



Exploring the Measurement and Effectiveness of the Local Public Sector:

Toward a classification of local public sector finances and a comparison of devolved and deconcentrated finances

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Abstract

Fiscal decentralization and local government finance reform have traditionally been treated as important themes in international development and in the design of country assistance strategies. However, over the past 10 years, the international development community has often narrowly focused on the devolution of financial resources within the context of elected local governments. Indeed, the only type of local public financial data that are collected as part of the International Monetary Fund's Government Finance Statistics is for devolved local governments. The exclusive focus on devolved local government finances ignores the broad array of subnational finance practices engaged in by deconcentrated countries, where the local public sector is typically formed by subnational departments or territorial units of the state administration that report upward but are tasked to deliver public services at the local level. This paper seeks to define a more detailed metric of (local) public sector finances, which recognizes that the central authorities in each country interact with residents, civil society, and the private sector in three ways: through the direct or delegated delivery of public services (by central government entities); through deconcentrated departments or jurisdictions; or through devolved local governments. Formulating a detailed methodology for measuring local public sector finances and collecting data in accordance with this methodology will serve as a foundation to better understanding of the production function of public sector outputs and outcomes. In particular, the more detailed measurement of local public sector finances would allow us to estimate whether centralized, deconcentrated, or devolved expenditures have a differential impact on local public service delivery outputs and outcomes.

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Exploring the Measurement and Effectiveness of the Local Public Sector:

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1. Introduction

Many developing countries have deficiencies in their ability to manage their government expenditures in an efficient and accountable manner, so as to effectively deliver critical, pro-poor public services such as basic education, health, and other public services that are essential to economic development and poverty reduction. An important—but often overlooked—element in sound public financial management is to make sure that resources flow down within the public sector to the local (subcentral) level where public services are actually delivered and where economic development takes place. Instead, public financial resources often remain stuck at the central government level, where these resources are either diverted or fund bloated and inefficient bureaucracies.

While fiscal decentralization and local government finance reform have been treated as important themes in international development and in the design of country assistance strategies for developing economies, the system of intergovernmental finance is seldom treated as a cross-cutting policy issue. In their focus on fiscal decentralization and subnational public finances, international financial institutions, international development agencies, and the related research community have focused to a considerable extent on the distribution of financial resources within the context of countries that largely rely on devolved, elected local government for the delivery of key public services. The (near) exclusive focus on devolved expenditures in practice and in research ignores the fact that in about half the developing countries around the world, key public services are delivered in a deconcentrated manner, where the local public sector is formed by subnational departments (or territorial units) of the state administration that report upward but are tasked to deliver public services at the local level. As such, the current measures of local government finance systematically fail to capture a broad array of deconcentrated subnational finances.

In the absence of systematic comparative data on the structure and nature of local public sector finances (including devolved as well as deconcentrated expenditures), cross-country studies that seek to estimate the “production function” of public services are either forced to systematically exclude almost half of the world (countries with predominantly centralized deconcentrated

public service provision) or make conclusions about the (in)effectiveness of the public sector while omitting details about the size and scope of deconcentrated expenditures. Without basic comparative data on local public sector finances, important real-world questions about public sector effectiveness, improvements in public service delivery, and the success of decentralization reforms are extremely difficult to answer:

- In Mozambique, the municipal level is responsible for only about 1 percent of total public spending. However, important public services including basic education and local health services are delivered in a deconcentrated manner by provincial and district administrations. In fact, approximately 25 percent of public sector resources is spent by deconcentrated administration departments. How does the level of local public sector spending in Mozambique compare to countries where education and health services are delivered in a devolved manner? Is Mozambique more or less efficient in producing public services in comparison to more devolved countries?
- In October 2010, Tanzanian Prime Minister Mizengo Pinda claimed that 80 percent of the country's national budget is being spent on public service delivery at the local level. When advised of the fact that only about 25 percent of the national budget is transferred to local government authorities in the form of intergovernmental fiscal transfers, the prime minister asserted that the remainder finds its way to the local public sector indirectly. How can such indirect funding flows to the local public sector be measured?
- Egypt spends approximately 16 percent of its recurrent budget on deconcentrated public service delivery for wages and nonwage expenditures. Compared to other deconcentrated countries, is this a lot? How does this compare to local public sector spending in devolved countries that are similar to Egypt?
- Sierra Leone provides only about 7 percent of its budgetary resources to the country's districts and municipalities. However, virtually all wages for staff involved in the delivery of local public services are paid by the central treasury. What is the "real" degree of decentralization in Sierra Leone?
- In Afghanistan, approximately three-quarters of public finances are disbursed by the central treasury in Kabul, with only one-quarter being disbursed by provincial treasuries or spent by municipalities and other local entities (World Bank 2008). Does this mean that the center is hoarding financial resources and that public sector finances in Afghanistan are overly centralized?
- Kenya's new constitution commits to sharing 15 percent of national financial resources with the new county government level. Based on the functions that are assigned to the new county governments, how does this compare with the amount of spending currently being made available to these public services?

A more comprehensive metric of (local) public sector finances ought to recognize that virtually no country in the world is purely devolved or purely deconcentrated, but rather, that the central authorities in each country simultaneously interact with residents, civil society, and the private sector in three possible ways: through the direct or delegated delivery of public services (by central government entities); through deconcentrated departments or jurisdictions; or through devolved local governments.

Box 1: An empirical research agenda on local public sector finance

Due to the lack of comprehensive data on local public sector structures and finances across a cross-section of devolved and deconcentrated countries, some critical questions about public sector effectiveness have hitherto been largely empirically unexplored. For instance, the subsidiarity principle suggests that many of the most important pro-poor public services (including education, health services, agricultural extension, access to potable water, and solid waste management) ought to be delivered at the local level within the public sector. But how does a country's governance structure affect the level of financial resources that is provided to the local public sector? Are devolved systems better at directing more resources to the local level than deconcentrated mechanisms? Or, stated differently, are devolved local governments more or less able to achieve vertical fiscal balance?

