expenditures and; (2) in Colombia the relation is 44.6 per cent against 33.3 per cent.

2.5.2.3 Education decentralization ratio

In general, the degree of decentralization of education expenditures depends, to a large extent, upon the allocation of responsibilities among the different layers of government. Nevertheless, it is important to analyze the education decentralization ratio to explore if there is any evidence that local governments are increasing their allocative function in this sector.

From the information of Table 2.7 it is possible to see that: (1) in Kenya the responsibilities for education are becoming increasingly centralized (on average only 5.7 per cent of all government expenditure on education is allocated through LGs); (2) in Colombia LGs educational budget accounts for about 41.3 per cent of all educational expenditures but with a decreasing tendency and; (3) in Chile there is a clear tendency to decentralize some educational responsibilities to the lowest level of government. Chile is also an interesting case since its educational decentralization ratio is significantly higher than its social expenditure decentralization ratio (indicator B). In other words, in Chile LGs are more involved in education than in other social sectors.

The decentralization of educational responsibilities in industrial countries shows that: LGs in the United Kingdom are responsible for 4/5 of the sectoral spendings, in Australia the ratio is 7/10, in Denmark about 1/2 and, in The Netherlands 1/5. In two cases (United Kingdom and Australia) the education decentralization ratio is higher than indicators A and B.

Even if the national experiences are very different, the above data suggest that the education decentralization ratio tends to be higher than the social decentralization ratios A and B. In fact, Table 2.7. shows that in industrialized countries the education decentralization ratio is higher (on average) than the social decentralization ratios A and B (55.8 per cent against 38.1 per cent and 49.2 per cent respectively) while in developing countries the same indicators account for 21.4 per cent in the first case and, 15.3 per cent and 20.9 per cent for the second ones (i.e. A and B).

2.5.2.4 Health decentralization ratio

From the information of Table 2.7. we can see that, within industrialized countries, in Denmark and Australia health services are highly decentralized responsibilities. In The Netherlands the sectoral decentralization ratio is far below the social one.

In Chile LGs spend only 2.4 per cent of all public health resources, while in Colombia and Kenya the same ratio is 55.9 per cent and 8.8 per cent respectively. Since in the last two countries the sectoral ratio is higher than indicators A and B, we can say that health is also a high priority for their LGs. Obviously, there is no possibility to identify a common ground for all countries in the sample.

### 2.5.2.5 Central and local governments social allocation ratios

The question here is whether or not LGs spend more than CGs in areas of human development priority.

In order to answer this question two indicators of social allocation were estimated: one with a wide definition of social spendings (indicator A') and the second with a more restricted one (indicator B'). The results are shown in Table 2.7 and with greater detail in Table 2.8 (refer also to Graphs 2.3a, 2.3b and 2.3c).

Indicator A'
From indicator A' we can see that, in industrialized and developing countries, the non-central component of the government tends to have a higher (or at least similar) social allocation ratio than the central one.

Graph 2.3a Social Expenditure Allocation Ratio
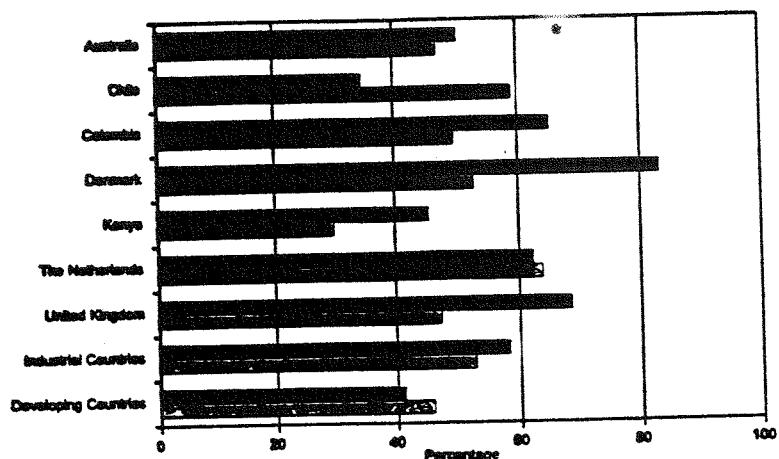
Graph 2.3b Education Expenditure Allocation Ratio
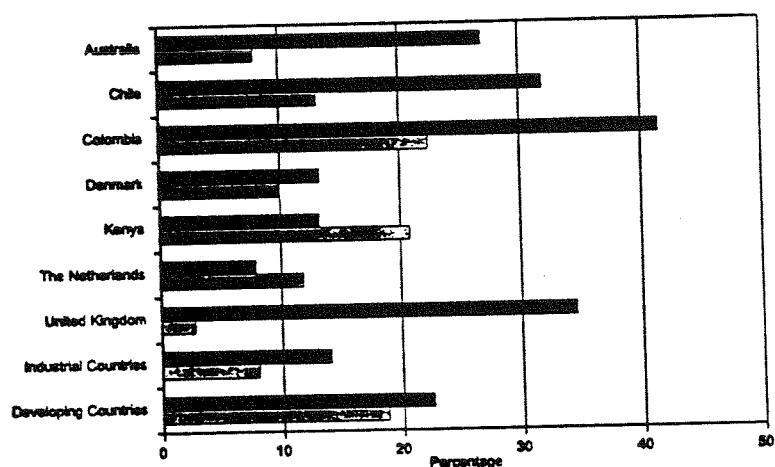
Graph 2.3c Health Expenditure Allocation Ratio
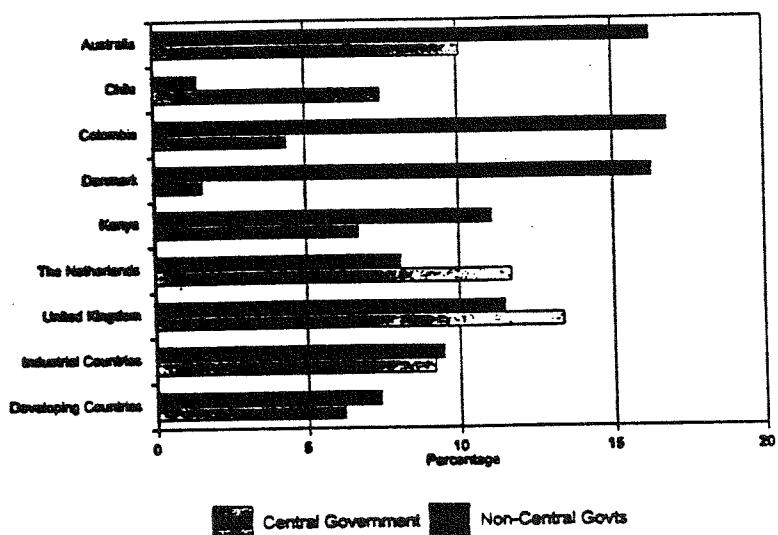
Central Government   Non-Central Govts

Source: Own elaboration based on IMF Government Finance Statistics.

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Table 2.8 Expenditures Composition (percentage)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth (2)-(1)	(3)-(2)	(4)-(3)
GENERAL PUBLIC SERVICES									
Australia	Cent. govt.	8.0	7.3	7.3	8.9	7.8	-9.0	1.0	21.3
	State, prov govt	6.3	6.9	7.7	9.6	7.4	8.7	12.2	24.7
	Local govt.	22.8	21.6	21.8	23.4	22.3	-5.0	0.5	7.3
	Local, state & prov govt.	8.4	8.8	9.6	11.4	9.4	5.2	8.9	18.6
Chile	Cent. govt.	12.0	11.2	7.4	3.9	8.9	-6.5	-33.8	-46.8
	Local govt		84.8	85.1		84.9		0.5	
Colombia	Cent. govt		18.7	19.0		18.8		1.9	
	State, prov. govt	16.2	14.2	15.9		15.3	-12.3	12.0	
	Local govt.	25.4	28.2	15.0		24.9	10.9	-46.5	
	Local, state & prov govt.	18.3	17.8	15.8		17.7	-2.6	-11.3	
Denmark	Cent. govt	9.1	7.9	7.0	6.6	7.8	-12.4	-12.2	-5.1
	Local govt	4.0	4.0	4.1	3.9	4.0	0.8	2.9	-4.7
Kenya	Cent. govt	17.6	12.2	10.0	11.8	13.2	-30.9	-17.5	17.7
	Local govt.	15.4	21.2	28.6	38.1	26.9	38.0	34.6	33.3
Netherlands	Cent. govt.	7.2	5.8	6.6	6.5	6.5	-19.1	12.4	-0.6
	Prov., local govt				9.5	9.5			
United Kingdom	Cent. govt.	7.8	3.7	3.9	4.2	5.1	-52.0	4.6	8.0
	Local govt		3.0	3.5	4.4	3.6		13.8	27.4
Indust. countries	Cent. govt	8.0	6.2	6.2	6.6	6.8	-22.7	0.0	6.0
	Local govt				10.3	6.6			
Devel. countries	Cent. govt		14.0	12.2		13.6		-13.2	
	Local govt		38.1	36.2		36.5		-4.8	
Total sample	Cent. govt.		9.5	8.8		9.7		-8.3	
	Local govt					22.3			
DEFENSE									
Australia	Cent. govt.	9.2	9.6	9.0	8.2	9.1	3.7	-6.1	-8.1
	State, prov govt.								
	Local govt								
	Local, state & prov govt								
Chile	Cent. govt.	12.8	11.9	10.3	9.9	11.3	-6.5	-13.3	-4.4
	Local govt.								
Colombia	Cent. govt		6.9	9.0		7.8		29.8	
	state, prov. govt								
	Local govt.								
	Local, state & prov. govt								
Denmark	Cent. govt	6.5	5.9	5.2	5.0	5.8	-10.3	-10.7	-4.6
	Local govt.	0.1	0.1	0.1	0.1	0.1	12.0	-1.8	-6.4
Kenya	Cent. govt	11.1	12.6	9.3	8.2	10.7	13.0	-25.9	-12.1
	Local govt.								
Netherlands	Cent. govt.	6.0	5.4	5.1	4.7	5.3	-10.6	-5.6	-8.5
	Prov., local govt								
United Kingdom	Cent. govt.	13.9	13.7	12.9	10.6	12.9	-1.0	-6.4	-17.4
	Local govt.		0.0	0.0	0.1	0.0		86.7	5.2
Indust. countries	Cent. govt.	8.9	8.6	8.0	7.1	8.3	-3.1	-6.9	-11.3
	Local govt.								
Devel. countries	Cent. govt.		10.5	9.6		9.9		-8.9	
	Local govt.								
Total sample	Cent. govt.	9.9	9.4	8.7	7.8	9.0	-5.0	-7.9	-10.6
	Local govt.								

