

Osterkamp, Rigmar; Eller, Markus

**Article**

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CESifo DICE Report

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*Suggested Citation:* Osterkamp, Rigmar; Eller, Markus (2003) : How Decentralised Is Government Activity?, CESifo DICE Report, ISSN 1613-6373, ifo Institut für Wirtschaftsforschung an der Universität München, München, Vol. 01, Iss. 1, pp. 32-35

This Version is available at:

<https://hdl.handle.net/10419/166756>

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## HOW DECENTRALISED IS GOVERNMENT ACTIVITY?

RIGMAR OSTERKAMP,  
MARKUS ELLER\*

The degree of decentralisation of government activity can be measured and analysed in several different ways. In this article we use total government expenditures and ask for the share which is spent by sub-central levels of government. This share is then looked at for its development over time. In a third step, we consider that an equal share of sub-central expenditures might hide a different degree of decentralisation due to different sources of funds (own or grants from the centre). Finally we ask whether the different degrees of decentralisation might be explained by constitutional factors (federal and unitary) or country size measures (area, population). In a later article the question of decentralisation will be posed not for total expenditures, as here, but for its structure (single public tasks, functions).

The question of the optimal assignment of public expenditures (or of specific public tasks) to the different levels of government is not tackled. Nor it is asked how the optimal assignment would look when one adds a supra-national (e.g. EU) level of government activity.

### Method and data

The degree of decentralisation can be approximated by calculating the sub-national government's (SNG) share of general government expenditures or revenues and by distinguishing between different public tasks. Such ratios are used in most empirical investigations on decentralised government structures.<sup>1</sup> There seems to be a consensus that the share of expenditures of sub-national govern-

ments in total government expenditures is the best (or most accessible) proxy for the degree of decentralisation. Additionally, self-reliance or vertical imbalance ratios (grants from other levels of government as a share of sub-national expenditures) are constructed in order to examine the independence of sub-national levels.

As a database, the Government Finance Statistics (GFS) of the International Monetary Fund is chosen, as is very common for most researchers.<sup>2</sup> The countries included in the study are the EU member states (without Greece) Switzerland, Norway, Australia, Canada, the United States and Russia: 20 altogether. The country selection depends also on the availability of data. The data stem from the 2002 edition of the Government Finance Statistics of the International Monetary Fund and are mainly from the year 2000.

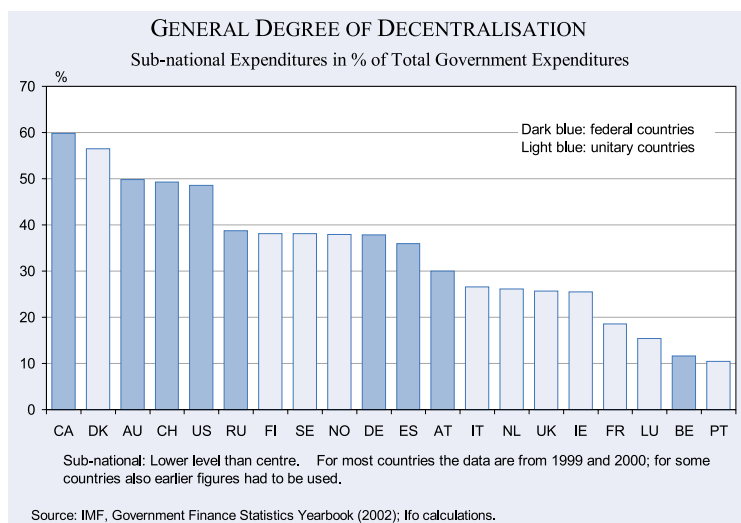
### General degree of decentralisation

On the basis of the GFS data set, we can construct the above-mentioned proxy for the general degree of decentralisation. The relevant values are summarised in Figure 1. In our sample the SNG share

<sup>1</sup> See, e.g., Elbel/Ylmaz (2002), Hoeller/Loupe/Vergriete (1996), Letelier (2001), Oates (1995), Thießen (2000).

