Urban Institute Center on International Development and Governance

Analyzing the role of the local public sector in achieving sustainable development: Does more spending at the local level result in better development outcomes?

An analysis of the vertical allocation of public sector resources in ten developing countries

Final Report

July 2013

Analyzing the Role of the Local Public Sector in Achieving Sustainable Development: Does More Spending at the Local Level Result in Better Development Outcomes?

An analysis of the vertical allocation of public sector resources in ten developing countries

Jamie Boex

July 2013

Abstract

In countries around the world, the local public sector delivers the public services that people rely on day-to-day: schools for their children, public health services, access to clean drinking water, extension services for small farmers, roads for getting goods to market, garbage collection, and so on. Many of these public services are crucial for achieving sustainable and inclusive development. While a considerable amount of research is being done on the impact of different service delivery technologies on service delivery outcomes across a wide range of public services in the developing world, relatively little is known about the extent to which the structure of a country's public sector—including the level of local public expenditures and the nature of local institutional arrangements—contributes to successful service delivery outcomes. The wide variety of service delivery outcomes at the local level, both within and between different countries, shouts out for a better understanding of the role that the local public sector plays in achieving pro-poor development outcomes.

With support from USAID, the Urban Institute engaged in an analysis of local public sector finances in ten developing countries, with the intent to better understand the size and scope of local public sector finances in achieving a country's development objectives. In particular, the study analyzed the vertical allocation of resources within the public sector by considering the share of public financial resources that is spent "close to the people" within the public sector at the local level. Our analysis finds that there is considerable variation in the degree to which financial resources trickle down to the local public sector (from less than 20 percent to over 50 percent), and that a positive relationship appears to exist between the size of the local public sector and government effectiveness.

Acknowledgements

This study builds on the *Local Public Sector Country Handbook* (December 2012) and is the product of the efforts and contributions of numerous researchers and research assistants. I am particularly thankful for the contributions of Faigy Abdelhak, Chethana Biliyar, Charles Cadwell, Ozias Chimunuane, Jihyun Chung, Jingqiang Du, Benjamin Edwards, Lesley Fisher, Brittany Lane, Mary Larzelere, Megan Meinen, Kimchoeun Pak, Louis Picard, Gohar Sargsyan, Renata Simatupang, Valerie Stevens, Benon Tumwine and James Wunsch in collecting, preparing and reviewing the local public sector expenditure profiles upon which the current study is based.

Financial support for this study was provided by the United States Agency for International Development (USAID) under an Economic Research Partnership through Cooperative Agreement #AID-OAA-A-12-00008.

Analyzing the Role of the Local Public Sector in Achieving Sustainable Development: Does More Spending at the Local Level Result in Better Development Outcomes?

An analysis of the vertical allocation of public sector resources in ten developing countries

Jamie Boex

July 2013

Background

All development is local in nature. In countries around the world, the local public sector delivers the public services that people rely on day-to-day—schools for their children, public health services, access to clean drinking water, extension services for small farmers, roads for getting goods to market, garbage collection, and so on. In fact, almost all pro-poor public services that are believed to spur sustainable economic development are delivered at the local level, where the public sector interacts on a regular basis and in a localized manner with the people that it serves.

Perhaps the most obvious indication of the critical role played by the local public sector in achieving growth-enhancing service delivery and inclusive development is the fact that industrialized countries typically spend 50 percent or more of public sector resources to fund public services at the local level, where the public sector interacts in a direct and localized manner with its citizens. In contrast, the majority of poor countries have much higher concentrations of public spending at the central level. Thus, an important, but often overlooked, problem in the public sector of developing countries around the world is to make sure that resources flow down "vertically" within the public sector to the local (sub-central) level, where public services are actually delivered and where economic development takes place.

While a considerable amount of research is being done within specific sectors on the impact of different service delivery technologies and interventions on service delivery outcomes in developing countries, many of these studies focus on projectized or experimental interventions that do not necessarily take into account the institutional context in which localized services are normally delivered within the public sector. As such, relatively little is known about the extent to which the structure of a country's public sector—including the level of local public expenditures and the nature of local institutional arrangements—contributes to successful service delivery outcomes. There are clear indications, however, that an effective local public sector is a critical ingredient in delivering effective public services across a wide array of important pro-poor public services. To the extent that the local level (whether through local governments or through other local entities) plays a critical role in delivering key pro-poor public services such as basic education or public health services, forming a better understanding of the role of local public sector should be recognized as an important cross-cutting issue within the global development community.