In a first-best world, it should theoretically be easier to achieve vertical fiscal balance in a public sector that includes autonomous local governments that have substantive revenue autonomy, since local governments would be able to collect own source revenues to fill any vertical fiscal imbalance. However, in a second-best reality, subnational governments are often provided limited revenue discretion or assigned undesirable or inefficient revenue instruments. In practice, the political economy of devolution may also underfund the local government level through the intergovernmental transfer system. Under these second-best conditions, it is an open empirical question whether deconcentration or devolution achieves greater vertical fiscal balance.

A second research question that arises is whether devolved countries are better able to achieve a more equitable and efficient horizontal allocation of resources than deconcentrated countries. Again, in a first-best (or first generation) fiscal federalism framework, a conceptual argument could be made that revenue autonomy would allow local governments to attain allocative efficiency by matching their desired expenditure level by increasing or decreasing their own source revenue collections accordingly. Again, this argument is weakened by the limited revenue autonomy of local governments in many countries. Furthermore, in reality, local governments are often responsible for government services with extensive social implications and/or inter-jurisdictional externalities. In these cases, whether an optimal horizontal allocation of resources is achieved (i.e., the horizontal allocation necessary to achieve the efficiency and equity objectives of the center) depends to a large extent on the horizontal allocation of intergovernmental fiscal transfers. Ample empirical evidence exists that politics and other forces beyond fiscal considerations (such as local expenditure needs and fiscal capacity) are important determinants of the horizontal allocation of public sector resources (Boex and Martinez-Vazquez 2004). Likewise, political factors commonly drive the net fiscal incidence of public sector finances.

A third empirical question, given the real-world limitations of intergovernmental institutions and fiscal systems, is which intergovernmental institutional structures are more effective at transforming fiscal inputs that reach the local level into policy outputs and outcomes. There are again conceptual reasons to argue that devolved local government officials may be best positioned to determine the optimal combination of inputs (in terms of human resource inputs, nonwage expenditures, and capital infrastructure) to achieve technical efficiency in the use of local resources. At the same time, limits to local discretion and weak local accountability structures may actually result in the inefficient use of local public financial resources. This again leaves the question—which intergovernmental institutional structure is more effective at transforming fiscal inputs into policy outputs and outcomes—open to empirical testing.

As a starting point, we do not assume that any of these institutional arrangements is inherently better than others. Instead, we seek to explore under which conditions different institutional mechanisms might be an appropriate and efficient approach for the delivery of government services.

In order to explore local public sector finance patterns in a more precise manner, the metric used to measure local public sector finances should be more nuanced and capture not only the size of devolved expenditures and revenues, but also the size and details of deconcentrated and centralized expenditures. As such, the first step that the research community has to take on this point is to formulate an accurate definition of devolved expenditures versus deconcentrated and delegated expenditures. However, local governments or local administrations do not necessarily have the same degree of discretion or control, either over devolved expenditures or over deconcentrated expenditures. As such, different types of local public expenditures and revenues should not merely be lumped together. Instead, in addition to measuring the size of the different types of resources flows, a comprehensive metric of local public sector finances should also capture qualitative (political, administrative, and fiscal) aspects of the local public sector, for instance, by capturing the degree to which local governments (or local administrations) actually have discretion or control over their expenditures.

The main purpose of this paper is to reflect on the current state of knowledge with regard to classification of (local) public sector expenditures across different countries and to arrive at a consistent classification of (local) public expenditures and revenues that allows us to identify what share of public expenditures is spent within the local public sector, especially in direct support of the delivery of public services that have a direct impact on the households and businesses that are the recipients of the services. Furthermore, to the extent possible, the classification scheme should be sufficiently detailed to identify what institutional mechanisms were used to make these expenditures. At the same time, the classification approach should be sufficiently easily to use that it can be operationalized in an effective manner.

2. The current categorization of local government subsector finances

The territorial-administrative structures of countries vary greatly among countries and over time in terms of the number of levels, the number of jurisdictions at each level, and the functions and responsibilities assigned to each level. It is an ongoing challenge to accurately capture the territorial and administrative structures of countries in a comparative manner (GADM 2011; Law 2011). Within most classification schemes, however, provision is made for three territorial levels of government or administration: (i) the central or national government; (ii) state, provincial, or regional-level jurisdictions; and (iii) local-level jurisdictions.

States, provinces, or regions can be defined as “the major administrative divisions of countries” (Law 2011) or “the largest geographical area into which the country as a whole may be divided for political or administrative purposes” (IMF 2001, 14). From country to country, these jurisdictions may be described by other terms, such as governorate, cantons, republics, prefectures, or administrative regions.

Next, a local government or local administrative jurisdiction can be defined as the institutional body for a specific local area—such as a town, county, or district—that constitutes a subdivision of a major political unit, such as a central government or regional government. The International

Monetary Fund (IMF 2001) defines local government units as “being restricted to the smallest geographic areas distinguished for administrative and political purposes.” The local government level can encompass a wide variety of different general-purpose or special-purpose local governmental units, such as counties, district administrations, municipalities, cities, towns, townships, village authorities, boroughs, school districts, water or sanitation districts, and so on.

The IMF’s Government Finance Statistics publications form the primary international data source for the comparative analysis of public sector finances, including subnational public finances. Therefore, the IMF’s (2001) classification of public sector structures provides the *de facto* global standard for classifying and categorizing public sector finances.

In classifying the public sector, the IMF relies on a combination of political, administrative, and fiscal features (table 1) to define local government entities. In the IMF’s view, local (and state) governments must be institutional units “entitled to own assets, raise funds, and incur liabilities by borrowing on their own account. They must also have some discretion over how such funds are spent, and they should be able to appoint their own officers independently of external administrative control” (IMF 2001, 14).