<sup>2</sup> The World Bank evaluates the application of the GFS on decentralisation issues (e.g., the lack of details on expenditure autonomy and own-source revenue, deficiencies regarding reported data for the sub-national levels, information scarcity for analysing dispersion among sub-national regions), provides a broad decentralisation bibliography and discusses thoroughly the measurement and adaptability of quantitative as well as qualitative fiscal decentralisation indicators (see: [www1.worldbank.org/publicsector/decentralization](http://www1.worldbank.org/publicsector/decentralization)). Besides the GFS, also several OECD sources are used for empirical decentralisation analyses: National Accounts, Revenue Statistics, Fiscal Design Surveys Across Levels of Government.

Figure 1



\* Rigmar Osterkamp is senior economist of the Ifo Institute for Economic Research. Markus Eller is Research Assistant at the Research Institute for European Affairs, Vienna University of Economics and Business Administrations.

in general government expenditures ranges from 10 percent in Portugal to 60 percent in Canada. We can distinguish between federal (dark blue bars) and unitary (light blue bars) countries:<sup>3</sup> while the former show, as expected, relatively high decentralisation ratios, the latter tend to spend less at the sub-national level. Nevertheless, the non-federal Scandinavian countries (Denmark, Finland, Norway, Sweden) show quite high degrees of expenditure decentralisation, while Belgium as a federal country exhibits a relatively low decentralisation ratio. Furthermore, we observe that larger countries exhibit higher ratios than smaller countries, with the exception of Denmark and Switzerland.

### Development of decentralisation over time

Figure 2 delineates the international decentralisation performance over the past 30 years. The various ratios do not fluctuate remarkably and have remained at a similar level. Nevertheless, structural breaks and unexpected changes took place in Spain (1979, 1989) Norway (1979) and France (1982, 1985). A steady annual decrease from 59 percent (1972) to 47 percent (1998) can be detected in Switzerland. The breaks reflect institutional changes and administrative reforms. In Spain the new constitution of 1978

specified a gradual transfer of powers from central government to autonomous provinces, regions, communities and inter-municipal bodies (Buttress et al. 1999, p. 69). Since then the degree of decentralisation has been increasing from 10 percent in 1978 to 32 percent in 1997. In France an extensive decentralisation of functions took place in the 1980s, devolving more functions to the municipalities (Buttress et al. 1999, p. 40; Frère 1997). The degree of decentralisation rose from 16 percent (1981) to 27 percent (1982) but returned to the previous level in 1985.<sup>4</sup>

### Vertical imbalance

The general decentralisation ratios characterise the hierarchical level to which spending permissions have

<sup>3</sup> *Federal system*: a form of government in which power is at least nominally shared (with some equality) between central and an intermediate tier of government and legislative powers exist at the national and intermediate tiers: Austria (AT), Australia (AU), Belgium (BE), Canada (CA), Switzerland (CH), Germany (DE), Spain (ES), Russia (RU), United States (US).

*Unitary system*: a form of government where the central government is the highest level of authority and all other levels of government are constitutionally subordinated to it: Denmark (DK), Finland (FI), France (FR), Ireland (IE), Italy (IT), Luxembourg (LU), Netherlands (NL), Norway (NO), Portugal (PT), Sweden (SE), United Kingdom (UK).

The source for the information on federal or unitary system is Worldbank; see above footnote.

<sup>4</sup> A new wave of decentralisation has been recently announced by the French government.