Table 2.8 Expenditures Composition (percentage) (continued)

	(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth (2)-(1)	(3)-(2)	(4)-(3)
PUBLIC ORDER & SAFETY								
Australia Cent. govt.	0.0	0.4	0.7	0.9	0.5		76.0	30.9
state, prov. govt.	7.1	7.7	7.4	7.7	7.4	8.3	-3.0	3.7
Local govt	1.3	1.6	1.5	1.3	1.5	26.1	-7.4	-11.7
Local, state, prov. govt.	6.3	6.9	6.6	6.9	6.7	8.1	-3.5	3.7
Chile Cent. govt.	0.0	0.0	3.5	4.8	1.9			39.9
Local govt.								
Colombia Cent. govt								
state, prov. govt.	1.0	0.6	0.0		0.7	-36.7	-100.0	
Local govt.	3.4	2.2	0.0		2.4	-35.7	-100.0	
Local, state, prov. govt.	1.6	1.1	0.0		1.2	-35.4	-100.0	
Denmark Cent. govt.	0.0	0.0	2.2	2.1	0.9			-4.4
Local govt	0.4	0.4	0.4	0.4	0.4	-1.4	0.9	-1.3
Kenya Cent. govt.	0.0	3.3	5.6	5.8	3.4		68.5	5.2
Local govt.	2.3	2.5	1.4	0.0	1.4	7.2	-44.3	-100.0
Netherlands Cent. govt.	0.0	0.9	2.2	2.3	1.3		150.0	3.6
prov., Local govt				3.6	3.6			
United Kingdom Cent. govt	0.0	1.3	3.0	3.6	1.8		127.4	20.0
Local govt		9.9	11.1	12.8	11.2		11.3	15.5
Indust. countries Cent. govt	0.0	0.7	2.0	2.2	1.1		212.1	9.8
Local govt				4.5	4.2			
Devel. countries Cent. govt.								
Local govt.								
Total sample Cent. govt								
Local govt								
SOCIAL SPENDING								
Australia Cent. govt.	47.7	45.4	46.2	51.4	47.3	-4.9	1.7	11.3
state, prov govt	57.3	55.5	54.1	53.4	55.3	-3.2	-2.5	-1.4
Local govt.	16.6	19.5	20.7	21.7	19.4	17.6	5.9	5.1
Local, state, prov. govt.	52.1	50.7	49.5	49.2	50.5	-2.8	-2.3	-0.6
Chile Cent. govt.	52.4	63.6	58.3	62.9	59.1	21.6	-8.3	7.8
Local govt.		35.2	34.9		35.0		-0.9	
Colombia Cent. govt		47.7	52.6		49.7		10.3	
state, prov govt	75.8	70.7	68.7		72.8	-6.7	-2.9	
Local govt.	47.4	38.2	45.9		43.6	-19.2	20.0	
Local, state & prov. govt.	68.6	62.2	63.3		65.3	-9.3	1.7	
Denmark Cent. govt.	56.6	52.9	49.8	51.5	52.9	-6.4	-5.9	3.4
Local govt	83.4	82.7	83.6	84.4	83.4	-0.9	1.1	1.0
Kenya Cent. govt.	30.5	30.2	30.1	28.8	30.0	-1.1	-0.2	-4.5
Local govt	38.4	42.7	52.3	47.4	45.6	11.0	22.6	-9.3
Netherlands Cent. govt	65.1	63.6	61.6	65.2	63.8	-2.4	-3.1	5.8
prov., Local govt				62.4	62.4			
United Kingdom Cent. govt.	43.6	46.4	50.8	49.1	47.4	6.4	9.4	-3.3
Local govt		68.0	69.2	68.3	68.6		1.7	-1.2
Indust. countries Cent. govt.	53.3	52.1	52.1	54.3	52.8	-2.2	0.0	4.3
Local govt.				59.2	58.4			
Devel. countries Cent. govt.		47.2	47.0		46.3		-0.3	
Local govt.		38.7	44.4		41.4		14.6	
Total sample Cent. govt.		50.0	49.9		50.0		-0.1	
Local govt.					51.1			

Table 2.8 Expenditures Composition (percentage) (continued)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
EDUCATION									
Australia	Cent. govt	9.5	8.0	7.1	7.0	8.0	-16.2	-10.4	-1.7
	State, prov. govt	34.2	32.3	29.1	27.2	31.1	-5.7	-9.9	-6.3
	Local govt	0.6	0.5	0.4	0.4	0.5	-17.3	-15.1	-2.4
	Local, state & prov. govt	29.9	28.0	25.1	23.7	27.0	-8.4	-10.3	-5.8
Chile	Cent. govt	13.8	14.2	12.1	12.8	13.2	2.7	-14.6	6.2
	Local govt		31.2	32.9		32.0		5.7	
Colombia	Cent. govt		21.3	24.3		22.5		13.7	
	State, prov. govt	48.7	49.6	41.8		46.0	1.9	-15.8	
	Local govt	27.0	18.2	21.9		22.8	-32.6	20.2	
	Local, state & prov. govt	43.2	41.4	37.1		41.5	-4.1	-10.4	
Denmark	Cent. govt	10.6	9.8	9.1	9.7	9.8	-7.8	-7.5	7.4
	Local govt	14.8	13.8	12.4	11.6	13.4	-6.7	-10.0	-6.9
Kenya	Cent. govt	21.4	20.1	21.1	20.2	20.8	-6.5	5.1	-4.2
	Local govt	15.5	18.6	9.9	9.5	13.3	19.7	-46.9	-3.5
Netherlands	Cent. govt	14.3	11.8	10.5	10.6	11.9	-17.3	-11.0	0.8
	Prov., local govt				8.0	8.0			
United Kingdom	Cent. govt	2.7	2.2	2.9	3.3	2.8	-18.8	33.4	12.5
	Local govt		35.1	34.6	34.0	34.6		-1.6	-1.5
Indust. countries	Cent. govt	9.3	8.0	7.4	7.7	8.1	-14.4	-6.7	3.3
	Local govt				13.5	14.1			
Devel. countries	Cent. govt		18.5	19.1		18.8		3.4	
	Local govt		22.6	21.6		22.7		-4.8	
Total sample	Cent. govt		12.5	12.4		12.7		-0.3	
	Local govt					17.8			
HEALTH									
Australia	Cent. govt	10.5	8.4	10.0	12.7	10.1	-19.7	19.0	26.3
	State, prov. govt	18.6	18.3	18.5	18.2	18.4	-1.6	1.2	-1.9
	Local govt	2.5	2.1	1.9	1.9	2.1	-16.2	-9.2	0.1
	Local, state & prov. govt	16.5	16.1	16.2	16.0	16.3	-2.5	0.6	-1.4
Chile	Cent. govt	6.8	6.6	6.8	10.6	7.5	-4.0	3.0	57.2
	Local govt		1.1	1.9		1.5		64.3	
Colombia	Cent. govt		4.2	4.7		4.4		12.0	
	State, prov. govt	22.5	14.2	21.5		19.1	-36.7	51.4	
	Local govt	9.4	9.7	10.7		9.7	3.5	10.5	
	Local, state & prov. govt	19.1	13.1	19.0		16.8	-31.6	45.3	
Denmark	Cent. govt	2.4	1.3	1.2	1.1	1.6	-43.9	-9.4	-10.1
	Local govt	17.4	16.0	15.9	15.6	16.3	-8.3	-0.9	-1.8
Kenya	Cent. govt	7.7	7.3	6.0	5.5	6.7	-4.7	-17.7	-8.3
	Local govt	9.8	10.6	12.2	11.7	11.1	9.0	14.4	-4.1
Netherlands	Cent. govt	11.7	11.4	10.9	13.1	11.7	-2.5	-4.4	19.4
	Prov., local govt				8.1	8.1			
United Kingdom	Cent. govt	12.7	13.0	13.8	14.1	13.4	2.8	6.0	1.8
	Local govt		12.3	11.7	10.2	11.5		-4.9	-12.6
Indust. countries	Cent. govt	9.3	8.6	9.0	10.2	9.2	-8.2	5.1	13.6
	Local govt				9.0	9.5			
Devel. countries	Cent. govt		6.0	5.8		6.2		-3.3	
	Local govt		7.1	8.2		7.4		15.3	
Total sample	Cent. govt		7.5	7.6		7.9		2.2	
	Local govt					8.6			

Table 2.8 Expenditures Composition (percentage) (continued)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
SOCIAL SECURITY & WELFARE									
Australia	Cent. govt.	26.6	28.0	27.3	30.1	27.8	5.5	-2.5	10.2
	State, prov govt	2.2	2.4	3.4	4.5	3.0	9.6	44.1	30.5
	Local govt.	1.6	2.5	3.4	4.2	2.8	54.4	35.8	24.9
	Local, state & prov. govt.	2.1	2.4	3.4	4.5	2.9	14.0	43.0	29.8
Chile	Cent. govt.	26.9	39.1	34.9	34.0	33.7	45.3	-10.6	-2.6
	Local govt		2.9	0.1		1.5		-96.3	
Colombia	Cent. govt.		18.8	18.6		18.7		-0.9	
	State, prov. govt	2.7	5.0	4.6		3.9	86.1	-8.3	
	Local govt.	7.1	4.9	9.2		6.6	-30.6	86.2	
	Local, state & prov. govt.	3.8	5.0	5.7		4.5	31.4	13.6	
Denmark	Cent. govt	41.7	39.7	38.2	39.0	39.7	-4.9	-3.7	2.2
	Local govt.	46.3	49.4	52.6	54.6	50.1	6.6	6.6	3.6
Kenya	Cent. govt	0.6	0.1	0.1	0.1	0.3	-74.5	-12.6	-22.5
	Local govt.	1.0	0.8	0.7	1.0	0.9	-15.9	-10.7	34.0
Netherlands	Cent. govt.	36.5	37.1	35.8	37.7	36.7	1.6	-3.3	5.0
	Prov. local govt				25.6	25.6			
United Kingdom	Cent. govt	24.1	29.3	31.2	28.7	28.2	21.6	6.6	-8.0
	Local govt.		16.2	18.7	19.6	18.3		15.2	5.0
Indust. countries	Cent. govt	32.2	33.5	33.1	33.9	33.1	4.0	-1.1	2.2
	Local govt				26.0	24.2			
Devel. countries	Cent. govt		19.3	17.9		17.6		-7.5	
	Local govt		2.9	3.3		3.0		15.9	
Total sample	Cent. govt.		27.4	26.6		26.4		-3.0	
	Local govt.								
HOUSING & COMMUNITY AMENITIES									
Australia	Cent. govt	1.2	1.0	1.6	1.6	1.3	-17.0	71.0	-3.6
	State, prov. govt.	2.4	2.5	3.1	3.5	2.8	7.4	21.9	13.3
	Local govt.	11.9	14.4	15.0	15.2	14.0	21.4	3.6	1.5
	Local, state & prov govt	3.6	4.1	4.7	5.0	4.3	15.7	14.3	6.8
Chile	Cent. govt	4.9	3.9	4.6	5.4	4.6	-20.3	18.6	18.5
	Local govt.								
Colombia	Cent. govt.		3.4	5.0		4.0		48.5	
	State, prov. govt	2.0	1.9	0.8		1.8	-7.0	-58.9	
	Local govt.	3.9	5.4	4.1		4.5	39.6	-24.2	
	Local, state & prov. govt	2.5	2.8	1.6		2.5	10.2	-44.0	
Denmark	Cent. govt.	1.9	2.1	1.3	1.7	1.8	14.4	-37.0	23.5
	Local govt	4.9	3.5	2.7	2.7	3.6	-29.1	-23.3	2.2
Kenya	Cent. govt.	0.8	2.7	2.9	3.0	2.2	225.0	9.4	2.1
	Local govt.	12.2	12.7	29.6	25.3	20.3	3.7	133.4	-14.5
Netherlands	Cent. govt	2.6	3.2	4.3	3.9	3.5	24.8	33.4	-9.5
	Prov., local govt.				20.7	20.7			
United Kingdom	Cent. govt.	4.1	1.9	2.8	3.0	3.1	-54.0	48.7	7.6
	Local govt.		4.3	4.2	4.4	4.3		-2.8	5.6
Indust. countries	Cent. govt.	2.4	2.1	2.5	2.5	2.4	-15.7	22.7	0.6
	Local govt.				8.2	8.2			
Devel. countries	Cent. govt.		3.3	4.2		3.6		26.3	
	Local govt.								
Total sample	Cent. govt.		2.6	3.2		2.9		24.6	
	Local govt.								