Table 1
Features of devolved local government entities (versus deconcentrated entities)

	Devolution	Deconcentration
Local entity	Local government	Local administration
Legal characteristics	Corporate body (can own assets and engage in financial transactions, sue and be sued in its own name)	Part of national / state administration
Political characteristics	Own political leadership (elected local council and/or local executive); adopts its own budget	No political decision-making power (advisory council, if any)
Admin. characteristics	Local government appoints own officers and has discretion over own human resources	Local staff are hierarchical part of national civil service
Fiscal characteristics	<ul style="list-style-type: none"> • Has its own budget (separate from higher-level government); can carry forward balance from year to year • Has own budget accounts • Can raise funds and retain its own revenues in its own budget • Can incur liabilities by borrowing on its own account 	<ul style="list-style-type: none"> • Budget of jurisdiction is part of national budget as (sub-)organization • Budget is approved by higher-level government (e.g., Parliament) • Finances are part of Consolidated Treasury Account • Any revenues belong to central government

The way in which the IMF approaches the definition of state and local government subsector finances suggests that the IMF’s aim is not to distinguish between different geographical or territorial administrative levels within the public sector: Instead, it seeks to distinguish between the central government apparatus as a whole (including its subcentral administrative tiers) on the one hand, and devolved (typically elected) subcentral government levels on the other hand,

which in principle are politically, administratively, and fiscally independent operating entities.¹ In accordance with this definition of the local government subsector, the financial transactions of deconcentrated administrative tiers are excluded from consideration, and are simply aggregated into central government finances. This means that within the current classification of local public sector finances, there is a single, sharp (and rather un-nuanced) categorization: Either public sector resources are part of the local (or state) government subsector because they are collected or spent by a devolved regional or local government unit, or the spending is simply considered part of central government expenditures.

Despite the emphasis on operational autonomy as a defining characteristic of local governments, the IMF *Government Finance Statistics Manual* (2001) acknowledges that in practice, local governments are frequently constrained in their operations in one way or another.² For example, while local government are supposed to have fund-raising powers, the IMF recognizes that the “scope of a local government’s authority is generally much less than that of the central or state governments, and such governments may or may not be entitled to levy their own taxes on institutional units or economic activities taking place in their areas.” It is also recognized that many local governments are heavily dependent on grants from higher levels of government, and that in some cases there is also a principal-agent relationship between the central or state government and the local government institution.

Thus, while the IMF definition of the local government subsector is supposed to be quite sharp, in practice, it does not appear that the dividing line between devolved local government units and dependent local jurisdictions (such as deconcentrated local administrations) is always clear, or that the definition is applied in strict accordance with the norms set forth by the GFS manual. It is not unusual for the degree of local entities’ administrative and fiscal powers to be considerably constrained by law or practice, without the entity losing the consensus designation of “local government.” For instance, it is not unusual for local government entities to be designated as local governments even when a local entity’s ability to appoint its own officers or staff is constrained by high-level administrative control;³ when the entity’s authority over its own budget is sharply curtailed;⁴ or when the entity virtually lacks own source revenue-raising powers or borrowing powers.⁵

¹ The degree of dependence is an important determining factor of whether a jurisdiction should be considered a government unit, versus a dependent agency of some broader government unit. For this purpose, the IMF (1986) specifically defined dependent agencies where (1) they depend for all or a substantial portion of their revenue on appropriations or allocations made at the discretion of another government; (2) they lack their own officers; (3) they must submit budget estimates to another governmental entity, which may in turn raise or lower the submitted estimates (not precluding administrative review); and (4) important aspects of their administration are controlled by another governmental entity.

² The emphasis on operational autonomy as a defining characteristic of local governments was particularly in the IMF’s 1986 formulation; it seems to have become a bit more nuanced in the 2001 version of the document.

³ Despite some experimentation with directly elected mayors, mayors in the Netherlands are appointed by the Ministry of Home Affairs. Similarly, Chief Administrative Officers in Uganda are centrally appointed.

⁴ The budget estimates of local councils in Uganda are incorporated in the national budget as separate budget votes.

⁵ For instance, local and provincial governments in many countries only raise a small percentage of their financial resources through own source revenue collections. In addition, local governments in many countries have extremely limited expenditure discretion. Similarly, central authorities in many lesser developed economies have imposed

In addition to the concerns about the scope of the local government subsector and the measurement of local government finances, an extensive literature exists that is concerned with the subsequent use subnational expenditure and revenue data drawn from the IMF's Government Finance Statistics as a measure of (fiscal) decentralization (e.g., Ebel and Yilmaz 2002; OECD, 2002). In particular, this strain of literature suggests that the different aspects of the intergovernmental fiscal system (including important qualitative elements) should be captured and measured. For instance, it is important to measure not only the size of local government expenditures, but also the nature of local government *control* over subnational expenditures and revenues, as these more qualitative aspects of (fiscal) decentralization help to determine the relationship between intergovernmental finances and subnational service delivery outcomes. It is a small step from this concern to the recognition that certain public sector expenditures—while not strictly adhering to the IMF's definition of state or local government expenditures—are in fact managed or controlled to a smaller or lesser degree by officials at the subnational level.⁶

3. Defining the local public sector

In the current thought experiment on local public sector finances, our interest is not to define subsectors of the public sector that are politically or operationally autonomous or independent, but rather, to identify that portion of the public sector that is “close to the people.” Then, the local public sector—in the way the term is used here—is largely, although not fully, consistent with a more territorial definition of subcentral (regional and local) governance units.

As a working definition, the local public sector could be conceived of or defined as that part of the public sector that regularly interacts with residents, civil society, and the private sector; it is where residents and businesses receive services from the public sector and where residents interact with government officials. As such, the distinguishing feature of being part of the “local public sector” is not exclusively the governance status of a subnational public entity, but rather, whether the primary objective of the local entity or institutional unit is to interact with the public, in terms of providing public services, regulation, public information, and so on.