The Local Public Sector Initiative (LPSI) was launched by the Urban Institute in December 2010 to start filling this knowledge gap. As part of the broader research agenda set out by LPSI, this study focuses on the analysis of the vertical allocation of public sector resources across ten developing countries, revealing a wide range of experiences with regard to the size, role, and institutional organization of the local public sector in different countries. Other research streams under LPSI include efforts to document the political and administrative context of the local public sector in different countries as well as targeted analyses of service delivery constraints in particular sectors.

Our theory of change: development progress depends on the effectiveness of the local public sector. Over the past fifty years, the focus of most international development agencies and international financial institutions has been on the provision of projectized interventions at the central government level (through sectoral line ministries) or through NGOs, largely ignoring the important role played by the local public sector in improving public services and in achieving inclusive and sustainable development.[1]

Recognizing that most pro-poor public services are quintessentially local in nature should motivate the global development community to pay greater attention to how local governments and other local entities can serve as catalysts for improved public service delivery and economic development. Indeed it could be argued that, within a well-structured public sector, the effective and equitable delivery of localized public services can only be achieved in a sustainable manner when

(1) frontline public servants within the local public sector are given the necessary financial resources to do their jobs well, relative to total available public resources and the public sector's priorities (vertical fiscal balance);

(2) the public sector's resources are distributed efficiently and equitably across the national territory in such a way that localities with greater need receive greater resources (horizontal fiscal balance); and

[1] Two major development phenomena over the past fifteen years—the Poverty Reduction Strategy approach, and the introduction of Millennium Development Goals—appear to have done little to reduce the central bias of the global development community. In fact, PRSs and MDGs may have exacerbated the focus on centralized development interventions to achieve quick wins in sectoral service delivery and poverty reduction without fundamentally improving the ability of the local-level institutions to deliver public services more effectively and in a sustainable manner.

(3) the institutional mechanisms at the local level are in place to efficiently transform public sector resources into the desired policy outputs and outcomes.[2]

As a first step into better understanding the role and functioning of the local public sector, this study of local public sector finances limits itself to empirically investigating the vertical allocation of public sector finances.

The finances of the local public sector: Limits on the current state of knowledge

While fiscal decentralization and local government finance reforms have traditionally been treated as an important theme in international development and in the design of country assistance strategies over the past ten years, the international development community (including USAID) seems to have increasingly focused on the governance aspects of decentralization. As such, within the realm of fiscal decentralization reforms supported by the global development community, efforts have almost exclusively focused on strengthening the role and impact of elected (devolved) local governments. Most academic research on local public sector finances in developing and transition countries has also focused narrowly on the finances of the local government sub-sector (i.e., exclusively on the finances of elected local governments).[3]

The considerable focus on devolved systems—in research and in practice—ignores the broad array of subnational finance practices engaged in by countries around the world. Most countries' local public sectors—in addition to including devolved local governments—are typically formed by subnational departments or territorial units of the state administration which often are tasked to deliver public services at the local level but report upward. A quick review of developing and transition countries suggests that up to half of all developing countries around the world deliver key public services (such as primary education, basic health services, water provision, and agricultural extension services) in a deconcentrated manner.

The scarcity of relevant data on local public sector organization, finances, and institutions. Understanding the local public sector is a complex and multi-disciplinary ambition. In order to better understand the role of the local public sector in economic development and effective public service delivery, we should recognize that there are four different dimensions or aspects of the (local) public sector that contribute to, or detract from, its effectiveness: (1) its organizational structure (which refers to the country's territorial-administrative structure, as well as the organizational (e.g., legal and budgetary) status of subnational entities), (2) the assignment

[2] Achieving effective systems at the local level—point (3) —typically requires giving local officials both the discretion as well as the incentives to perform well, in addition to ensuring that appropriate mechanisms are in place to hold local officials accountable for their performance.

[3] The focus of the academic (empirical) literature on devolved government finances is driven to some extent by the (virtual) absence of comparative international data of non-devolved local public sector spending. In predominantly deconcentrated countries, non-devolved expenditure often account for somewhere between 80 percent to 90 percent of public expenditures. In addition, the evolution of the fiscal decentralization and fiscal federalism literature has been strongly influenced by thinkers from the United States and other countries with a tradition of devolved local governments.

of functional responsibilities, (3) its fiscal (expenditure and revenue) profile, and (4) the political, administrative, and fiscal institutions that define how subnational entities operate and guide their interactions with other government levels and tiers. Indeed, no meaningful understanding of the role and functioning of the local public sector in a country can emerge without at least a basic understanding of each of these four different aspects of the local public sector.