Table 2.8 Expenditures Composition (percentage) (continued)

	(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1980-84	Average	Rate of growth (2)-(1)	(3)-(2)	(4)-(3)
REC. CULTURAL & RELIGIOUS AFFAIRS								
Australia Cent. govt.	1.2	1.1	1.3	1.1	1.2	-5.4	13.8	-15.8
State, prov. govt.	1.5	1.9	2.5	2.0	2.0	28.1	27.0	-19.5
Local govt.	14.8	15.3	15.3	14.5	15.0	3.8	0.0	-5.7
Local, state & prov. govt.	3.2	3.7	4.2	3.6	3.7	16.5	13.4	-14.2
Chile Cent. govt.	0.6	0.7	0.6	0.0	0.5	18.0	-11.9	-100.0
Local govt.								
Colombia Cent. govt.		0.6	1.5		0.9		163.5	
State, prov. govt.	1.6	2.0	0.0		1.5	27.4	-100.0	
Local govt.	2.6	3.3	0.0		2.5	27.0	-100.0	
Local, state & prov. govt.	1.8	2.3	0.0		1.7	27.5	-100.0	
Denmark Cent. govt.	2.1	1.8	1.7	1.7	1.8	-14.2	-6.1	-1.2
Local govt.	3.3	3.1	3.0	2.9	3.1	-5.1	-3.0	-4.1
Kenya Cent govt	2.2	2.7	3.6	1.9	2.8	21.6	31.2	-46.5
Local govt	2.4	2.4	3.0	1.1	2.1	0.5	25.8	-64.1
Netherlands Cent. govt.	0.9	0.9	0.7	0.4	0.7	4.2	-16.6	-50.2
Prov., local govt.				6.5	8.5			
United Kingdom Cent. govt.	0.3	0.3	0.5	0.5	0.4	1.9	34.8	7.2
Local govt.								
Indust. countries Cent. govt.	1.1	1.0	1.0	0.9	1.0	-7.2	0.3	-13.5
Local govt.								
Devel. countries Cent. govt		1.3	1.9		0.9		42.5	
Local govt.								
Total sample Cent. govt		1.2	1.4		1.2		21.0	
Local govt.								
ECONOMIC AFFAIRS & SERVICES								
Australia Cent. govt.	8.5	8.4	8.0	7.9	8.3	-0.9	-4.7	-1.8
State, prov govt.	18.6	18.8	18.2	15.0	17.9	0.8	-2.7	-17.7
Local govt	37.8	34.2	33.7	32.0	34.7	-9.6	-1.5	-4.9
Local, state & prov. govt.	21.0	20.8	20.4	17.3	20.2	-1.1	-2.2	-15.2
Chile Cent. govt	14.9	9.6	10.2	13.5	12.0	-35.3	6.1	31.9
Local govt.								
Colombia Cent. govt.		24.2	14.5		20.3		-39.9	
State, prov. govt.	13.9	11.7	12.2		12.8	-15.7	4.1	
Local govt.	21.3	25.8	21.8		23.1	21.3	-15.5	
Local, state & prov. govt.	16.0	15.4	14.5		15.5	-3.3	-6.2	
Denmark Cent. govt	11.1	8.5	7.4	7.6	8.9	-23.5	-12.7	2.2
Local govt	6.7	8.3	7.5	7.0	7.4	23.9	-9.4	-6.3
Kenya Cent. govt	29.4	24.7	22.7	17.3	24.1	-15.9	-8.4	-23.6
Local govt	35.4	28.2	17.4	19.9	24.5	-20.4	-38.4	14.6
Netherlands Cent. govt	9.3	10.6	9.8	6.4	9.2	14.8	-7.9	-35.0
Prov., local govt.				8.7	8.7			
United Kingdom Cent. govt.	9.3	7.7	7.8	7.9	8.3	-16.9	0.4	1.4
Local govt.		9.0	7.4	7.3	7.8		-18.6	-0.7
Indust. countries Cent. govt.	9.6	8.8	8.3	7.4	8.6	-7.6	-6.5	-10.0
Local govt.				13.8	14.7			
Devel. countries Cent. govt.		19.5	15.8		18.8		-19.0	
Local govt.								
Total sample Cent. govt.	·	13.4	11.5		13.0		-14.3	
Local govt.								

Table 2.8 Expenditures Composition (percentage) (continued)

		(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth		
							(2)-(1)	(3)-(2)	(4)-(3)
OTHER EXPENDITURES									
Australia	Cent. govt	25.3	27.8	27.5	21.5	26.0	9.7	-1.1	-21.6
	State. prov. govt.	9.2	9.3	10.1	12.3	10.0	1.4	8.0	22.5
	Local govt	6.8	7.7	7.1	7.1	7.2	13.8	-8.3	0.4
	Local, state & prov. govt.	8.9	9.1	9.6	11.6	9.8	2.4	6.1	20.5
Chile	Cent. govt	7.4	2.9	10.4	9.0	7.4	-61.3	264.4	-13.4
	Local govt.								
Colombia	Cent. govt		5.4	3.3		4.5		-37.4	
	State, prov. govt	1.5	2.2	3.2		2.1	49.3	44.1	
	Local govt	3.3	2.2	2.3		2.7	-32.7	4.3	
	Local, state & prov. govt.	1.9	2.2	3.0		2.2	15.2	35.8	
Denmark	Cent. govt	15.5	23.3	26.7	25.5	22.2	50.4	14.6	-4.3
	Local govt	2.1	1.4	1.3	1.2	1.6	-32.2	-12.4	-3.5
Kenya	Cent. govt.	9.1	13.5	18.7	26.1	16.0	48.8	38.4	39.7
	Local govt.	0.5	0.5	0.4	0.2	0.4	6.3	-29.2	-53.9
Netherlands	Cent. govt.	11.5	12.8	14.0	14.5	13.1	11.1	9.4	4.2
	Prov., local govt.				9.3	9.3			
United Kingdom	Cent. govt	25.1	27.7	22.3	25.1	24.7	10.4	-19.3	12.5
	Local govt		10.0	8.9	7.1	8.7		-10.5	-20.0
Indust. countries	Cent. govt	19.3	22.9	22.6	21.7	21.5	18.3	-1.2	-4.1
	Local govt				6.2	6.7			
Devel. countries	Cent. govt		7.2	10.8		9.3		49.5	
	Local govt								
Total sample	Cent. govt		16.2	17.6		16.3		8.6	
	Local govt.								

Source Own elaboration based on IMF Government Finance Statistics

In fact, the information from Tables 2.7 and 2.8 show that: (1) both in the United Kingdom and Denmark social functions accounts for about 68.6 per cent and 83.4 per cent of all the LG budget, while at central level the same indicator is only 52.9 per cent and 47.4 per cent respectivelly; (2) in the Netherlands all levels of government have more or less the same social allocation ratio (about 63 per cent); (3) in Australia the state-local governments' social allocation ratio is higher than the central one and; (4) in Colombia and Kenya indicator A' is always lower at the central level than at the local-provincial one.[24]

Indicator B'

The use of indicator B' gives us additional information about the importance of health and education in local and central governments budgets. In developing countries, Chile and Colombia have social allocation ratios that are higher at local level than at the central one, while the opposite is true for Kenya. A possible explanation for this situation is that developing countries with a relatively high decentralization ratio (Colombia and Chile) are very selective in their social spendings, especially in those areas of human development priority.

In industrialized countries, the results are the same as in indicator A'. In fact, in the United Kingdom, Denmark and Australia, the LG social allocation ratio is higher than the central one. The opposite is true for The Netherlands where the CG has more responsibilities in the areas of health and education than the LG.

2.5.3   An overview of the other components of LG expenditures

There are two components of government expenditures that require a closer look: (1) social security and welfare and, (2) housing and community affairs (Table 2.8).

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[24] Chile is the exception with a social allocation ratio of 59.1% at central level and 35% for its local governments.

Both in industrialized and developing countries social security expenditures are basically a CG concern.[25] However, this does not mean that LGs are not involved in this area, especially in countries with a well developed welfare state. For example, in the United Kingdom 18.3 per cent of all the local government budget is dedicated to this item, while in the Netherlands and Denmark the percentage is even higher (25.6 per cent and 50.1 per cent respectively).

In developing countries, since the welfare state is not yet well developed, LG involvement in the provision of social security and welfare is minimal. Table 2.8 shows that in Chile LGs spend only 1.5 per cent of the aggregate budget on this area, while in Colombia the proportion is at most 5.7 per cent.

Contrary to social security and welfare expenditures, housing and community amenities are a local government concern both in industrialized and in developing countries. In fact, in most cases the LG social allocation ratio is higher than the CG one.

3. DECENTRALIZATION TO THE MARKET, QUASI-MARKETS AND NGOs

3.1 The Problem

The issue of decentralization implies the redefinition of the economic roles assigned to the different levels of government and a redefinition of the balance between the public and private sectors. In this section we will analyse this topic on the basis of two guiding questions: what are the main changes in the processes of decentralization to the governments and to the markets both in industrialized and developing countries and, what are the economic factors (efficiency considerations) that account for these changes.

The methodology is similar to the one already applied to the study of decentralization of governance in the sense that it combines cross-section and time series analysis. However, since decentralization to the markets, quasi-market, and non-governmental organizations is a relatively new area of research some indicators are only a rough approach to the phenomenon. A further analysis was possible using 'illustrating experiences' of innovative arrangements in the provision of public services for each country in the sample.

3.2 Size of Governmental Sector

In order to measure the extent to which resource allocation is dominantly market controlled or determined by government we can use, as a 'proxy' variable, the proportion of government expenditures to the Gross Domestic Product (GDP). Additionally, if we relate the size of the governmental sector in each country with its respective per-capita income we can explore if there is any link between economic development and the system of resource allocation. Graphs 3.1a and 3.1b (based on Tables 3.1 and 3.2) allow us to analyse these issues.[26] Both graphs clearly show that the higher the level of economic development of a country the higher are the aggregate resources for the development of the governmental sector and the provision of services. Indeed, while in developing countries about 24 per cent of all resources are allocated through the government, in industrialized countries this figure is about 50 per cent.

The difference between percentages is not only quantitative but also qualitative. In industrialized countries governments are involved in the provision of social services or 'welfare', while in developing countries, the aggregated resources are more restricted and, therefore, the possibilities for government to provide 'welfare' or intervene in the economy.

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[25] The exception is Denmark where social security and welfare functions are mainly a local government responsibility.

[26] The first graph shows the relation between means and the second tries to capture the long-term trends. For all countries the signal (') shows the final possition in a trend analysis.

Graph 3.1a Government/Market Size GDP
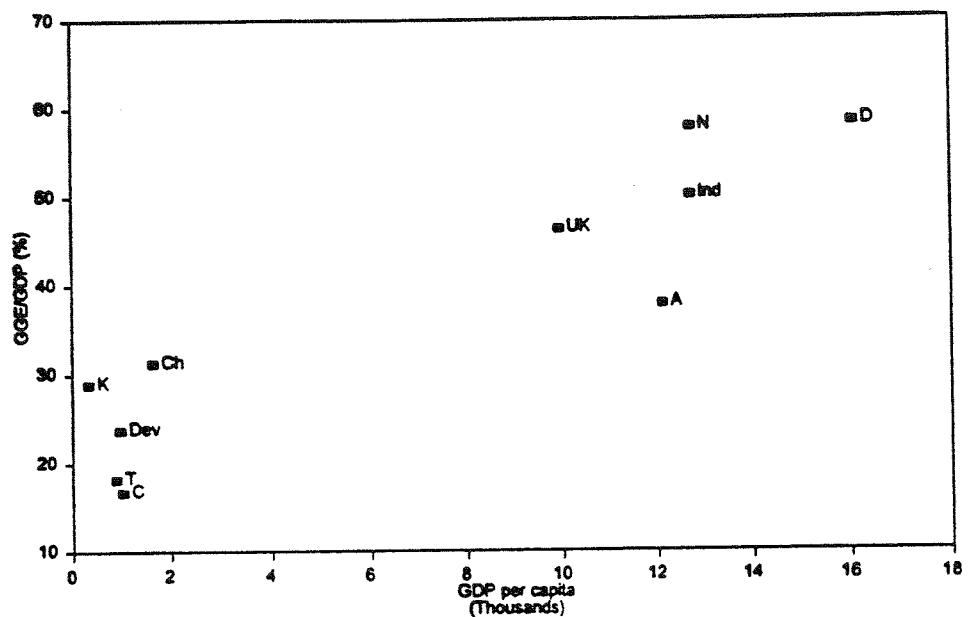
Graph 3.1b Government/Market Size GDP
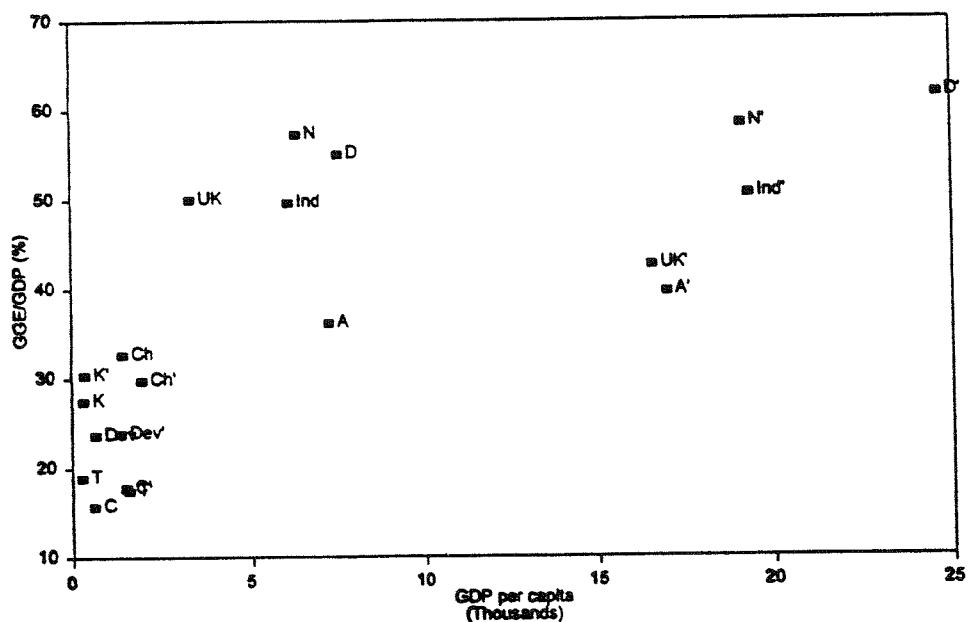
GGE: General Government Expenditures.
(X): Initial position; (X'): Final position.