In virtually all (if not all) cases, the local public sector fully encompasses the local government or administrative level (whether it is devolved or deconcentrated in nature), including frontline service delivery units and their administrative staff, such as schools and health clinics and

controls on local governments' authority to borrow funds, to the extent that many local governments—in law or in practice—are not authorized to borrow funds.

⁶ Consider, for instance, a district local government in Uganda, which has no control over its wage bill, as the determination of local establishments (staff positions), wage rates, and (virtually) all other local human resource management decisions are made centrally. However, since local governments in Uganda are corporate bodies with elected local councils, the existing metric counts local wage expenditures in Uganda as part of local public sector expenditures. In contrast, infrastructure projects that are funded under the Fund for Local Investment Initiatives in Mozambique are *not* considered as “local spending” under the current methodology (despite being determined in a participatory manner at the district level), since districts in Mozambique are deconcentrated administrative entities rather than corporate bodies.

teachers and local health workers. To the extent that the state or regional level or tier in a country is a direct provider of public services and/or interacts regularly with residents (for instance, in case of the regional level in Namibia), this government level could equally be considered to fall within the local public sector.

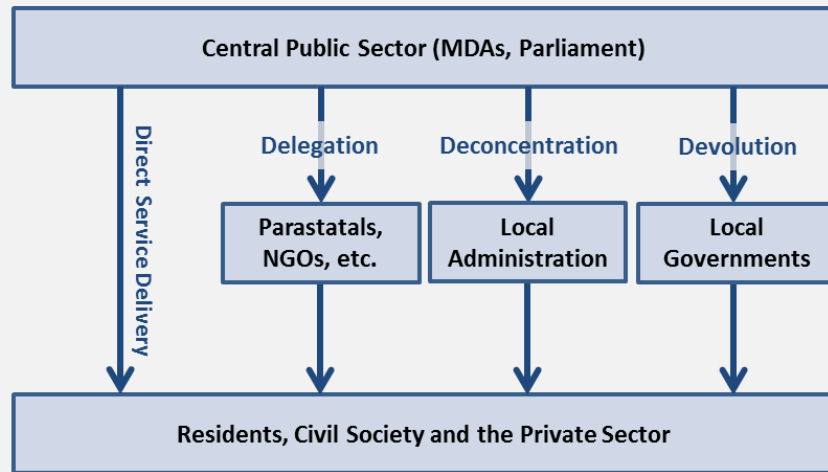
In rare instances, as further discussed below, some central government activities may (or may not) be considered to fall within the local public sector.

As noted earlier, although in common parlance countries are often referred to as “deconcentrated” or “devolved,” in fact, the central government in any country often interacts with its citizens or residents in a number of different ways. For instance, a country that has a “devolved” public sector structure (i.e., a country that predominantly relies on elected regional and/or local governments for the delivery of key public services) may nonetheless deliver certain public services in a deconcentrated manner, just as a predominantly deconcentrated country may engage in a limited amount of devolved expenditures.⁷ Indeed, an initial review of public sector structures would find it difficult to identify any countries that are fully consistent with any single one of the pure “textbook” models for the public sector structure. As such, it is generally more appropriate to measure the relative share of centralized (direct) expenditures, delegated expenditures, deconcentrated expenditures, or devolved expenditures in a country rather than characterizing an entire country as adhering to one approach or another. In addition, we would want to capture the institutional arrangements that surround each of these funding flows.

Having taken into account that the public sector can be categorized geographically in central, regional, and local-level jurisdictions, perhaps one of the most intuitive ways to look at the local public sector is to consider the institutional ways the central public sector interacts with its residents and delivers public services (figure 1). Together, these four institutional arrangements—in one way or another—comprise the building blocks of the local public sector.

⁷ An example of the centralized or deconcentrated provision of public services in an otherwise devolved country could include police services or the provision of national and regional hospital services, in a country where other public services (public education and so on) are provided in a devolved manner through elected local governments. An example of a devolved service provision in a predominantly deconcentrated country is Mozambique, where municipal services are delivered by elected municipal governments, while all other public services are delivered in a deconcentrated manner. Under the new constitutional framework in Kenya, public education services will be delivered in a centralized (deconcentrated) manner, whereas public health services, agriculture services, and a range of other public services will be delivered at the county level in a devolved manner.

Figure 1. Interaction between the Central Public Sector and Residents, Civil Society and the Private Sector



Devolved (elected) local governments. Devolution can be defined as “the transfer of authority for decision-making, finance, and management to quasi-autonomous units of local government with corporate status” (Litvack and Seddon 1999). In a devolved public sector, local governments have clear and legally recognized geographical boundaries over which they exercise authority and within which they perform public functions. While in some countries a broad range of public functions and services are assigned to the local government level (including basic education, health services, and so on), in other countries local governments are responsible for a narrower set of services (e.g., typical municipal services, such as local markets and solid waste management). A devolved governance structure enables residents to interact not only with local service providers and local administrators, but also with the elected officials who are responsible for supervising the delivery of government services at the local level.

Deconcentrated line departments. In countries without elected local government levels, the local public sector is typically formed by “deconcentrated” subnational line departments or subnational territorial units of the national government, which form a hierarchical, administrative tier of the higher-level government. In these countries, the subnational administrative units are generally assigned the responsibility for delivering key government services—such as education, health services, and so on—within their respective geographic jurisdictions.