Our understanding of the role and functioning of the local public sector is hindered by a scarcity of relevant and comparative international data on decentralization, local governance, and local public sector finances. In fact, there is no single global dataset that applies a consistent methodology and provides consistent and comparable information about the political, administrative, and fiscal institutions of state and local governments around the world (Abdelhak et al, 2012).

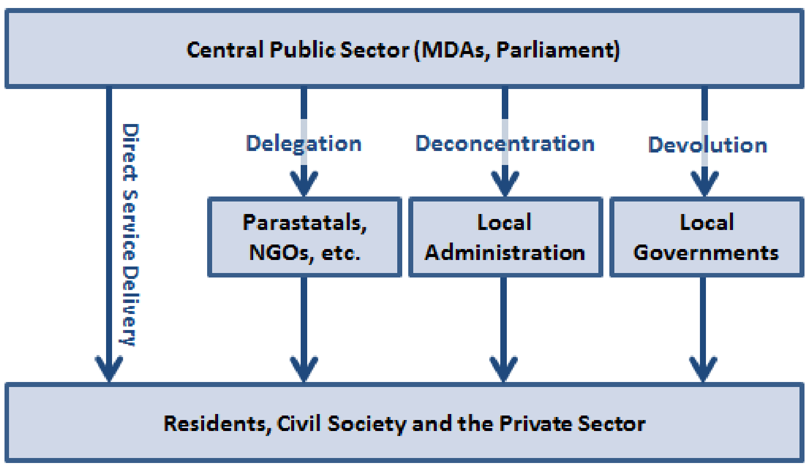
There is a similar absence of data on local government finances. Even the International Monetary Fund's (IMF) Government Finance Statistics—arguably the most-used data source for measuring (fiscal) decentralization—provides quite limited coverage of sub-central public sector finances in developing economies. When the IMF recently prepared an analysis of subnational public finances for 67 countries for which "subnational maps of government" were available, this analysis contained only four Asian countries, three African countries, and two countries in the Middle East and North Africa region (Dziobek, Gutierrez Mangas, and Kufa 2011).

Absence of an appropriate metric of local public sector expenditures. A concern with regard to the available statistics on local public sector finance is that the available measures only capture one specific type or dimension of local public sector finances, notably finances that are transacted by devolved local (or regional) governments. However, roughly half of the countries around the world deliver public services (predominantly or exclusively) through central government ministries directly, or through non-elected "deconcentrated" local administrative structures. Even though some countries spend a considerable share of their budget in a deconcentrated manner "close to the people," the expenditures of deconcentrated entities are not considered to be part of local public sector finances under the existing metrics, and therefore, local public sector spending in deconcentrated countries is simply considered to equal zero. In the absence of a metric that measures non-devolved local public sector expenditures, we will have no idea about the vertical allocation of resources in countries that have a deconcentrated public sector structure.

Even in countries that rely on elected local governments to deliver important public services to the people, the existing metrics fail to recognize that considerable funding for public services is often provided through central line ministries or through deconcentrated structures, in addition to (or around) the funding provided to the local government level. For instance, this is the case when a line ministry provides in-kind transfers (for instance, school books or medicines) or when a central line ministry procures capital infrastructure on behalf of local authorities (for instance, the construction of schools that are operated and managed by local governments). Without taking such funding flows into account, any existing study that seeks to explain the impact of decentralized finances on service delivery indicators (or on other measures of development outcomes) simply by measuring the level of public resources spent by local governments might suffer from omitted variable bias.

A comprehensive metric of local public sector finances thus ought to recognize that virtually no country around the world is purely devolved or purely deconcentrated, but rather, that central authorities in each country simultaneously interact with residents, civil society and the private sector through four different mechanisms: through the direct delivery of public services (by central government entities directly); through the delegated delivery of public services (for instance, through NGOs or para-statal organizations); through deconcentrated subnational departments or jurisdictions; or through devolved, elected local governments. Together, these four institutional and fiscal mechanisms comprise the range of arrangements that make up the local public sector (figure 1).