Source: Own elaboration based on IMF Government Finance Statistics.

Table 3.1 Size of Government Sector in Selected Countries

	(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth			Trend (Regression)	
						(2)-(1)	(3)-(2)	(4)-(3)	Initial	Final
GGR/GDP (%)										
Australia	31.35	33.98	37.54	37.50	34.83	8.38	10.49	-0.13	30.55	39.10
Chile	33.65	32.45	28.62		31.78	-3.57	-11.79		35.30	28.26
Colombia	14.06	14.32	15.01		14.31	1.85	4.85		13.84	14.77
Denmark	51.22	54.84	59.69	58.98	56.04	7.06	8.84	-1.18	50.62	61.45
Thailand	13.89	15.89	17.12	19.63	16.47	14.41	7.74	14.70	13.18	19.77
Kenya (*)	22.52	24.89	24.84	28.21	24.83	10.53	-0.23	13.59	21.60	28.07
Netherlands	50.82	54.71	54.56	54.06	53.51	7.65	-0.27	-0.92	51.57	55.45
United Kingdom	41.15	44.33	43.02	41.85	42.67	7.71	-2.95	-2.73	42.46	42.88
CGR/GDP (%)										
Australia	23.57	25.49	27.74	26.49	25.75	8.14	8.82	-4.52	23.45	28.05
Chile	33.05	30.79	25.90	22.66	28.39	-6.85	-15.87	-12.53	34.72	23.08
Colombia	11.79	11.49	12.47		11.78	-2.58	8.53		11.63	11.92
Denmark	35.36	37.78	41.86	40.23	38.65	6.87	10.78	-3.89	34.87	42.43
Thailand	12.95	15.00	16.22	18.66	15.55	15.76	8.14	15.06	12.27	18.83
Kenya	20.75	23.28	23.39	26.79	23.25	12.19	0.44	14.58	19.79	26.71
Netherlands	48.55	51.68	50.79	49.37	50.13	6.47	-1.74	-2.78	49.67	50.60
United Kingdom	34.20	37.08	36.38	37.79	36.20	8.42	-1.88	3.89	34.65	37.76
LGR/GDP (%)										
Australia	2.03	4.18	8.05	11.32	5.85	105.42	92.77	40.68	0.28	11.42
Chile	0.59	1.66	1.61		1.26	178.51	-2.91		0.58	1.95
Colombia	0.67	0.88	0.87		0.78	32.79	-2.03		0.63	0.93
Denmark	15.87	17.05	17.83	18.41	17.23	7.50	4.55	3.25	15.64	18.82
Thailand	0.93	0.89	0.90	0.97	0.92	-4.38	1.02	8.22	0.90	0.94
Kenya	1.77	1.61	1.08	1.42	1.49	-8.89	-32.75	30.95	1.75	1.22
Netherlands	2.28	3.03	3.78	4.69	3.38	32.89	24.76	24.12	1.90	4.86
United Kingdom	6.96	7.25	6.64	4.05	6.47	4.24	-8.41	-38.96	7.81	5.12
LPGR/GDP (%)										
Australia	7.78	8.49	9.80	11.01	9.08	9.08	15.51	12.30	7.11	11.05
Chile	0.59	1.66	1.61		1.26	178.51	-2.91		0.58	1.95
Colombia	2.27	2.83	2.55		2.53	24.91	-10.04		2.21	2.84
Denmark	15.87	17.05	17.83	18.41	17.23	7.50	4.55	3.25	15.64	18.82
Thailand	0.93	0.89	0.90	0.97	0.92	-4.38	1.02	8.22	0.90	0.94
Kenya	1.77	1.61	1.08	1.42	1.49	-8.89	-32.75	30.95	1.75	1.22
Netherlands	2.28	3.03	3.78	4.69	3.38	32.89	24.76	24.12	1.90	4.86
United Kingdom	6.96	7.25	6.64	4.05	6.47	4.24	-8.41	-38.96	7.81	5.12
GGE/GDP (%)										
Australia	36.59	37.22	39.50	38.40	37.87	1.74	6.11	-2.77	36.16	39.59
Chile	31.79	32.10	29.36		31.21	0.95	-8.52		32.65	29.76
Colombia	15.71	17.82	16.94		16.71	13.44	-4.95		15.65	17.77
Denmark	52.73	60.17	57.76	60.82	58.30	14.09	-3.99	5.29	55.03	61.57
Thailand	17.15	20.14	18.64	15.63	18.14	17.43	-7.44	-16.18	18.87	17.42
Kenya	27.28	29.82	28.59	30.10	28.89	9.34	-4.12	5.28	27.43	30.34
Netherlands	54.10	62.15	59.04	55.44	57.80	14.89	-5.00	-6.11	57.26	58.34
United Kingdom	46.01	48.81	43.74	43.59	46.31	1.67	-10.38	-0.35	50.02	42.60

Table 3.1 Size of Government Sector in Selected Countries (continued)

	(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth			Trend (Regression)	
						(2)-(1)	(3)-(2)	(4)-(3)	Initial	Final
CGE/GDP (%)										
Australia	18.66	18.78	20.17	18.90	19.15	0.64	7.38	-8.25	18.57	19.74
Chile	30.71	29.68	25.52	20.99	27.02	-3.35	-14.02	-17.75	31.64	25.09
Colombia	11.34	11.93	10.99		11.52	5.19	-7.93		11.62	11.41
Denmark	20.32	25.88	26.08	27.97	24.91	27.32	0.79	7.24	20.49	29.32
Thailand	13.82	18.15	17.30	14.81	16.08	31.35	-4.65	-14.41	15.48	16.68
Kenya	24.55	28.09	27.49	28.67	26.99	14.42	-2.15	4.30	24.45	29.54
Netherlands	36.68	42.75	39.78	38.44	39.46	16.56	-6.95	-3.36	38.75	40.17
United Kingdom	33.05	35.08	31.38	30.65	32.75	6.15	-10.56	-2.33	34.82	30.68
LGE/GDP (%)										
Australia	2.20	2.44	2.61	2.56	2.44	10.78	7.05	-2.03	2.18	2.70
Chile	1.09	2.42	2.38		1.93	122.55	-1.62		1.01	2.85
Colombia	1.10	1.54	1.40		1.31	39.88	-8.73		1.08	1.55
Denmark	32.11	34.29	31.68	32.85	32.80	6.80	-7.61	3.69	33.15	32.45
Thailand	3.34	1.99	1.34	1.29	2.03	-40.20	-32.78	-3.63	3.36	0.69
Kenya	2.10	1.73	1.37	1.43	1.69	-17.60	-20.76	4.65	2.17	1.22
Netherlands	17.42	19.40	19.27	16.99	18.34	11.39	-0.69	-11.79	18.51	18.17
United Kingdom	14.96	13.73	12.36	12.94	13.56	-8.22	-9.93	4.68	15.19	11.93
LPGE/GDP (%)										
Australia	17.93	18.44	19.33	19.50	18.72	2.89	4.81	0.86	17.59	19.85
Chile	1.09	2.42	2.38		1.93	122.55	-1.62		1.01	2.85
Colombia	4.36	5.89	5.95		5.19	34.90	1.08		4.03	6.36
Denmark	32.11	34.29	31.68	32.85	32.80	6.80	-7.61	3.69	33.15	32.45
Thailand	3.34	1.99	1.34	1.29	2.03	-40.20	-32.78	-3.63	3.36	0.69
Kenya	2.10	1.73	1.37	1.43	1.69	-17.60	-20.76	4.65	2.17	1.22
Netherlands	17.42	19.40	19.27	16.99	18.34	11.39	-0.69	-11.79	18.51	18.17
United Kingdom	14.96	13.73	12.36	12.94	13.56	-8.22	-9.93	4.68	15.19	11.93

3.3 The Historical Trends: Squeezing the State

Graphs 3.2a to 3.2h show the changing government size for the period 1975–94.

In general two forces have combined to reduce the size of the state over the last two decades. One has been the economic crisis, which has reduced both governments' tax revenues and their ability to borrow. The other has been deliberate policy. Neo-liberal governments working from 'private interest' premises have sought to reduce the size of the state; while other governments have been pushed into similar reforms under the scheme of Structural Adjustment Programs (SAPs) (Mackintosh 1992).

In advanced countries the government size had a first fluctuation during the economic crisis of the seventies and a second one from the 1980s onwards. The best example of this behavior is the United Kingdom where from the 80s market mechanisms were introduced to provide public services and, therefore, the contribution of the government sector to the GDP dropped drastically. The same behavior can be fund in The Netherlands and Australia, while in Denmark the size of the government had some fluctuation but, not as in the other advanced countries.

In order to analyse the downsizing of the government in developing countries it is important to have in mind some aspects. First, the countries are relatively small and, as a consequence, there is less scope for cuts than in industrialized countries. Second, since the structure of spendings shows that social security and welfare are, especially in low-income countries, relatively small, the budget cuttings had to be in other items. Third, that in order to keep under control the public deficit and the external gap most developing countries decided to apply a Structural Adjustment Program that seriously reduced the role of their public sector in the overall economy aggregate (Mackintosh 1992).