Because deconcentrated departments or jurisdictions are merely a hierarchical part of the next-higher government level, unlike local governments, deconcentrated units are not corporate bodies. Nor do deconcentrated jurisdictions have their own budgets; instead their budgets are typically contained as sub-organizations within the budget of the higher government level. In deconcentrated systems, “local” government officials are an integral part of the national public service, and local executives (such as regional or district governors, as well as local department

heads) are generally appointed by the central government. Even in countries that do have elected local governments, the central government often delivers certain public services in a deconcentrated manner. For instance, in many countries—even those with elected local governments—police services are often delivered in a deconcentrated (or even in a centralized) manner.

Deconcentration is often considered a relatively weak form of decentralization. Within this category, however, policies and opportunities for subnational input vary: Deconcentration can merely shift implementation responsibilities from central government officials in the capital city to those working in regions, provinces, or districts, or it can create strong local administrative capacity where a degree of operational and budgetary discretion is yielded to deconcentrated line departments under the supervision of central government ministries (Litvack and Seddon 1999).

Delegation to parastatals and Non-Governmental Organizations.⁸ In some instances, central line ministries or agencies may deliver government services and interact with the public through parastatal organizations that are part of the central government, but that are not on-budget central government entities. For instance, although national hospitals and public universities generally are funded by—and report to—their respective central government line ministries, these institutions typically have a degree of legal, administrative, and financial autonomy as parastatal entities.⁹ By establishing these entities as parastatal entities, these organizations tend to gain discretion in managerial and budgetary decisionmaking, as the construct may allow them to be exempt from constraints on regular civil service personnel and enable them to charge users directly for services.

Alternatively, central government agencies sometimes deliver government services by delegating the responsibility for providing the services to non-governmental organizations (NGOs), which are contracted to act as agents of the public sector. Religious-based organizations that are contract to provide health care services or nonpublic schools that receive public sector funding could also be counted as being part of local public sector expenditures. Since in these cases NGOs act as agents of the public sector, such delegated expenditures should be considered to be part of local public sector expenditures.

Direct interactions between residents and central government institutions. Finally, central governments sometimes (albeit not very often) interact directly with their residents and/or deliver

⁸ Note that according to the classification described here, delegation in principle does not include functions devolved to local government entities. The transfer of functions to elected local government entities—even if local government authorities have extremely limited or no discretion over the delivery of certain local public services—is captured under the concept of devolution. In practice, local governments have limited discretion over a sizeable share of the functions and resources assigned to them, whether as a result of central government regulation or as a result of earmarking of the intergovernmental transfer system.

⁹ Similarly, in some countries “local” public water utility companies are agents of the central Ministry of Water rather than of the local jurisdictions which they serve, while local housing corporations may report to the central ministry with responsibility for housing. To the extent that local governments themselves use public corporations, public enterprises, and NGOs for the purpose of delivering services, these locally delegated expenditures are clearly part of the local public sector as well.

government services directly to the general public. It is not uncommon for border control, the issuance of passports and national identity papers, the issuance of certain (business) licenses, and the collection of national taxes and revenues to be conducted directly by central government line ministries or agencies. In addition, in many countries, the provision of law and order (or police services) is a central government function, which is often fully funded through the central government budget.

In addition, it is not unusual for central line ministries to incur capital infrastructure expenditures and other expenditures (such as spending on schoolbooks and drugs and medical supplies) that are used for frontline services delivery by the local public sector. A broad definition of local public sector spending could count such expenditures as a centralized expenditure toward local public sector service delivery.

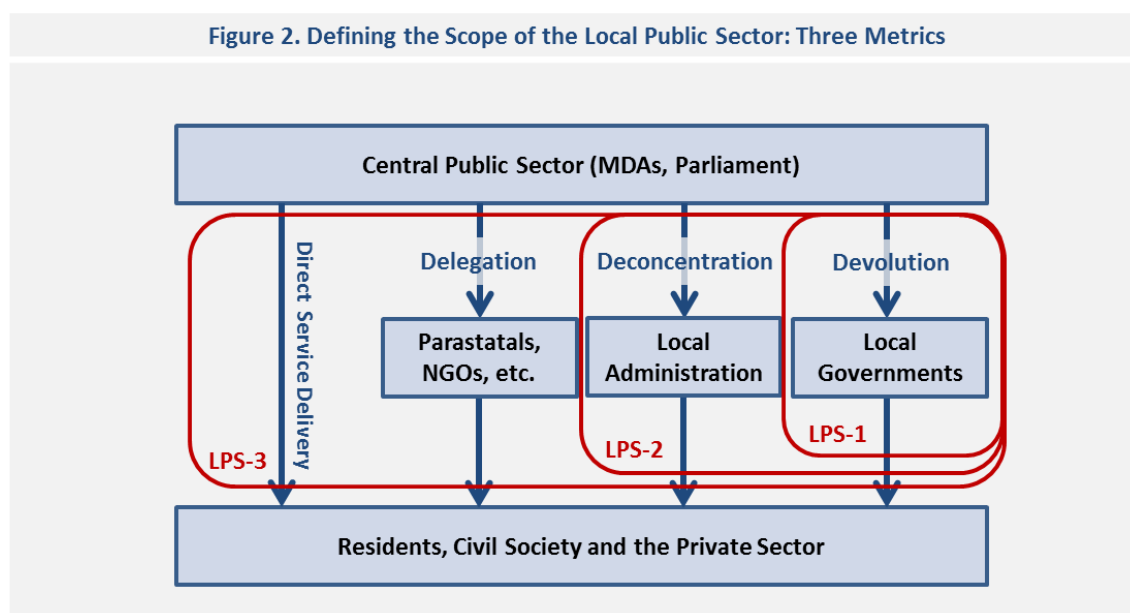
4. Toward a set of metrics for local public sector finances

A complete metric of the local public sector should not merely add up the different types of funding flows to the local public sector, but rather, capture the qualitative as well as the quantitative aspects of each of these local public sector financial flows that are part of the local public sector in each country. As such, defining a metric of local public sector finances should, first, define the scope of the local public sector; second, define a consistent way to measure local public sector funding streams; and third, capture the institutional dimensions of the local public sector and intergovernmental (fiscal) systems.