Figure 1. Interaction between the central public sector and residents civil society, and the private sector



A good measure of local public sector finances, however, should not simply aggregate the different funding streams to the local public sector into a single measure of local public sector finance, since each funding flow is guided by different political, administrative, and fiscal arrangements at the subnational level. Different intergovernmental mechanisms should be expected to provide different levels of discretion, accountability, and incentives to local officials, and in turn, different service delivery outcomes. As a result, rather than simply aggregating all types of local public sector expenditures into a single amount, the local public sector expenditure profile (the metric of local public sector expenditures developed as part of this study) provides a breakdown of the different types of local public sector expenditures in each country.[4]

[4] As noted above, a comprehensive analysis of local public sector finances needs to reflect on the political, administrative, and fiscal governance arrangements that guide the funding flows to the local public sector.

Research objective

The existing empirical research that has sought to determine whether allocating a greater share of public financial resources to the local level indeed improves public sector outcomes (such as faster economic growth, improved services, or greater poverty reduction) has largely been inconclusive. As already noted above, one potential reason for these inconclusive findings in the literature is the fact that the measure of fiscal decentralization most commonly used to capture the vertical allocation of public resources (i.e., a country's share of expenditure devolution) is an inadequate reflection of the level of local public sector expenditures.[5]

In analyzing the vertical allocation of resources across the public sector, the current study does not *a priori* assume that any single type of subnational or intergovernmental institutional arrangement is inherently more efficient or superior than others. Instead, the methodology developed here provides the foundation for a future line of research to empirically explore efficient mechanisms for the delivery of localized public services and whether—and under what conditions—different institutional approaches (such as devolution or deconcentration) might be appropriate. Although it is beyond the current study to answer the ultimate empirical question—whether increased local public sector spending improves public sector outcomes such as economic growth, improved services, and greater poverty reduction—the current study does offer important building blocks that build towards an answer to that question.

The main objective of this study is therefore to engage in an analysis of local public sector finances in a sample of developing countries, with the intent to measure the size and scope of local public sector expenditures, regardless of the form of the institutional mechanism, to better understand the role of local public sector expenditures in achieving a country's development objectives.

To this end, a first research objective is simply to explore the size of the vertical distribution of resources across countries: how big is the local public sector within different countries, and within what range do countries vary with regard to the size of their local public sector? What is a "normal" amount of resources to be allocated to the local level? Is the perception correct that in many developing countries, a considerable share of public resources remains stuck at the central level, thereby underfunding the delivery of public services that need to be delivered in a localized manner?

A second research question might ask why the size of the local public sector varies across countries. Do we see patterns in the vertical allocation of resources across sectors? Does a country's subnational governance structure influence the size of the local public sector? For instance, is the share of local public sector finances generally larger or smaller in predominantly devolved countries when compared to predominantly deconcentrated countries? What other factors help to determine the size of a country's local public sector?

[5] In addition, other factors that would likely influence the success of decentralization reforms—including the decentralization of authority, discretion, accountability, and incentivize to perform—are difficult to measure and account for in explanatory models of decentralization success.

Third, we explore whether the size and the composition of the local public sector matters. Most importantly, does more spending at the local level result in better development outcomes? Ideally, we would like to know if service delivery performance improves when more resources reach frontline service delivery units.

In order to start addressing these questions, this study will (1) develop a rigorous methodology for comparing local public sector finances for countries with different subnational budget structures; (2) collect comparative data for a variety of developing countries; and (3) conduct an analysis of local public sector finances, by comparing local public sector expenditures in both predominantly devolved as well as deconcentrated countries.

Research methodology

With the immediate focus of the current study being on the analysis of the vertical allocation of financial resources within the public sector resources, our research methodology involves three key steps: (1) the selection of countries to be included in our initial research sample; (2) the development of a methodology to capture the size and composition of the local public sector expenditures; and (3) consideration of the potential shortcomings of the methodology. It would also be prudent to establish prior expectations about the potential determinants of the size of local public sector expenditures, as well as about the potential impact of the size of the local public sector on government effectiveness and other development outcomes.

Country selection. The aim for the initial country selection was to create a dataset that would include data points for about a dozen countries, including countries with a predominantly devolved public sector structure and countries with a predominantly deconcentrated public sector. Additional considerations for country selection included the expected availability of the necessary (fiscal and non-fiscal) data to prepare a local public sector Country Profile, as well as the desire to have regional diversity. In particular, the aim was to collect data for countries from Asia and sub-Saharan Africa, as these are the most under-represented regions in terms of available data.