Table 3.2 Size of Government Sector in Industrial and Developing Countries

	(1) 1974/5-79	(2) 1980-84	(3) 1985-90	(4) 1990-94	Average	Rate of growth			Trend (Regression)	
						(2)-(1)	(3)-(2)	(4)-(3)	Initial	Final
GGR/GDP (%)										
Indust. countries	43.64	46.96	48.70	48.10	46.76	7.62	3.70	-1.25	43.80	49.72
Devel. countries	22.17	23.16	22.19		22.73	4.48	-4.21		20.98	22.71
CGR/GDP (%)										
Indust. countries	35.42	38.01	39.19	38.47	37.68	7.32	3.11	-1.84	35.66	39.71
Devel. countries	19.64	20.14	19.49		19.74	2.55	-3.21		19.60	20.13
LGR/GDP (5)										
Indust. countries	6.78	7.88	9.07	9.62	8.23	16.13	15.20	8.00	8.41	10.05
Devel. countries	0.99	1.26	1.11		1.11	27.33	-11.59		0.97	1.26
LPGR/GDP (%)										
Indust. countries	8.22	8.95	9.51	9.54	9.04	8.94	6.23	0.29	8.11	9.96
Devel. countries	1.39	1.75	1.54		1.55	25.69	-12.17		1.36	1.74
GGE/GDP (%)										
Indust. countries	47.86	52.09	50.01	49.56	50.07	8.84	-3.99	-0.90	49.62	50.53
Devel. countries	22.98	24.97	23.36		23.74	8.65	-6.35		23.65	23.82
CGE/GDP (%)										
Indust. countries	27.18	30.62	29.35	28.99	29.07	12.67	-4.15	-1.23	28.16	29.98
Devel. countries	20.10	21.96	20.32		20.40	9.24	-7.46		20.80	20.68
LGE/GDP (%)										
Indust. countries	16.67	17.46	16.48	16.34	16.78	4.76	-5.63	-0.88	17.26	16.31
Devel. countries	1.91	1.92	1.62		1.74	0.71	-15.45		1.91	1.58
LPGE/GDP (%)										
Indust. countries	20.60	21.47	20.66	20.57	20.85	4.19	-3.75	-0.43	21.11	20.60
Devel. countries	2.72	3.01	2.76		2.71	10.46	-8.22		2.84	2.78

It is difficult to generalize about the rebalance between market and government in developing countries. Chile is probably the best example of downsizing the government sector based on deliberate policies. Indeed, from the mid seventies to the late eighties, we can see that there was not only a reduction of the government sector but also a decentralization process to the local government.

In Colombia, the process was some how different since this country did not apply an SAP during the period for which we have statistical information, it did not have a critical debt problem and, its government size was always relatively small. As a consequence, its governmental sector shows an unusual stability for a developing country.

Thailand shows a significant process of market decentralization from the mid eighties onwards. It is also interesting to note that during the early nineties there was again a growth in the size of its governmental sector.

Kenya is a country with a very fluctuating presence of the governmental sector in the economy. However, once its government sector reached its maximum size in 1982 there has been a permanent effort to reduce it or at least to maintain stable its contribution to the GDP.

3.4 Mechanisms of Market Decentralization: Some Illustrating Experiences

The aim of this section is to illustrate some of the institutional arrangements that are frequently used to redefine the balance between governments and markets and to show that privatization is only its extreme form.

Indeed decentralization, as a redefinition of the government size, can take three forms: (1) to the market (as the case of privatization), (2) to quasi-markets (contracting out, vouchers and franchises) and, (3) to non-government organizations (voluntary associations).

Graph 3.2a Australia: Government/Market Sizes

LPGE/GDP (%)   CGE/GDP (%)   NGE/GDP (%)
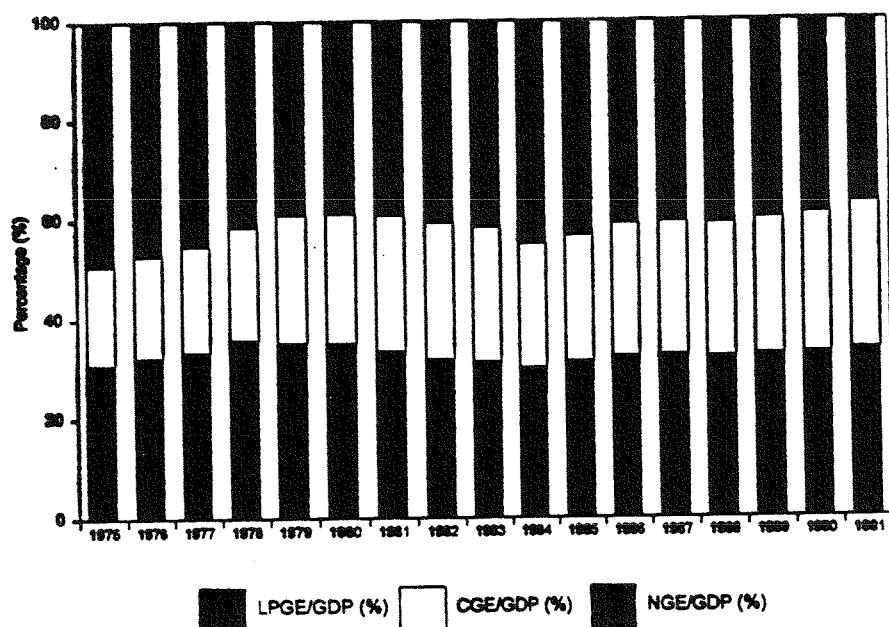
Graph 3.2b Denmark: Government/Market Sizes
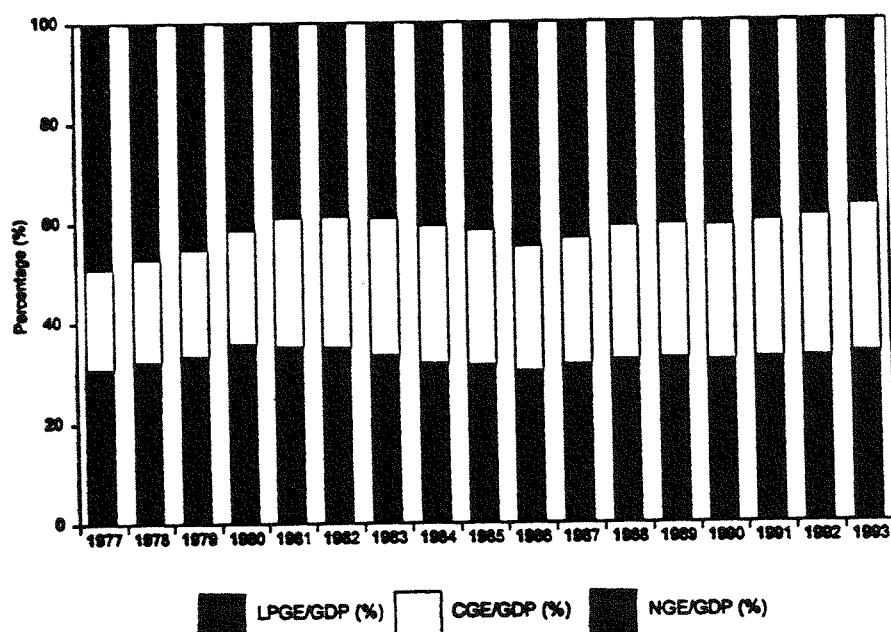
LPGE/GDP (%)   CGE/GDP (%)   NGE/GDP (%)

GGE: General Government Expenditures.
(X): Initial position; (X'): Final position.

Source: Own elaboration based on IMF Government Finance Statistics.

Graph 3.2c   Netherlands: Government/Market Sizes

LPGE/GDP (%)   CGE/GDP (%)   NGE/GDP (%)
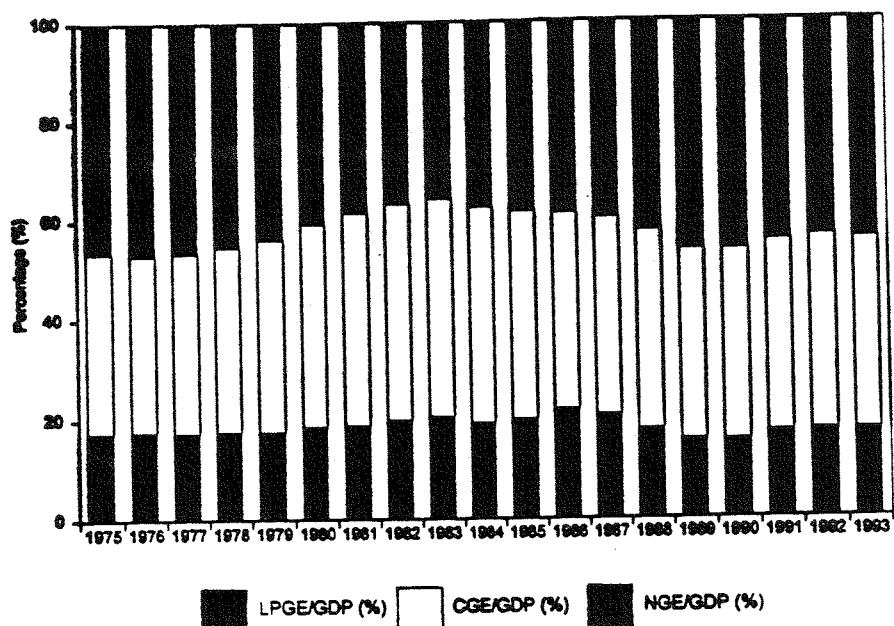
Graph 3.2d   United Kingdom: Government/Market Sizes
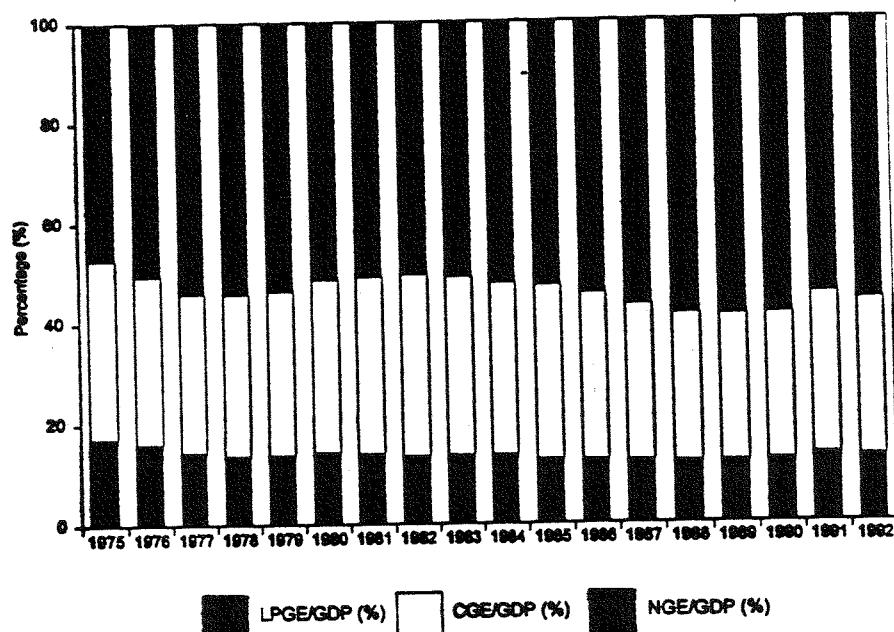
LPGE/GDP (%)   CGE/GDP (%)   NGE/GDP (%)

GGE: General Government Expenditures.
(X): Initial position; (X'): Final position.

Source: Own elaboration based on IMF Government Finance Statistics.