Defining the scope of the public sector. Unlike the IMF, our interest in the local level of the public sector is not necessarily limited to measuring the financial transactions of local government entities that are not legally or budgetarily part of the central government. Instead, we are interested in knowing to what degree people are empowered over the local public sector. As a result, in addition to measuring funding flows to local governments, we are equally interested in knowing about the resources that flow to regional and local administrative jurisdictions that are not considered to be autonomous local government entities, but that nonetheless provide direct public services to local communities and the private sector. In order to move the state of knowledge forward on the role of the local public sector, our challenge is to arrive at a metric for local public sector finances that allows us to measure regional and local-level public finances in a standardized and comparable manner around the world, even though the institutional structure, responsibilities, powers, and characteristics of public sectors vary considerably between countries.

The exact scope of the local public sector, however, depends on our specific interest. In some cases, it may be appropriate to define the local public sector more narrowly, while in other instances it may be appropriate to capture the local public sector in a more comprehensive

manner.¹⁰ If the local public sector is defined as that part of the public sector that regularly interacts with residents, civil society, and the private sector—where residents and businesses receive services from the public sector, then—for measurement purposes—we could define the local public sector more broadly. However, if we conceive of the local public sector as that segment of the public sector where residents interact with either subnational administrators or elected local government officials who are responsible for delivering services in their subnational jurisdiction, then the scope of the local public sector would be less expansive. The set of metrics used to measure the local public sector should accommodate these different interests and different interpretations of the concept. Thus, local public sector finances are defined by three progressively comprehensive metrics (figure 2):



- LPS-1. The narrowest definition of the local public sector (LPS-1) captures only the finances of devolved local governments. This formulation considers that in order for there to be a true interaction between the public sector and residents at the local level, there should be political and administrative as well as fiscal decisionmaking authority and discretion at the local level.
- LPS-2. A somewhat broader definition of the local public sector (LPS-2) captures the financial transactions of devolved local governments as well as the transactions of deconcentrated local administrative jurisdictions. This metric implies that a necessary condition for inclusion in the local public sector is the existence of a subnational administrative jurisdiction (whether devolved or deconcentrated) that interacts with residents, civil society, or the private sector.

¹⁰ For instance, if we are interested in subnational financial management, it may be appropriate to define the local public sector more narrowly as local public sector entities that have their own financial management processes (LPS-1, below). In contrast, if we are interest in the production function of the public sector, than all financial flows between the central public sector and civil society are relevant (LPS-3, below).

- LPS-3. The broadest definition of the local public sector incorporates all interactions between the central public sector and residents, civil society, and the private sector, through devolution, deconcentration, and delegation, as well as public services and infrastructure provided directly by the central government. This definition recognizes that—in addition to devolution and deconcentration—delegation and direct service delivery is an attempt by the center to bring the public sector closer to the people.¹¹

Since “institutions matter” and not all decentralized expenditures necessarily result in the same responsiveness of the public sector, the same quality of public services, or the same economic or governance benefits, each metric of the local public sector should provide a breakdown of the different types of local public sector expenditures (rather than simply aggregating them), in addition to providing a political-administrative governance profile of each of the different funding streams for each country for which the local public sector is assessed.

Measuring Local Public Sector Finances. Each of the funding flows presented in figures 1 and 2 have to be carefully defined in order to ensure that the metric that quantifies the local public sector captures the quantitative aspects of the local public sector’s finances in different countries in a consistent and comparative manner.

Central Government Expenditures on Direct and Delegated Public Service Delivery

Most central government expenditures are spent by central ministries, departments, and agencies in ways that do not—or only indirectly—provide benefits for residents. To the extent that line ministry spending takes place to cover the operational and administrative costs of the central ministry or department itself, these expenditures should be considered central public sector finances. Only in very limited cases—when central government ministries or agencies incur expenditures to deliver public services directly to the public at large—can central government expenditures plausibly considered to be part of the local public sector.

What central expenditures *should not* be considered direct or delegated expenditures?

- Per the IMF definition of the general government sector, social security expenditures should be excluded from general government finances (at all government levels).
- Central government spending on central administration (i.e., the operational cost of central ministries) and central government spending on public services that do not result in a direct interaction between the public sector and the public (e.g., national defense) should not be considered.
- Direct subsidies to individuals, households, or firms should not be considered direct or delegated expenditures (and not part of the local public sector).
- Deconcentrated expenditures (as defined further below) should not be counted as central government contributions to local public sector expenditures.

¹¹ The reason delegated and direct expenditures are grouped together in LPS-3 is that they are similar in two important aspects: first, the funds for both direct and delegated functions are contained in the central government budget, and second, the direction of accountability for direct and delegated spending is toward the central government.

- Financial transfers to devolved entities (including revenue sharing, grants, or other intergovernmental fiscal transfers) should not be considered part of the central government's direct contribution to the local public sector.

What central expenditures *should* be considered direct or delegated expenditures?

- Expenditures for central government agencies or departments (budget entities) that entirely or predominantly interact with the public. For instance, the budget of a National Park Service could be counted toward the local public sector if the predominant function of this agency (budget agency) is to operate one or more national parks. Likewise, if the predominant function of the Immigration Department of the Ministry of Justice is to issue visas to the public and control border posts, then this department's budget could be counted as being part of the local public sector.
- Expenditures (subsidies or transfers) to (central) parastatal entities that provide direct public services, such as public universities, public hospitals, and so on.
- Central expenditures for recurrent goods and services that are subsequently transferred in kind to the local level for direct use in service delivery, including schoolbooks and other learning materials, drug and medical supplies, and so on.¹²
- Central expenditures for capital investments that are used at the local (government or administration) level for direct public service delivery (for instance, capital expenditures for the construction of school buildings made directly by the Ministry of Education).

