

Course: Fiscal decentralization made effective

GROUPWORK ON THE ALLOCATION OF FUNCTIONS

Prepared by Stefan Pfäffli

Prepare a proposal for the allocation of the following two sub-functions using the tools suggested below:

- Form for the assessment of decentralization potential with decentralization index, page 2-3
- Comparison of suggested function type with specifications for this type of function, page 4-8

1. Residential waste collection

general collection of waste, garbage, rubbish, refuse, trash, and commingled materials from residential locations*

2. Lower secondary education

Educational services at ISCED Level 2 generally aiming to complete the provision of basic skills and knowledge of the primary level, although teaching is typically more subject-focused, often employing more specialized teachers who conduct classes in their field of specialization. These services cover education that prepares participants for direct entry, without further training, into specific occupations. Successful completion of such programmes leads to a labour-market relevant vocational qualification*

*Descriptions taken from UN-Department of Economic and Social Affairs (2015). Central Product Classification.

Assessment of decentralization potential for _____

Criteria	True	Partially true	False	Total
Score	1	0.5	0	
Allocative efficiency:				
1/ Uniform needs across subnational governments exist				
2/ Spill-over effect exists, need for coordination				
Operational efficiency:				
3/ Economies of scale exist				
4/ High technology, expensive know how is required				
5/ No frequent contact with local clients				
Equity:				
6/ Uniform standards required				
7/ Affects equal rights issue				
Total score				

Which type of function might be the best solution?

Check 1:

Decentralisation Potential index

$$DPI = \left(1 - \frac{\text{actual score}}{7}\right) * 100$$

Score	DPI	Spectrum
7	0.0%	Dark Blue
6.5	7.1%	Blue
6	14.3%	Blue
5.5	21.4%	Blue
5	28.6%	Light Blue
4.5	35.7%	Light Green
4	42.9%	Yellow
3.5	50.0%	Yellow
3	57.1%	Yellow
2.5	64.3%	Yellow
2	71.4%	Light Green
1.5	78.6%	Light Green
1	85.7%	Green
0.5	92.9%	Green
0	100.0%	Green

Check 2:

Consider the *specifications* for the suggested type of function. See annex.

Annex:

Categories of functions of government, specifications and legal regulation

It is recommended to define clear types of functions. For each type, guiding considerations for the allocation are required. In addition, its legal regulation should be clearly defined. When functions are assigned to the appropriate type, the kind of regulation is implicitly specified.

The process should start with the analysis of the current allocation of functions and their financing per policy area. Policy areas are called “divisions” under COFOG. Then the question should be asked how it should look like in the future. In general, this should be done on the 2nd level of the COFOG classification, dedicated to sub-functions which are called “groups” by COFOG. In Mongolia, the existing programme classification will be used for that purpose. This classification is represented in the annex; it is generally quite detailed and comparable to the COFOG classification.

3d level: Soum and District Functions (SD)

Description

The function is completely assigned to Soums/Districts. They are responsible for planning, decision making, implementation, and financing.

Considerations for the allocation

The function can be carried out by the Soum or District independently. There is no need for coordination by a higher state level. The function is not part of a connected overall system as this would be the case with roads or sewerage or with region-wide public transportation. Soums of a medium size as well as Districts are capable to carry out the function in the quality required; they have the adequate size to fulfil the function in a cost-effective way (making use of economies of scale). Furthermore, Soums and Districts are in a position to finance the function autonomously.¹ It is acceptable that Soums or Districts of different areas carry out the function differently, respecting differences in citizen preferences (no bigger conflict with equity considerations exists). The function is of local interest; citizens might be attracted to participate in the planning and decision making process. There is scope for different types of solutions. Allocative efficiency is of particular interest. Finally, it is economically cost effective to carry out the function at local level (travel cost of customers should be considered together with the direct costs for service provision).

Legal regulation

Soums or districts are obliged to carry out the function by law. But there are no policy-related standards set by the higher level which go beyond basic standards.²

Examples: Street lighting, maintenance of sidewalks.

¹ We assume that revenues follow suit when functions are re-adjusted. In addition, we assume that an effective fiscal equalization system will provide a minimum level of resources for each sub-national entity.