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Graph 3.2e Chile: Government/Market Sizes

LPGE/GDP (%)   CGE/GDP (%)   NGE/GDP (%)
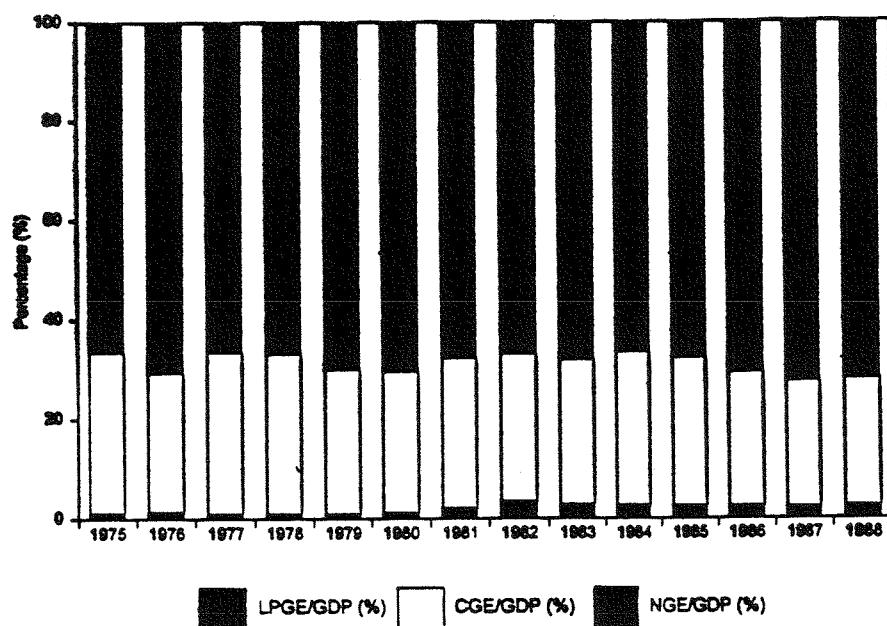
Graph 3.2f Colombia: Government/Market Sizes
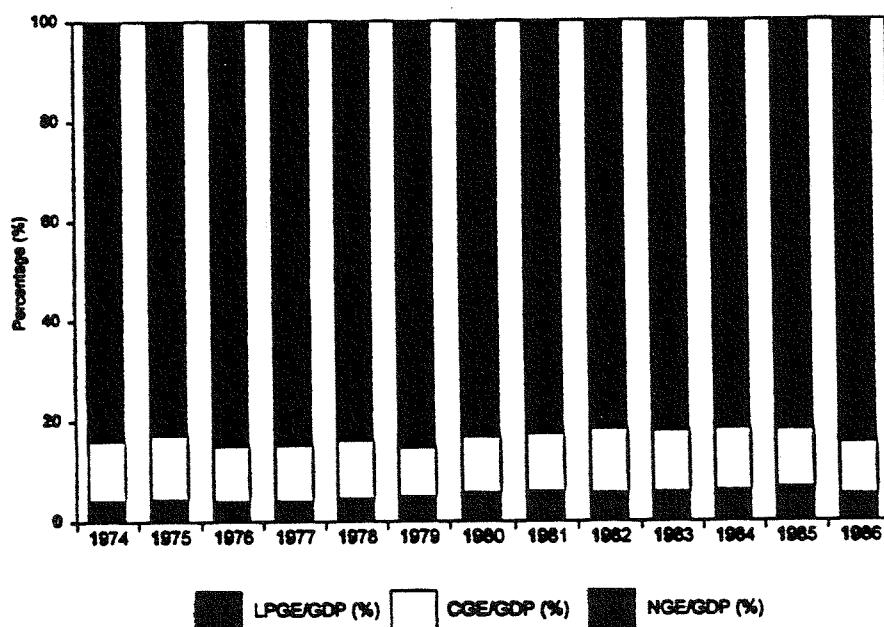
LPGE/GDP (%)   CGE/GDP (%)   NGE/GDP (%)

GGE: General Government Expenditures.
(X): initial position; (X'): Final position.

Source: Own elaboration based on IMF Government Finance Statistics.

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Graph 3.2g Thailand: Government/Market Sizes

LPGE/GDP (%)   CGE/GDP (%)   NGE/GDP (%)
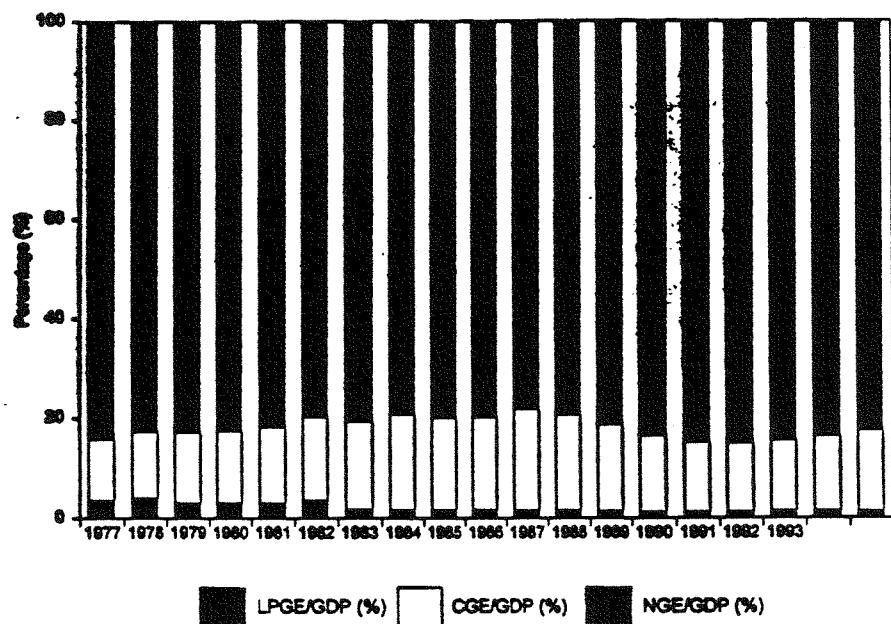
Graph 3.2h Kenya: Government/Market Sizes
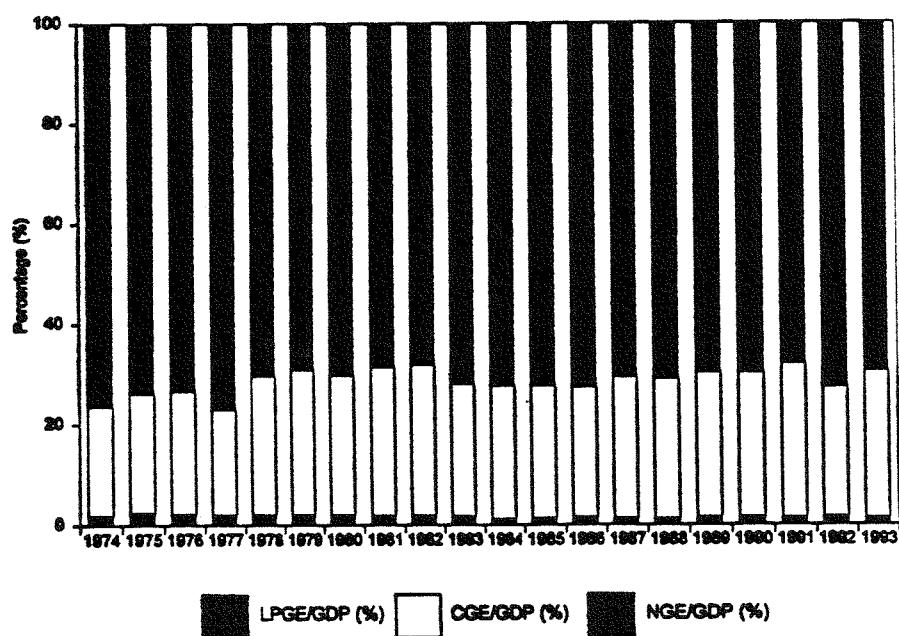
LPGE/GDP (%)   CGE/GDP (%)   NGE/GDP (%)

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3.4.1 Decentralization to the markets

<u>Chile</u>: Compañía de Teléfonos de Chile (CTC)
In 1987 there was a transfer of the (very profitable) telephone monopoly to the employees (4500 out of 6800) and a 30 per cent (later 45 per cent) holding to the Australian Bond Group. The actual (1991) division of the capital is Asociación de Fondo de Pensiones (10 per cent), stock market (19.5 per cent), employees (8 per cent) and private groups (62.5 per cent) (OECD 1991).

<u>Colombia</u>: Instituto de Fomento Industrial (IFI)
The process of market decentralization began in Colombia only in the early nineties. One of the most illustrating experiences is the privatization of eleven enterprises of the public development coorporation Instituto de Fomento Industrial (IFI) in the relativelly short period October 1990 and September 1991. Some of these enterprises are the Compañía Automotriz Colombiana transferred to Massed Corporation, CEM sold to Cementos del Valle and, PROCARBON sold to the private Propal[27] (Consejería Presidencial para la Modernización del Estado 1994)

3.4.2 Quasi-market mechanisms

<u>Contracting out</u>
In this arrangement a private firm is the producer and the government arranges and pays for the service.

Denmark. Contracting out fire and ambulance services
In Denmark the private Falck Company has contracts with 271 of 279 municipalities for at least one service, particularly municipal fire and ambulance. It also pays reservists to supplement full-time personnel (Hatry 1983).

United Kingdom. Contracting out refuse collection services
The example illustrates a policy that could better be described as 'competitive tendering' as opposed to 'contracting out' because the term contracting out carries an implicit assumption that the service will be provided by a private contractor. Instead the objective is to compare costs of existing provision with alternatives, either those offered by private firms or the city's own labor force' (OECD 1987: 88).
The case study was presented on the OECD/Sweden seminar on 'Community Involvement in Urban Service Provision' and involves two boroughs of inner London: Kensington and Chelsea. 'These two boroughs were amalgamated inheriting two separate refuse collection systems, both publicly provided. Chelsea's system was considered inefficient and thus invitations to tender were issued while Kensington refuse collection was to remain in the hands of a direct labor force. In Chelsea the contract was awarded to a firm proposing costs reductions of 51 per cent. In addition, in conjunction with the evaluation process, improvements were made in the Kensington service resulting in an annual 29 per cent per cent cost savings.
Although complaints were lower in Kensington than Chelsea, the direct labor organization was not allowed to tender for Chelsea work when it came up for renewal. The authority decided that it wanted to maintain a situation for which part of the service was provided by the direct labor force and part by external contractors since, if competition was reduced, some of the advantages of competitive tendering were going to be lost' (OECD 1987: 89).

Chile. Water Services
A public water company, Empresa Metropolitana de Obras Sanitarias (EMOS), in Santiago, Chile, encouraged employees to leave the company in 1977 and compete for service contracts for tasks previously performed internally. The results were large productivity gains. The tasks that were subject to this arrangement are meter reading, billing and collection, and maintenance of private connections (World Bank 1994).

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[27] The Colombian government intends to sell between 1995 and 1998 eight electricity companies, two mines (Carbones de Colombia and the nickel mine Cerro Matosa), an insurance company (La Previsora) and other 28 public enterprises for a value of US 2.3 billions. The privatization plan includes to sell the country's five main airports at Bogota, Medellin, Cali, Barranquilla and Cartagena plus the cities' pipelines and refineries. (Latin America Report, September, 1995).

Colombia. Contracting out refuse collection services.

Refuse collection was partially transferred to the private sector in Bogota under the scheme of competitive tendering. •

In Barranquilla, private management was contracted out but the refuse collection services is still public (Consejería Presidencial para la Modernización del Estado 1994).

Kenya. Contracting out locomotive repairs

The state railroad in Kenya has private contractors to do limited locomotive repair and maintenance. The objective was to induce X-efficiency (technical) gains. (World Bank 1994)

Netherlands. Universities and Hospitals.

In The Netherlands several public services are regulated through a special law that allows private organizations (mainly foundations) to have management contracts in several social areas as high education (i.e. universities) and hospitals. The system has the advantage to increase flexibility on service delivery and, therefore, induce efficiency gains.

Vouchers

Chile: Primary Education

A good example of this system of quasi-market decentralization can be found in Chile. In this country private education has been encouraged by means of vouchers paid by the government to a school that was freely selected by the consumers. The aim was to increase competition between private and public schools through 'per-student' vouchers (MacKintosh 1992, Castañeda 1992).

Franchises: Multiple Franchising on Urban Bus Transport

Competition has stimulated both innovation and cost reduction in urban public transport. In Sri Lanka, for example, deregulation permitted the profitable operation of smaller vehicles by small-scale entrepreneurs, substantially improving service availability. Competitively tendered franchises or the granting of overlapping franchise to competing associations of operators is being practiced successfully in several major cities of Latin America and Africa (World Bank 1994).

3.4.3 Voluntary and non-government organizations

Chile. Non-government organizations and technical schools

As part of the 1980–81 educational reform, the public vocational secondary schools were transferred to private non-profit organizations created by associations of employees. For example, the agricultural schools were transferred to the National Agriculture Association (Castañeda 1992).