**Figure 2**

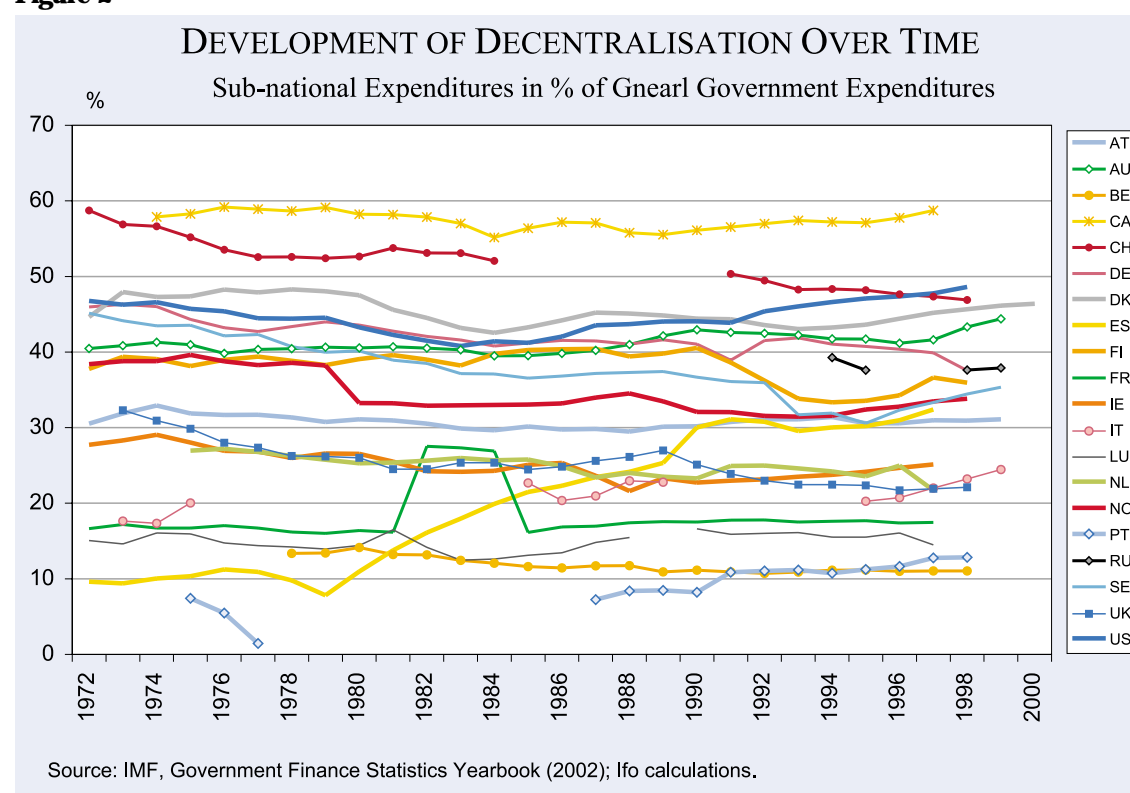
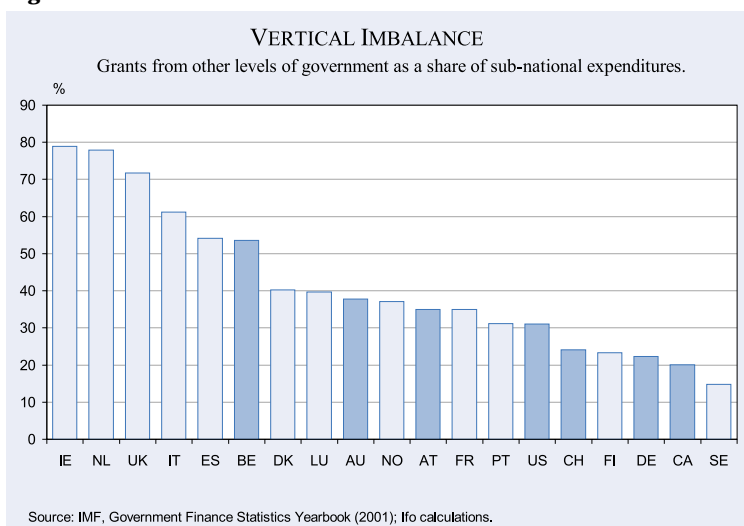


Figure 3



been allocated. But for an adequate measure of decentralisation the sources of funds must also be taken into consideration. It makes a difference for decentralisation whether the spending can be made from own funds or must be made from means which are granted by the centre. The larger the share of grants is, the larger is the “vertical imbalance” and the smaller is the “true” degree of decentralisation. Figure 3 gives the relevant information. The ratios to which sub-national governments must rely on central government revenues to support their expenditures range from 15 percent in Sweden to 79 percent in Ireland (IE). Federal countries exhibit, on average, considerably lower vertical imbalance ratios than unitary countries. This might be explained by the fact that sub-national levels in federal countries – by the very nature of federalism – generally dispose of more own revenues to support their expenditures than is the case in unitary countries. However, an equal vertical imbalance ratio might hide a different degree of

“true” decentralisation because it matters whether the transfers are bound (conditional) or not bound (unconditional, general). This further differentiation can only be pursued by detailed country studies.