² Such standards are generally applicable for all policy sectors like construction or environmental standards or policy-related minimum standards.

2nd level: Aimag Functions (AM)

Description

The function is completely assigned to Aimag. Aimag are responsible for planning, decision making, implementation, and financing.

Considerations for the allocation

The function can be carried out by each Aimag independently. There is no need for coordination by a higher state level; the function is not part of a connected nation-wide system as this would be the case with national roads, high-voltage lines or nation-wide public transportation. In addition, interest for the particular service is not uniform across the country; it differs from aimag to aimag as an effect of the socio-demographic or topographic situation in the Aimag or of tradition. Therefore, it is of a particular interest that Aimag of different areas can carry out the function differently, respecting differences in citizen's preferences (issue of allocative efficiency). There is scope for different types of solutions and ways of procedure. If services are delivered in such a differentiated way, no bigger conflict with equity considerations exists. Furthermore, the function is of Aimag-wide interest. Moreover, Aimag are in a position to finance the function autonomously and capable to carry it out in the quality required. Also, Aimag have the adequate size to fulfil the function in a cost-effective way (making use of economies of scale). Finally, it is cost effective to fulfil the function at Aimag level also when travel costs of customers are considered.

Legal regulation

Aimag are required to carry out the function by national legislation. But there are no policy-related standards set by the central state which go beyond basic standards.

Examples: Aimag museums and theatres, sports facilities, programs and measures to support employment and alleviate poverty in the Aimag

Capital City Functions (CC)

Description

The function is completely assigned to the Capital City. The Capital City is responsible for planning, decision making, implementation, and financing.

Considerations for the allocation

The function is of particular interest for the Capital City. It can be carried out by the Capital City independently. There is no need for coordination by the central state. The function is not part of a connected nation-wide system. The Capital City is capable to carry out the function in the quality required and it has the adequate size to fulfil the function in a cost-effective way (making use of economies of scale). Furthermore, the Capital City is in a position to finance the function autonomously.³ It is acceptable that the Capital City carries out the function in a different way than elsewhere in the country or that the Capital City may be responsible for a function that is carried out by the Central State elsewhere in the country. If services are delivered in such a differentiated way in the Capital City in order to respond to the specific preferences of its citizens and to the specific circumstances of a Capital City, no bigger conflicts with equity considerations exist. Finally, it is economically cost effective to carry out the function in the Capital City.

³ We assume that the fiscal equalization system will make provisions for the specific role of the Capital City.

Legal regulation

The Capital City is required to carry out the function by national legislation. But there are no policy-related standards set by the central state which go beyond basic standards.

Examples: Capital City museums, concert halls, parks, car parking policy, programs and measures to support employment and alleviate poverty in UB, urban public transportation, city planning, flood protection

Central State Functions (CS)

Description of the function

Functions are exclusively allocated to the higher state level. This level is responsible for policy planning, implementation and financing. Centralized governance is needed for this function, no local differentiation is allowed e.g. for reasons of legal equality. Furthermore, it is required that services are delivered country-wide at the same standard. Moreover, the function requires a connected and inter-linked system. Finally, highly specialized capacities are needed to regulate and implement this function.

Two variants exist:

CS-1 Central state function with centralized implementation

Criteria for the allocation

There is little direct contact with clients / citizens. Implementation needs highly specialized staff and large capital investments.

Legal regulation

Policy planning, implementation and financing are a responsibility of the central level.

Examples: High-end medicine, national defence, highways, railway.

CS2 Central state function with decentralized implementation

Criteria for the allocation

Contact with clients is frequent. Services are less costly if they are provided in a decentralized way (including costs of clients for travelling)

Legal regulation

Policy planning and financing is a responsibility of the central level; for the implementation, there are various possibilities: branches of line ministries or local public corporations, contracts with Soum or Aimag governments, Public Private Partnership. In each case, financing of the function remains to be a responsibility of the central state.

A central state function that is implemented by branches of line ministries or local public corporations makes use of the de-concentration approach.

A central state function that is implemented by Soums or Aimags is a delegated function.