United Kingdom. Royal Institute for British Architects' (RIBA) Community Project Fund

'This scheme began in 1982 as part of the Department of the Environment's Urban Initiative Fund (UIF), which is matched by RIBA contributions, mainly staff resources. UIF subsidizes voluntary organizations which provide advice and other assistance to local groups wishing to improve, or bring back into use, land and buildings in urban areas. The fund is managed by RIBA which appoints a group of architects to examine them. An architect visits the site, meets with the community group and prepares a report on the architectural feasibility of the project, sources of funding and further technical advice. The RIBA arranges training for the architects involved and publicity for the project.

More than half of the projects are building conversions, one-third new constructions and the remainder are environmental improvements, development plants and campaigns to save buildings or communities. The results of the scheme, helping citizens to mobilize community resources to improve the urban environment, have been shown to be large compared to the amount of CG grant' (OECD 1987: 89).

3.5 Decentralization to the Governments and to the Markets: A Unifying Approach

3.5.1 Extent of decentralization to the governments and to the markets

The extent of decentralization to the governments and to the markets in any country can be compared with that of other countries by using a diagram that: on the vertical axis classifies the extent to which resource allocation is dominantly market controlled or determined by government and, on the horizontal axis, classifies the general financial, economic and political powers of governments with respect to their level of centralization or localization.

Graphs 3.3a, 3.3b and 3.3c show what are the extents of decentralization to the governments and to the markets in all the countries of the sample and in industrialized and developing countries taken as separated groups. The differences between these three graphs are that the horizontal axis measures the extent of expenditure decentralization through the ratio local government expenditure/total government expenditure (Graph 3.3a), the modified expenditure decentralization ratio (Graph 3.3b) and, the revenue decentralization ratio (Graph 3.3c). On the vertical axis, Graphs 3.3a and 3.3b show the ratio general government expenditure/GDP and Graph 3.3c measures the proportion of the general government revenues to GDP.

In the bottom left corner of all graphs we find most developing countries since they assign most of their resources through the market and, with different extent, are power centralized. The theoretical model that best applies to them is the Centralized Market Model and not the Centralized Public Sector Model as proposed by Bennett.[28] In fact, all our developing countries have a relatively small public sector and, therefore, it is evident that they allocate most of their resources through the market.[29]

Using the same graphs we can also analyse if one country is more decentralized or centralized. In fact, in developing countries only Colombia is close to the industrialized countries in matters of government decentralization[30] but, of course, the size of its government sector is far below the ones of Denmark, Australia, United Kingdom or The Netherlands.

All industrialized countries are placed in the center of the graphs so we can say that they have a Mixed Model of decentralization. This hybrid model is a complex mix of decentralization to the governments and to the markets and, in general, it applies to countries with a 'well developed welfare state'.

3.5.2 Analysis of change

Graphs 3.4a to 3.4c show the direction of the decentralization trends using a dash to differentiate a final position from the initial one (e.g. D identifies Denmark at the beginning of the analytical period and D' represents the same country at the end).[31]

In general, there are two patterns of change in developing countries (refer to Graph 3.4a). Kenya and Thailand are moving towards a greater centralization with a relatively static government size.[32] Chile and Colombia, on the other hand, made a significant effort to decentralize power to the LGs and, in the first case, increase the allocation of resources through the market.[33] Obviously, none of the developing countries was able to develop a welfarist model.

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[28] Explicitly Bennett says that "The botton left case, of a centralized public sector model, can perhaps be identified with Spain, Portugal, and to a lesser extend France in the early seventies. This model is close to the form of many developing countries today" (Bennett, 1994: 7).

[29] The classification capabilities of Bennett's models could be improved adding a third dimension: the degree of decentralization/centralization of economic units (Helmsing). The advantage of such addition is that it could allow a better understanding of the decentralization process not only based on fiscal variables but also including statistics about the distribution of economic units.

[30] Specially if we use the expenditure decentralization ratio.

[31] The tendencies were calculated using Ordinary Least Squares for each series.

[32] In order to analyse each country experience it is necessary to complement the information of graphs 3.4.a, 3.4.b and 3.4.c. with graphs 3.2.a to 3.2.h of this chapter.

[33] It is important to recall that the available data do not show the recent changes registered in Colombia. The reason is that decentralization to the market began in Colombia only in the early nineties as a consequence of the economic reforms.

Graph 3.3a Expenditure Decentralization Ratios
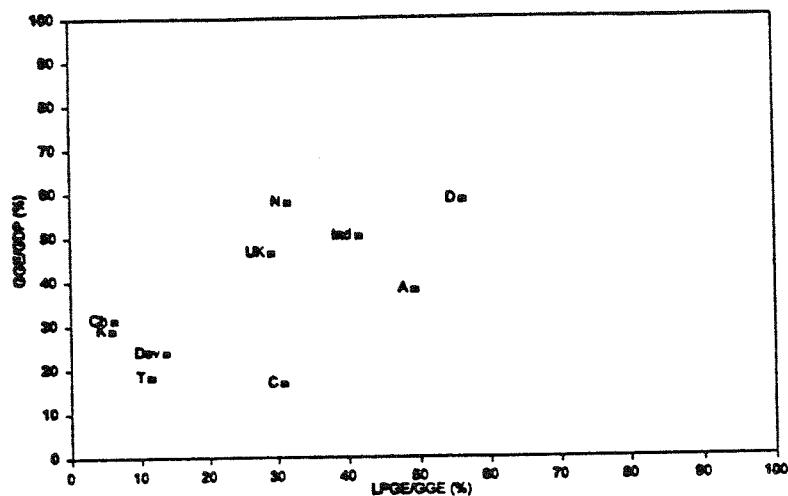
**Graph 3.3b Expenditure Decentralization Ratios**
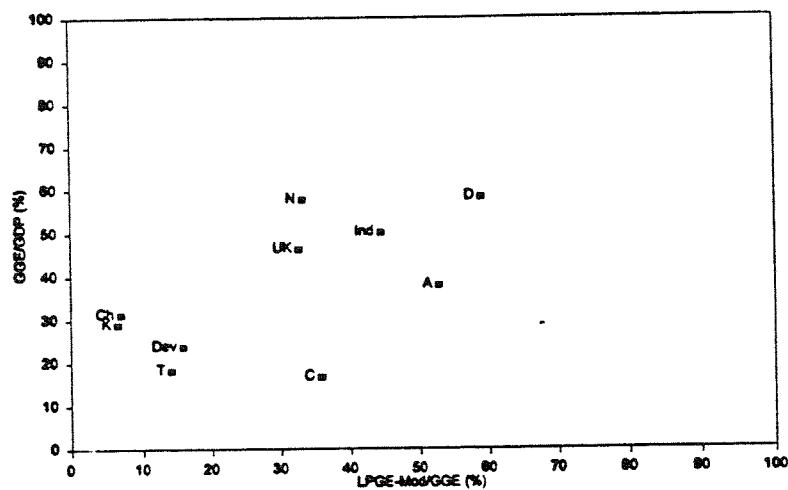

Graph 3.3c Revenue Decentralization Ratios
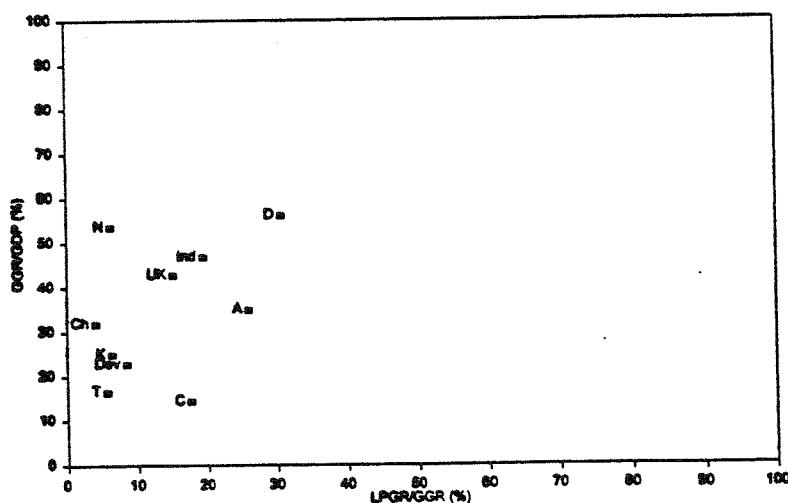
Source: Own elaboration based on IMF Government Finance Statistics.

Graph 3.4a Expenditure Decentralization Trends
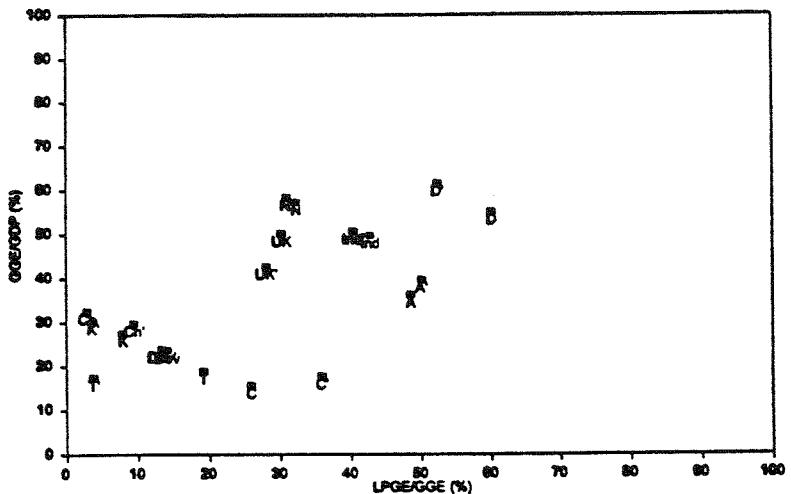
Graph 3.4b Expenditure Decentralization Trends
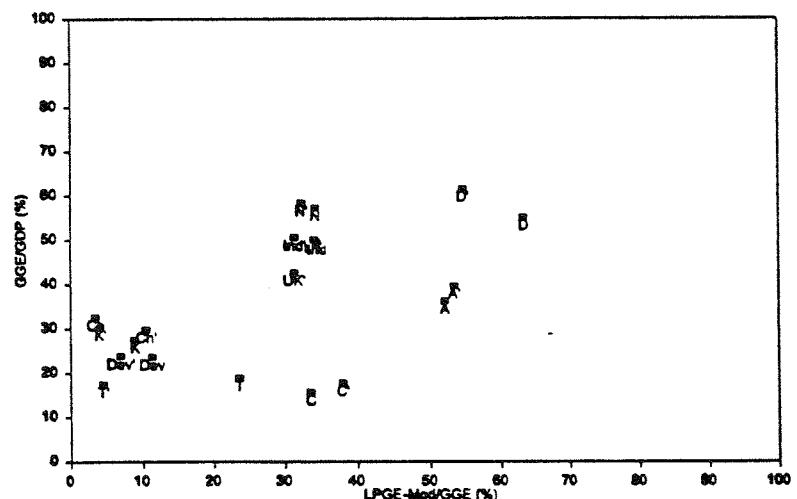
Graph 3.4c Revenue Decentralization Trends
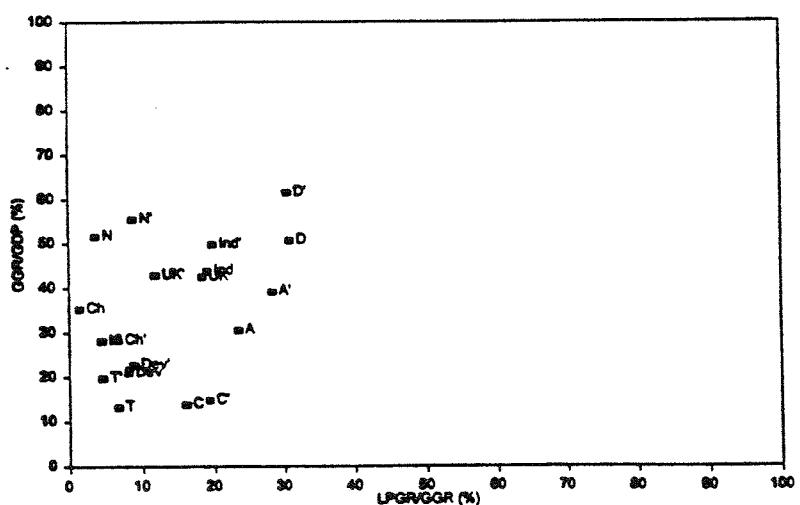
All industries are moving in the area of a mixed or post-welfare model (central area of the graphs). The common characteristic of this model are: (1) demand for greater responsiveness to costumers; (2) innovations on service delivery; (3) managerial reform (internal accountability); (4) reinterpretations of representation and external accountability and; (5) attempts to shift the boundary of government (Bennett 1994).