With these selection criteria in mind, the following twelve countries were selected for the initial analysis of the vertical allocation of public sector resources in developing countries: Bangladesh, Cambodia, Ghana, Indonesia, Kenya, Mozambique, Nepal, Nigeria, South Africa, Sierra Leone, Tanzania, and Uganda. Expenditure data for Ghana and Kenya were omitted from the analysis at this time, due to the incomplete nature of their expenditure profiles.

Capturing the size and composition of the local public sector: the LPS expenditure profile. Public spending decisions, especially in developing countries, are seldom driven by a detailed analysis of how public resources ought to be spent in order to obtain the biggest impact on the policy objective being pursued (i.e., how to obtain the best value-for-money).[6] Instead, poor budgetary practices (whether caused by political influence, incrementalism in budget

[6] In developed economies, a host of analytical tools are available and frequently used in a domestic context before major spending decisions are made.

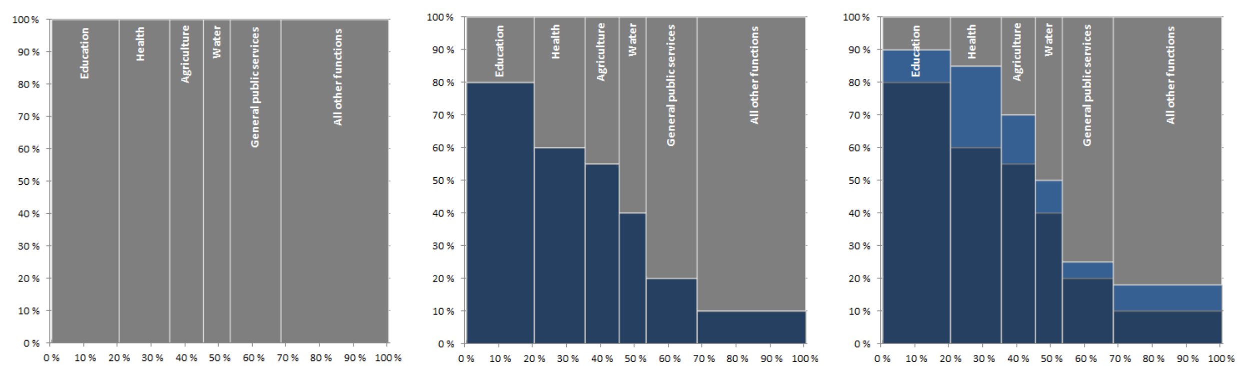
formulation, weaknesses in budget execution, or institutional or bureaucratic capture) often drive the allocation of budgetary resources. In an odd alignment with host-country practices, the same lack of analysis generally characterizes the interventions pursued and supported by the international development community as well.

Although the vertical allocation of public resources (i.e., the share of public sector finances that is spent close to the people—in contrast to resources spent on central government bureaucrats sitting hundreds of miles away) would likely be an important indicator of the efficiency or performance of a public financial management system (PFM), most PFM assessment instruments generally do not look at how resources are actually allocated or spent: instead these assessment tools tend to focus on the adequacy of the PFM systems themselves without looking at actual resource allocations, and without looking at the share of public resources spent on frontline services or other indicators of expenditure effectiveness.[7]

Based on existing data sources, the approach that comes closest to allowing us to establish a link between public sector expenditures on specific public sector functions and specific development outcomes is to rely on the functional classification of expenditures. While the IMF Government Financial Statistics yearbook presents a functional breakdown of public sector expenditures for dozens of countries, statistics for functional expenditures at the regional or local governments are generally not reported for developing countries in Africa and Asia. Nonetheless, a mapping of public expenditures by functional classification would at least show the share or public sector resources that the public sector allocated in pursuit of sectoral development objectives (shown in figure 2, panel A). Note that the width of each sectoral bar in the graph corresponds to the relative share of sector expenditures (as percent of total public expenditures).

Figure 2. Capturing the size and composition of the local public sector
The local public sector expenditure profile—an example

Panel A: Sectoral expenditures (central and local combined) | **Panel B: Local government expenditures by sector** | **Panel C: Local public sector expenditure profile**



[7] For instance, consider the Public Expenditure and Financial Accountability (PEFA) assessment, or the Open Budget Index.