Deconcentrated Local Administration

The second category of local public sector finances is composed of deconcentrated expenditures and revenues. Since the distinguishing feature of being part of the local public sector is whether the primary objective of the operating entity is to interact with the public (generally by providing direct services to the public), the local public sector can be defined to encompass expenditures made at the local government and/or local administrative level, including the totality of frontline service delivery units and local administrative staff. This means that deconcentrated expenditures and revenues by definition are part of the local public sector. Then, what comprises a deconcentrated financial transaction?

In contrast to a devolved local government (as noted in table 1 above, and further discussed below), a deconcentrated administration department is an integral, hierarchical part of its higher-level government agency. By default, deconcentrated entities are not corporate bodies with their own budgets; instead, the budgets of deconcentrated entities are part of the budget of the higher-level government. In a system of vertical or sectoral deconcentration, deconcentrated departments should be formally recognized as a sub-organization of the central (or high-level) government entities within the organizational classifications that are part of the Chart of Accounts. In this case, the central ministry's budget should break out spending on central administration departments within the ministry and spending for the ministry's local administration departments (whether in aggregate or by jurisdiction).

¹² Although these goods and services are recurrent in nature, these expenditures are often considered part of a country's "development expenditures."

In a system of horizontal or territorial deconcentration, deconcentrated subnational jurisdictions (for instance, deconcentrated provinces or districts) are formed by subnational budget organizations that contain deconcentrated expenditures for the relevant territorial-administration jurisdiction at hand. In this case, the deconcentrated jurisdiction should be reflected as a budget entity in the organization classifications that form part of the Chart of Accounts. In other words, under a system of territorial deconcentration, subnational expenditures are not contained within the ministerial budgets, but rather, deconcentrated line departments are contained within the budgets of their respective subnational jurisdictions, which are assigned their own (top-level) organization codes.

The key distinction, then, between central expenditures on direct and delegated public service delivery on the one hand, and deconcentrated expenditures on the other hand, is that deconcentrated expenditures are classified and identified by a subcentral (sub-)organization in the national budget, whereas this is not the case for purely central expenditures.

With the key social and economic sectors, it might be prudent to assume that the majority of deconcentrated expenditures are intended and used for the delivery of frontline public services, or for other interactions between the public sector on the one hand and civil society and the private sector on the other hand.¹³ As such, to the degree that deconcentrated expenditures are broken down by sector, such expenditures are assumed to be “local public sector expenditures” unless the opposite is evident from an evaluation of functional assignments and available budgetary documentation.¹⁴

To the extent that a country may have more than one level or tier of deconcentrated administration, from a measurement viewpoint, deconcentrated expenditures should be attributed to the lowest level of deconcentration contained in the budget breakdown. For instance, as part of budgetary practices in the Soviet Union and other planned economies, the budgets of higher administrative levels would systematically contain the budgets of the lower administrative levels, in what was sometimes referred to as the “matrushka” model of deconcentrated budgeting. For these countries, to the degree that lower-level budgetary information is available, the lowest level of deconcentrated budget data should be used. This budgetary practice continues to be followed in certain countries of the former Soviet Union as well as other deconcentrated planned economies.

Devolved Local Government Finances

The share of devolved local government finances in the local public sector depends to a large extent on where the distinction is drawn between deconcentrated entities and devolved local

¹³ Some countries have a “location” classification code as part of their Chart of Accounts. For instance, this is the case in Afghanistan. However, such a location code should not be deemed a valid substitute for a subnational organization code (or sub-organization code) in order to classify an entity or expenditure as “sub-national.”

¹⁴ Not all deconcentrated expenditures should be considered to be part of local public sector finances. For instance, deconcentrated expenditures on military schools (e.g., as in Mozambique) could reasonably be excluded from the local public sector finances.

governments. In contrast to some of the public financial management literature, much of the decentralization literature recognizes that, while greater levels of autonomy at the subnational level may be desirable or an ideal, in reality, local governments (unlike central governments) are not fully autonomous entities but rather semiautonomous entities, subject to the legislative, regulatory, and administrative controls of the central government. Therefore, it seems prudent to define local governments as local entities that (i) are corporate bodies; (ii) engage in governance activities; (iii) have their own political leadership (typically an elected council and/or elected executive); and (iv) prepare and adopt their own budget. In this view, the remaining IMF “conditions” for being a local government then become desirable factors rather than necessary conditions of local government entities.

By this definition, the objective of devolved, elected local governments is to engage in governance activities, or in the words of Mancur Olsen (1969), to provide a mechanism for collective decisionmaking and public service delivery at the local level. Therefore, the preponderance of local governments’ functions and services—whether exclusive local functions or concurrent responsibilities—involve direct interaction with civil society and the private sector. To the extent that “local public sector finances” measure the financial transactions of that part of the public sector that regularly interacts with residents, civil society, and the private sector, the local public sector should then generally include expenditures made at the local government level, unless there is a specific reason to exclude specific local government expenditures from local public sector expenditures.

Local Public Sector Revenues

In addition to capturing the expenditures of the local public sector, the metric of local public sector finances should also seek to capture revenues that belong to the local public Sector. In contrast to the expenditure funding flows, local public sector revenues are not necessarily equivalent the revenue streams collected by delegated, deconcentrated, or devolved entities. A strong argument could be made that while revenues of devolved local governments should be considered local public sector revenues, most revenues collected by deconcentrated and delegated entities should not be considered local public sector revenues.

In most countries, public revenues that are collected by deconcentrated administrative entities or deconcentrated entities are neither collected at the discretion of the local entity nor retained at the local level. Instead, “local” revenues in deconcentrated public financial management systems are typically collected either by the deconcentrated units of the national revenue authority or by deconcentrated units of the national treasury, and the resulting funds are generally deposited in the general treasury account of the central or national government. As such, it might be prudent to consider revenue collections to be part of the local public sector only to the extent that local (devolved or deconcentrated) officials are allowed to retain these resources in an account controlled by local officials, and to the extent that local jurisdictions are allowed to carry these finances forward from year to year.¹⁵

¹⁵ For instance, deposits from fees and other revenue into the Local Service Deliver Accounts in Egypt could be considered revenue collections of the local public sector.