The most interesting experience in industrial countries is the United Kingdom. 'The reforms of the three Thatcher administrations have at one level imposed new and major centralizing controls: limitation of local tax rates; direct capital and expenditure controls, local spending targets with penalties and grant 'clawback'; and directives to modify local services'. (Bennett 1990: 9). At another level, however, the Thatcher government has been profoundly decentralizing to the markets as we could see from our graphs.

Analysing all the sample we can say that it is only in two countries in which there is evidence of a significant effort to increase the expenditure responsibilities of LGs. These countries are Chile and Colombia. In industrialized countries, there is a redefinition of the balance between the different layers of government but LGs remain very important.

The process of market decentralization is more recent and, therefore, its premature to talk about its effects. However, both in Chile and the United Kingdom, there is evidence that market decentralization is an emerging phenomenon. The common ground for these two countries is that they underwent significant economic and political reforms as part of their shift towards a greater market allocation of resources. The rest of the countries show a surprising stability.

4. POLICY CONSIDERATIONS

Both decentralization to the markets and to the governments have common objectives: increase economic efficiency on the provision of public services and promote a higher responsiveness to the consumer. Several policy considerations are associated with these objectives (Bennett 1990):

4.1 Shifting the Boundary of the Government

Even though the increase in economic efficiency and responsiveness to the consumer can be achieved almost in any institutional arrangement, there seems to be a greater consensus to shift back the boundary of the state. The efficiency arguments in favor of this strategy are: (1) 'that the welfare gain to be derived from pursuit of equity goals is less than the efficiency loss which government intervention produces' (Bennett 1990: 22) (i.e. price of fairness principle) and; (2) that government administration is less efficient than a market where incentives to good management and personnel performance are used to assure greater efficiency (fallibility of government principle) (Bennett 1990). From the responsiveness to the consumer point of view the argument in favor of market decentralization is that government intervention has created dependency on public services and, therefore, it failed to reflect individual preferences.

Some of the instruments used to reduce the government size are 'privatization' (e.g. Colombian privatization of public enterprises of the Instituto de Fomento Industrial) and transfer of government responsibilities to Non Government Organization, associations, cooperatives and voluntary bodies (e.g. Chilean transfer of technical schools to non-profit private organizations). However, as we argue in the next section these are only extreme possibilities for 'load shedding' since there is a wide range of innovative arrangements to provide public goods.

4.2 Innovative Arrangements to Provide Services

As we saw from our illustrating experiences, an alternative strategy for restraining government involvement in service delivery is to make greater use of those arrangements in which government plays a relatively minor role. These arrangements include franchise arrangements for toll goods (e.g. multiple franchising of urban bus services), vouchers (e.g. Chilean experience on primary education), contracting out for the provision of toll or collective goods (e.g. Kenyan locomotive repair system) and, grants or subsidies to private firms that provide

private or toll goods (e.g. in transit systems where the companies are not permitted to raise fares or remove unprofitable routes, subsidies are frequently used to reimburse the company).

Additionally, the policies to increase economic efficiency and costumer responsiveness do not necessarily imply downsizing the governmental sector. In fact, efficiency gains can also result from: new financial arrangements on public service delivery (e.g. user charges, cost recovery mechanisms), improved systems of government accountability and, a greater government capacity to provide an appropriate regulatory environment (Bennett 1990).

4.3   Financial Reforms

Another approach to increase economic efficiency and responsiveness to the costumer is the introduction of 'cost recovery' mechanisms (i.e. user charges and fees) and innovations in the area of taxation.

User charges and fees are important to reveal costumer preferences and improve efficiency because unsatisfied citizens have the possibility to look for an alternative provider if they feel a service is not worth the price. According to Bennett (1990: 22) cost recovery mechanisms have the potential of: '(1) improving resource allocation in the economy as a whole; (2) controlling the possibility of 'crowding out' by imposing a uniform basis for competition which allows alternative suppliers in the non-governmental area to survive and develop; (3) stimulating a closer response of service producers and managers to consumer demands which in turn should raise quality and remove unnecessary production and; (4) may be used to improve social equity and environmental policy by incorporating the social costs of externalities'.

In the area of taxation there is a shift from taxation according to the ability to pay to taxation according to benefits. The argument behind this shift is that on efficiency considerations, better resource allocation can be achieved by more closely linking service benefits and tax charges (Bennett 1990). Examples of this approach are sales taxes and value added taxes. Since cost recovery and taxation according to benefits imply a closer link between consumers and providers, they are a strong argument in favor of decentralization to the local level of government.

4.4   Internal Accountability, Representation, Effectiveness and External Accountability

Internal accountability
The objective of internal accountability is to improve local government efficiency and responsiveness to the customer setting up a managerial system that is more sensible to demand-supply forces. For example, the introduction of accounting concepts used in the private sector can improve the financial control over the costs of providing public services.

Representation and effectiveness
Decentralization to the LGs is important because it minimizes political rents and therefore, improves representation and effectiveness. In other words, the higher the level of information the lower is the probability that politicians receive more votes than they deserve.[34] Consequently, intergovernmental decentralization should be promoted as a way to achieve greater representation and LGs effectiveness.

External accountability
Since 'voting as a signal of market preferences is a very imperfect copy of real markets' (Bennett 1990: 18) there must be mechanisms to improve the link between decisions and services outcomes. These mechanisms involve four areas of external accountability: to taxpayers (i.e. 'no taxation without representation'), to local business, to higher levels of government and, to the electorate (Bennett 1990).

As we can deduce from the policy considerations that are involved in decentralization, the redefinition of the balance between governments and markets and intergovernmental relations are part of broader policy issues: economic efficiency, customer responsiveness, effectiveness and representation. These are aspects that exceed

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[34] This is what Galeotti calls "minimization of political rents" (Bennett, 1990).

the scope of this research but they can be tackled on the basis of a better understanding of the recent trends of decentralization to the governments and to the markets. Obviously, this paper is just a contribution on this last area of research.

CONCLUSIONS AND FUTURE RESEARCH AGENDA

Decentralization is a complex issue if we define it not only in the context of intergovernmental relations but as a process that includes a redefinition of roles between governments and markets.

In order to analyse this process this research was divided into four main aspects: (1) analysis of decentralization to the LGs; (2) analysis of decentralization to the markets, quasi-markets and NGOs; (3) analysis of decentralization using a unifying approach of its components and; (4) identification of policy issues relevant for developing countries.

In relation to the process of decentralization to the LGs several issues were explored and we found that:

(1) Industrialized countries have a higher decentralization ratio than developing ones. The reason for this situation is that the level of economic development of a country determines the aggregate resources that are available for the growth of the governmental sector and, consequently:
   - the scale of government action will be limited by lower levels of GDP; and
   - the extent, form and complexity of government structures will be less developed with lower levels of economic activity.

   The logical corollary of this finding is that low levels of economic development will limit the possibilities of decentralization (especially to the Lgs).

(2) In general, the degree of decentralization of expenditures is higher than the degree of decentralization of revenues and, therefore, LGs are always financially dependent on CG transfers.

   The direct consequence of this dependency is that LGs are restricted on their capacity to respond to costumer preferences especially because they have to follow CGs' standards, norms and regulations rather than local demands.

(3) Generally, higher levels of decentralization imply a lower financial autonomy. However, both in industrialized and in developing countries, LGs are trying to reduce their financial imbalances as a way to better link managerial decisions and the use of LGs resources.

(4) Both in industrialized and in developing countries LGs have a restricted capacity to rely on their own resources because they have limited tax possibilities. This is a direct consequence of the CGs tendency to reserve for themselves the most buoyant and lucrative tax-revenues.

(5) Another restriction of LGs is the weak correlation between tax-revenues and the economic fluctuations of prices and income. This generates a financial problem for LGs (i.e. potential financial crisis) since their expenditures change with income variations and inflation while their revenues are more static. In other words, expenditures are cyclical while revenues are not.

(6) Both subsidies and interest payments are more important for LGs in industrialized countries than in developing ones. The reasons for this situation are:
   - that welfare services in industrialized countries are partly financed through LGs subsidies.
   - that LGs in industrialized countries have an easier access to the banking system and less legal limitations to finance their programmes through it than their counterparts in the Third World.

(7) The proportion of current expenditures in the total shows an increasing tendency both in industrialized and developing countries. Part of this situation can be explained by LGs tendency to adjust their budgets (especially during periods of financial constraints) using capital rather than current items (i.e. it is much more easy to delay a big project than to reduce 'wages and salaries').

(8) Although LGs are supposed to be more efficient and effective in providing social services, in general social spending is still very centralized. The disaggregation of the general government social budget shows that this is not true for all social services.

(9) In most countries LGs have more responsibilities in areas of high priority for human development (education and health) than in other social matters. This implies that social policies directed to increase human capital could be more effective if they involve LGs.

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(10) In general, the education decentralization ratio tends to be higher than the social decentralization ratios A and B. This shows that education is a LGs' primary concern.

(11) In industrialized and in developing countries the non central component of the government tends to have a higher social allocation ratio than the CG. On average, the education and health allocation ratios are also higher at LGs than at CGs.

In relation to the process of decentralization to the markets, quasi-markets and NGOs we found that there is a variety of possible institutional arrangements to achieve efficiency gains and a greater responsiveness to costumers. Indeed, through illustrating experiences we showed that public goods can be provided using private firms, contracting out public services, providing vouchers, granting franchises, and through voluntary work or NGOs involvement.

Additionally, using a 'proxy variable' we measured the extent to which resources are allocated using the market. The results show that in industrialized countries an important part of the aggregate resources is allocated through the government while, in developing countries, governments are still very small and, therefore, most resources are generally allocated through the markets, quasi markets and NGOs.

The third chapter ends showing the relative position and trends of our sample countries in a system that measures both decentralization processes. The results indicate that developing countries are very near a Centralized Market Model since they allocate most of their resources through the market and their governmental systems are highly centralized. On the other hand, all industrialized countries have a Hybrid Model of resource and power allocation. This model is a complex mix of decentralization to the governments and to the markets.

Finally, the last chapter is a discussion of the common policy issues that are associated with the processes of decentralization to the local governments and to the markets. In this area we argue that: (1) the shifts in the governmental 'boundary', (2) the use of innovative arrangements to provide public services, (3) the financial reforms of LGs and, (4) the greater concerns about local government accountability, are part of a broader discussion of the ways to increase economic efficiency and a greater responsiveness to the costumers. These last issues are a central concern for policy makers involved in the process of decentralization.

Based on the findings of this paper it is evident that the processes of decentralization to the governments and to the markets is a complex issue that requires more extensive research. In order to contribute in this direction I tried to identify some preliminary questions that certainly will have to make part of a future research agenda. These questions are:

(1) Under what circumstances can decentralization induce efficiency gains?;

(2) What is the policy environment that is required to implement a successful decentralization process?,

(3) Can decentralization be feasible without a deep Governmental Reform?,

(4) What are the institutional aspects that constrains the decentralization processes?,

(5) What are the limits and constraints of the process of market decentralization?,

(6) How is it possible to balance efficiency and equity considerations in the assignment of economic roles to the different layers of government? and,

(7) How does decentralization contribute to areas of human development priority?.

Obviously, any effort to answer these questions should focus on relevant policy issues for developing countries.

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