From this level of detail (i.e., based on total sectoral expenditures alone), it is possible to conclude that a country allocates a smaller or larger share of its public finances in support of the education sector or the health sector, perhaps revealing a preference for spending in these sectors vis-à-vis spending on other sectors. One might use such a profile to analyze whether greater public spending within a sector results in better sectoral performance, for instance, by relating sectoral MDG performance indicators in the education, health, or water sectors to sectoral expenditures. This rudimentary expenditure profile, however, provides no information whether the resources within each sector are spent in a prudent manner. For instance, are the majority of sectoral resources used to fund teachers and school books, or are these funds retained at the central government level for workshops and travel allowances for central-level officials?

In order to establish an (incrementally) stronger link between public sector expenditures and development outcomes, it would be useful to know—within each sector—the share of sectoral expenditures made by local government officials versus central government entities. This information is especially helpful if we believe that local officials under the control of locally elected leaders are responsive and accountable to their communities, whereas central officials are far removed from effective accountability controls. This option is highlighted in figure 2 (panel B), where the dark blue bars denote the share of sectoral expenditures that are made by elected regional or local governments, while the grey portion of each bar indicates the proportion of sectoral expenditures made by central authorities. As was the case in the first panel, the width of each bar reflects the relative share or proportion of each sector in total public expenditures. Currently, the data necessary to prepare a public expenditure profile at this level of detail is only available for a number of OECD countries, as well as a handful of developing countries in Latin America.[8]

As was noted earlier in this document, an public expenditure profile looking exclusively at devolved expenditures (as is the case for panel B) continues to fall short from showing a complete picture of local public sector expenditures, as it fails to reflect other local public sector expenditures, such as deconcentrated expenditures or other (central direct or delegated) expenditures on localized public services. In response, panel C present a comprehensive local public sector expenditure profile, which shows not only devolved local government expenditures (dark blue), but also reflects expenditures made by deconcentrated local administration bodies and other local public expenditures (in light blue). This is the level of detail with which the current study was able to collect public expenditure data for a sample of developing countries. In order to achieve a consistent picture of local public sector expenditures across countries, guidance on how to characterize and quantify local public sector expenditure was developed as part of a detailed *Local Public Sector Country Profile Handbook* (Boex 2012).

Although an even greater level of detail would be desirable,[9] the current LPS expenditure profile establishes a unique starting point to construct a "production function" for each sector, linking

[8] See Dziobek, Gutierrez Mangas, and Kufa (2011) for public expenditure mappings by government level and by economic classification.

[9] An even more meaningful breakdown of expenditures would be to collect public expenditures for each government level or administrative tier by sector *and* by economic classification. It was not possible to obtain local public sector expenditure profiles at this level of detail given the constraints on time, resources, and data access.

how desired sectoral outcomes may be determined not only by the total amount of sectoral expenditures, but also the different levels and types of sub-central spending within each sector.

Weaknesses of the LPS expenditure profile methodology. The process of applying the local public sector expenditure profile methodology to a dozen developing countries revealed a number of practical—but largely unavoidable—weaknesses of the methodological approach. These issues are common to all cross-country comparative efforts that depend on data consistency across different forms and levels of government. To the extent that these issues may result in potential biases in the resulting expenditure profiles, it is appropriate to recognize these issues and contemplate the impact of these issues on the empirical results.

- **Expenditure profiles are influenced by the degree of detail in budget documents.** The composition of LPS expenditure profiles is unavoidably influenced by the level of expenditure detail with which budget documents are available. In countries with a highly centralized or deconcentrated budget structure, the LPS methodology relies extensively on central budget documents to identify the degree to which national budget expenditures are in fact deconcentrated expenditures, and the extent to which central ministries provide (direct or delegated) funding to support localized public services. In countries where the national budget provides greater expenditure detail, it is easier to identify deconcentrated expenditures and/or other public sector expenditures that are local in nature. As such, the degree to which the methodology will identify expenditures as "local" is driven in part by the level of transparency in the national budget.[10]

- **Lack of reporting on local government expenditures and revenues.** Many countries do not collect or aggregate local government expenditure data, and even those countries that do collect local government finance data seldom collect them based on the functional classification of expenditures. In such cases (in the absence of local government reports on expenditures), we typically made the assumption that earmarked (or sectoral) intergovernmental fiscal transfers are spent for their intended purpose. For some of the other countries in our sample, assumptions or estimates had to be made regarding (1) the level of local own source revenue collections, and (2) the way in which these revenues were spent across functions, in order to arrive at the most comprehensive picture of local government finances possible.