A central state function that is implemented by private service providers is outsourcing services.

Examples: Universities, hospitals, customs,

Shared functions (SF)

Shared functions require vertical collaboration, i.e. higher and lower state levels fulfil a function jointly. They must be financed jointly in accordance with the principle of fiscal equivalence. The splitting of costs between the higher and lower state level should depend on the benefit each level has from the fulfilment of the function and from the operative discretion for cost optimization the implementing level has. In accordance with the principle of cooperation, in the area of shared functions, consultation of lower level is needed before the higher level takes any decisions which involve policy changes.

There are two broad variants:

SF-1 Shared functions with partial flexibility

The higher state level and the lower state level collaborate in the execution of a function. The higher state level enacts general binding standards, for example in a framework law, which may be (or must be) specified by the lower state level. The lower state level has operational leeway for the implementation.

Consideration for the allocation

There is a strong common interest for mandatory norms with country-wide applicability. Reasons could be legal equality including equal opportunities (e.g. pre-university education or social security). Furthermore, the regulation may require a high degree of specific knowledge. In addition, if central regulation was lacking, free-riding might occur resulting in spill-over effects. This could be the case if one sub-national government offers poor services only and does this on purpose in order to shoo away citizens in need to other sub-national governments, thus avoiding costs at home but creating additional costs for neighbouring soums or aimags. This could be the case with social welfare services or education. Provision of such services by the central state could be a way out. However, the service should not be centralised but provided locally because of frequent contacts with the local clients, and, according to the principle of subsidiarity, the objectives can be reached best and most efficiently produced by sub-national governments. Sub-national governments do have the necessary capacities to implement the function appropriately. Finally, there is no need that the function is implemented in each sub-national government in an identical way.

Legal regulation

Collaboration between the higher and lower state level is mandatory. The higher state level sets the strategic goals. The lower state level can or must specify these goals to a certain extent and has operative discretion for the implementation.

Examples: pre-university education, local roads, primary health care.

SF-2 Shared functions without flexibility

The higher state level enacts the policy standards in detail and leaves only limited discretion for the implementation by sub-national governments.

Considerations for the allocation

The same considerations for central state regulation apply as for SF-1. However, regarding implementation, there is no room for discretion. Methodologies and procedures need to be standardized for reasons of legal equity, comparability or technical compatibility.

Legal regulation

Collaboration between the higher and lower state level is mandatory. The higher state level sets strategic goals and specifies methodologies and processes for the implementation. The lower state level has little or no operative discretion for the implementation.

Examples: Elections, territorial planning, standards for public finances, national statistics, fighting infectious livestock and animal diseases, pest eradication and control.

Horizontal Collaboration Functions (HC)

In the case of horizontal collaboration, two or more governments of the same state level work together. This collaboration may take place for two reasons: making use of a synergy potential (e.g. economies of scale) or addressing spill-over effects. Synergy potentials exist in cases of high fixed costs together with capacity reserves. By actively cooperating, fixed costs per unit can be reduced as capacity utilization increases. Spill-over effects⁴ exist when neighbour state entities can benefit from services or systems provided and subsidized by another regional or local authority, without paying for these services. When these spill-over effects are not addressed, there is a risk that these services are not provided in a sufficiently high quantity or quality.

Considerations for the allocation

Substantial synergy potential or spill-over effects exist. Collaboration is essential.

Legal regulation

Collaboration needs to be based on a collaboration agreement of the collaboration partners. Collaboration is voluntary. However, it can be declared mandatory in case of substantial spill-over effects or economics of scale. The higher state level can intervene when individual sub-national governments refuse to collaborate. Sub-national governments have discretion on how the collaboration should be organized. Nevertheless, the collaboration arrangement should respect the principle of fiscal equivalence.

Examples: Secondary schools, inter-Soum public transportation, waste disposal, water protection of lakes and rivers.

If needed, horizontal collaboration can be combined with vertical collaboration.

⁴ In fact, there are two classes of spillover-effects; they can be beneficial or adverse. In the case mentioned above, only beneficial spillover-effects are considered. For adverse effects, mitigation strategies or compensation schemes are needed.