### Possible causes of different degrees of decentralisation

It is highly plausible that the different degrees of decentralisation can be partly explained by the constitutional structure. In Figure 1 the majority of the federal countries exhibits relatively larger

decentralisation ratios. This may be roughly characterised by the respective averages. The average decentralisation ratio of the federal countries is 40.6 percent, while that for the unitary countries is 26.8 percent. But other variables might also play a role, e.g. the country size, measured in terms of area and/or population.<sup>5</sup> The larger a country is, a) the more diseconomies of scale might be at work in governing the country and b) the more heterogeneous might be the preferences of the population. If country size (area) goes hand in hand with lower population density, it might also be the case that c) external effects between regions are less relevant so that higher level governance would be required to a lesser degree.

The regression of decentralisation ratios on area, population and population density has been performed (with constitution as a dummy). The best fit turned out to be that on area and is reported in

Figure 4

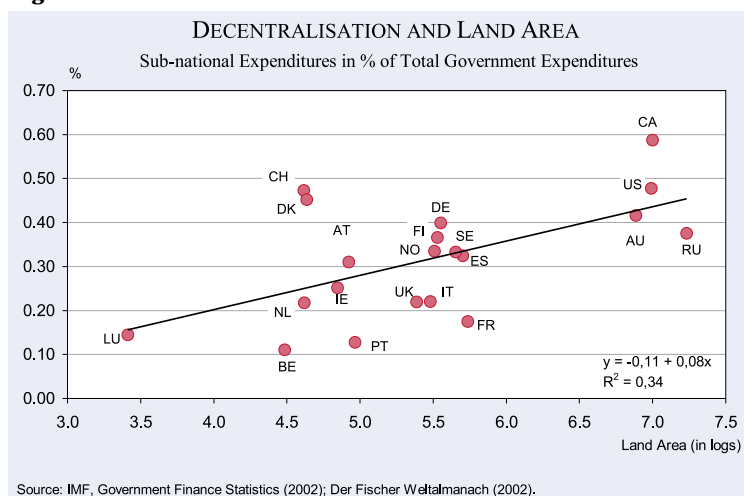


Figure 4. Obviously, country size in terms of area explains to a certain degree the differences of decentralisation ratios. However, some countries are remarkable outliers. Switzerland, Denmark and Canada exhibit comparatively high, Belgium, Portugal and France comparatively low degrees of decentralisation.

<sup>5</sup> See for example Elber/Yilmaz (2002), pp. 20f; Alesina/Perotti/Spolaore (1995), p. 754; Färber (2001), p. 112; Thießen (2000), p. 12).

The next best fit is on population density (not reported in detail)<sup>6</sup> which has, interestingly, a slightly negative impact on decentralisation. This observation would confirm the hypothesis that sparsely populated countries (like Australia, Canada or Russia) prefer a decentralised government structure because central collection of information costs too much due to widespread jurisdiction areas, inadequately developed networks of infrastructure and communication and relatively strong heterogeneous preferences at the local level.

## Summary

Public expenditure of sub-national government levels is compared in order to measure the degree of vertical decentralisation in 20 countries. The following results have been obtained:

- The degree of decentralisation differs widely between countries.
- Sub-national tiers of federal countries spend, on average, more and rely less on central revenues to support their expenditures than unitary ones. Exceptions are the Scandinavian countries (unitary, but high degree of decentralisation) and Belgium (federal, but low degree of decentralisation).
- Over the past 30 years the share of sub-national levels in general government expenditures has not fluctuated remarkably, nor is there a visible trend. Nevertheless, the article shows considerable structural breaks in France, Norway and Spain.
- Country-size variables help to explain the international differences in the degree of decentralisation. Within our country sample, land area has the strongest positive impact on the share of sub-national tiers in total government expenditures.

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<sup>6</sup> Rsquare of 0.27.