- **The profile performs better in countries with a single local government level.** The LPS expenditure profile (as shown in figure 2, panel C) cannot necessarily be given the same interpretation in countries with a single local government level when compared to countries that have one or more substantive intermediate government levels. In countries with a single local government level or local administrative tier, local public sector expenditures consistently reflect resources flowing down to the local level, much of which is used to fund

[10] To the extent that vertical resources flow to the local public sector in a highly fragmented manner in the national budget—with fragmentation that makes these funding flows unobservable at the level with which the national budget is prepared and reported—the potential bias due to the level of budget reporting might be partially offset by the fact that multiple, highly dispersed, small vertical funding flows might be more prone to capture or diversion before actually arriving at the local level.

or support frontline services. This stands in some contrast to countries with a substantive intermediate government level, as regional governments in such countries may in fact perform administrative and oversight functions similar to central governments in single-tiered unitary countries. Similarly, depending on the size of intermediate (regional) government jurisdictions, these intermediate-level governments may be too far removed from the electorate to be meaningfully held accountable by their constituents.

- **The extent to which development resources are captured is unclear.** The intent of the expenditure profile is to capture all of the public sector's resources that are available for service delivery and infrastructure development in each sector; this includes both financial resources contributed by domestic taxpayers as well as development spending contributed by international donor agencies. Whenever development assistance is captured on-budget, these resources are included in the local public sector expenditure profile. Without further investigation, however, it is difficult to determine to what extent donor agency resources are appropriately reflected in government budgets at various levels.

- **The expenditure profile shows financial resources spent at the local level, but not necessarily who controls them.** Finally, it is important to recognize that the LPS expenditure profile—when taken by itself—does not show how resources are controlled at each level.[11] For instance, it is not unusual for local government spending on wages to be fully earmarked and controlled (in essentially all aspects) by the higher-level government. As a result, the expenditure profile reflects the degree of spending that takes place at the local level, and not necessarily the degree of local spending that falls under the control of local governments or other local entities.

Possible determinants of the size of the local public sector. Before proceeding with the analysis of the size and composition of local public sector expenditures in different countries, it is useful to take a moment to consider possible determinants of the size and composition of local public sector expenditures. Why is the local public sector in one country larger than in another? Both economic and technical reasons, as well as political economy arguments, should be considered. Although the initial data sample is too small to conclusively answer these questions, these potential determinants are explored below. These possible determinants could further be transformed into testable hypotheses in the future when additional data points become available.

- **Demand for localized public services.** If the demand for the services provided by the local public sector varies from one country to the next (for instance, based on different levels of income across countries), then this would likely cause variations in the size of the local public sector. The standard assumption in public finance literature is that the demand for public services is highly income elastic (exceeding unit), meaning that the demand for spending on public services rises more than proportionally when household incomes grow. This phenomenon would (help) explain relatively small public sectors in low-income

[11] It should be noted that the institutional profile—which is part of the broader Local Public Sector Country Profile—does seek to identify the degree of institutional discretion that local entities have, including the discretion over managing their own financial resources. However, the institutional profile considers the overall degree of discretion, rather than considering discretion and control over each separate funding flow.

countries vis-à-vis large public sectors in more developed economies. Similarly, if the income elasticity of demand for local public sector services (e.g., education and health services) exceeds the income elasticity for central public services (e.g., national defense), then we would expect wealthier countries to have a larger local public sector.

- **Population size of country.** A second economic argument could be made based on the concept of scale economies. If there are fixed costs to the provision of central public services in a country, then we would expect the relative size of the central public sector to decline (and conversely, the size of the local public sector to increase) as a country's population size increases.

- **Capacity and responsiveness of the local level.** Next, the overall capacity and responsiveness of the local level could also have an impact of the size of the local public sector. Economists would argue that a higher relative price for (local) public services associated with lower levels of capacity (vis-à-vis central public services) could potentially either increase or decrease the total amount of spending on local public services, depending on the price elasticity of demand for local public services. Of course, it is likely difficult to measure the capacity or responsiveness of local-level officials and local jurisdictions, especially in proportion to the capacity level of central government officials. Furthermore, care should be taken to interpret the relationship between local-level capacity and the size of the local public sector, as local capacity levels could either be a cause or an effect of a larger local public sector.