A Profile of Local Public Sector Institutions and Governance. Although devolution, deconcentration, and delegation (and possibly even direct centralized service delivery) all play a role in the “production function” of the public sector, this does not necessarily mean that each of these intergovernmental mechanisms is expected to produce the same public service delivery outputs or outcomes. In line with decades of writing on the topic, a comprehensive profile of local public sector institutions and governance should decompose the public sector (and the decentralized public sector in particular) into its political, administrative, and fiscal dimensions. Each of these three main dimensions of decentralization should be balanced with the others in order for the benefits from decentralization to materialize (Eaton and Schroeder 2010). For instance, unless meaningful political authority is provided to a local government—in a manner that balances discretion and accountability—it is unlikely that decentralized finances will end up being used in an efficient and accountable manner in response to the needs of the local community. Therefore, in order to achieve a thorough understanding of local public sector finances, a detailed local public sector institutional profile is required that captures the detailed aspects of the public sector’s subnational political, administrative, and fiscal dimensions.

Building on work by Yilmaz, Beris, and Serrano-Berthet (2008), Boex and Yilmaz (2010) developed a detailed analytical framework for assessing decentralized local governance and the local public sector. This assessment framework breaks down each of the three main dimensions of decentralization into more detailed components.

For instance, political decentralization and empowerment are divided into four components: (1) institutional arrangements for separation of powers among executive, legislative, and judicial bodies at the local level; (2) election laws and the electoral systems; (3) the nature (existence and functioning) of party systems and political party laws; and (4) local participation and accountability mechanisms. Each of these technical dimensions requires the balancing of local authority and autonomy on the one hand versus local capacity and accountability on the other hand.

Next, it is recognized that local governments require powers in four broad areas of local public administration in order for local governments to play a meaningful role in local government administration. These areas are (1) to make, change, and enforce plans and regulations, including regulations regarding the use of local physical space and local economic development; (2) to administer and manage local government finances and manage local procurements; (3) to engage in local human resource management and make local employment decisions; and (4) to flexibly administer and deliver local government services.

Finally, fiscal decentralization and the fiscal empowerment of local governments is traditionally divided into four elements or “pillars”: (1) the assignment of expenditure responsibilities; (2) revenue assignments and local revenue administration; (3) the design and provision of intergovernmental fiscal transfers; and (4) local government borrowing and debt. Each of these elements potentially provides the local government level with authority and fiscal discretion, but

each pillar should also incorporate fiscal accountability mechanisms to ensure that local officials manage local government finances in a responsive and accountable manner.

Thus, in addition to the preparation of a quantitative local public sector budgetary profile, a deeper understanding of local public sector finances requires us to capture these more qualitative subnational governance and institutional details as part of a local public sector institutional profile.

5. Next steps

How to move forward from here? The inception of this manuscript was the realization that our current understanding of subnational governance and local public sector expenditures was poorly being served by existing measures and definitions of local expenditures and revenues. With that void in the state of knowledge in mind, the description of the local public sector in the previous section starts to delineate a (potentially) measurable metric of state and local expenditures and revenues that defines the subnational public sector beyond the local government subsector as defined by the IMF (2001). Having a metric that captures all subcentral expenditures—in addition to a more comprehensive picture of subnational institutional arrangements—should enable the community of development scholars and practitioners to better understand the degree to which the public sector is able to transform public expenditures into service delivery outcomes, and how public sector governance impact the public sector’s “production function”.

The next logical step in the process would be to operationalize this thought experiment by collecting data on local public sector finances in a variety of countries, including countries that predominantly rely on devolved local governments, as well as those that predominantly (or exclusively) rely on centralized or deconcentrated government expenditures. In addition to collecting local public sector budget and fiscal data for these countries, it would be prudent to pursue gathering systematic qualitative information about the political, administrative, and fiscal dimensions of the local public sector in these countries as well.¹⁶

If a sufficiently large comparative data set of local public sector finances emerges, the community of public policy researchers and practitioners will have a data set to answer basic policy-relevant questions linking governance and public sector effectiveness. For instance, are devolved systems better able to achieve vertical fiscal balance when compared to deconcentrated systems? Or alternatively, does the degree of political discretion bestowed on elected subnational governments limit the political appetite for decentralizing functions and expenditure responsibilities?

Similarly, are devolved systems better able to achieve a more equitable and efficient horizontal allocation of resources? While there is a considerable literature that analyzes the horizontal

¹⁶ Such quantitative and qualitative public data sets, however, essentially form a public good among development agencies, international financial institutions, and the relevant research community. As such, it is likely that the development community as a whole under-invests in such data gathering.

allocation of public sector finances, this literature is almost exclusively limited to the study of intergovernmental financial allocations patterns in devolved countries.¹⁷ As such, the wider study of the political, administrative, and fiscal aspects of the horizontal distribution of resources and powers would be furthered by the proposed local public sector (finance) data set.

The final—and possibly most challenging—set of questions is whether, and if so, under which circumstances, certain intergovernmental institutional structures are more effective at transforming fiscal inputs into policy outputs and outcomes. Answering these questions will require combining detailed information about local public sector finances with information on governance structures and systems in different countries, along with information on (pro-poor) public service delivery outcomes. Of course, this set of questions—if answered authoritatively—will have important implications for public sector structures around the world, in addition to the implications that these questions hold for the way in which the global development community supports economic and public sector development.

¹⁷ See Boex and Martinez-Vazquez (2004) for a review of the literature on this issue.

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