- **Organizational structure of the subnational public sector.** Building on the previous point, one may expect the organizational structure of the subnational public sector to influence the size of the local public sector. For instance, devolved countries may have a larger local public sector if the presence of elected local bodies makes the provision of local public services more responsive or efficient and thereby creates a stronger demand for vertical fiscal balance. Similarly, other features of the organizational structure of the subnational public sector could influence the size of the local public sector. For instance, one could speculate that the average jurisdiction size of the main local level might have an impact on the level of local public sector expenditures: local public sector spending is likely to go down when jurisdictions are inefficiently small (failing to capture scale economies) or inefficiently large (failing to be responsive or accountable).

  In the same way, one could argue that the political economy effect could run in the opposite direction: the more autonomous local entities are, the smaller the institutional incentive would be for higher-level officials to advocate for subnational resource increases. Under this alternate hypothesis, public sectors that are more politically decentralized could face greater pressures from central-level stakeholders (politicians and senior civil servants) to reduce the level of local public sector expenditures.

- **Central monopoly power.** Finally, if excessive centralization is driven by political and institutional motives at the central government level, then we would expect countries that are less politically competitive (e.g., where more political power is centrally monopolized) to have a smaller local public sector. In contrast, countries with a competitive political environment would tend towards an optimal vertical sharing of powers and resources.

Does the size of the local public sector matter? Possible impacts of the size of the local public sector. A final question to be asked is whether the size of the local public sector matters. What are the possible impacts of the size of the local public sector on the functioning of the public sector?

The theory of change proposed earlier suggests that greater local public sector spending, all else equal, will result in a more effective public sector, greater levels of popular empowerment over the public sector, and better (more efficient and equitable) public services.[12] In contrast, other voices have suggested that due to perceived weak capacity and accountability of local institution, more decentralization (i.e., greater local public sector spending) generally has the opposite effect. In this line of reasoning, a larger local public sector would be associated with less effective public service delivery and greater corruption.

Although the current study does not relate local sectoral spending shares with sector-specific development outcomes,[13] the preliminary empirical analysis below considers the relationship between the size of the local public sector in different countries and the relative level of government effectiveness in each of these countries based on an indicator of government effectiveness prepared by the World Bank. In addition, the analysis considers the relationship between the size of the local public sector and the effectiveness of corruption controls based on the available data sample.

Of course, we would not necessarily expect all local government expenditures to have the same level of impact on government effectiveness. For instance, although one could speculate that different types of local public sector spending all have a positive impact on the effectiveness of the public sector, many observers would expect certain types of local public sector spending (e.g., devolved local public sector spending) to have a bigger impact on government effectiveness than other types of local public sector spending (e.g., deconcentrated local public sector spending or central line ministry spending on localized services). The simplest multivariate empirical model might define this relationship as

$$Government\ Effectiveness_i = \beta_0 + \beta_1\ Devolved\ LPS_i + \beta_2 Non-devolved\ LPS_i + \epsilon_i$$

Although conducting a multivariate quantitative analysis would require a sample size that is greater that the ten observations currently available, it is useful to think ahead to the types of empirical analysis that would be feasible when a sufficient number of observations are available.

[12] One of the things held equal is the system of local governance, which influences the degree of discretion, accountability and incentives for local officials to perform well.
[13] More detailed sectoral analyses are currently being pursued for the education and health sectors (DeLoG/UI 2013).

Empirical results: an overview of the size and composition of local public sector expenditures in different countries

As part of this study, local public sector expenditure profiles were prepared for ten countries: Bangladesh, Cambodia, Indonesia, Mozambique, Nepal, Nigeria, South Africa, Sierra Leone, Tanzania, and Uganda.[14]

It is difficult to provide in-depth discussions of ten public expenditure profiles without distracting from the main story line. As such, two figures are presented in this section in order to provide an overview of the main finding from the large number of profiles prepared. First, figure 3 (next page) shows detailed local public sector expenditure profiles for four sample countries: Indonesia, Mozambique, Tanzania, and Bangladesh. These four country examples provide a range of experiences with regard to the size and scope of the local public sector. Next, figure 4 presents a comparative overview of the size and composition of Local Public Sector Expenditures in all ten countries included in the study.

Figure 3 shows considerable variation in size and composition of local public sector expenditures in each of these four countries. A brief description of the salient features of local public sector expenditures in each of the four countries follows. More detailed country case descriptions—along with detailed Local Public Sector Country Profiles— can be found online at www.localpublicsector.org.

Indonesia. The role of Indonesia's subnational public sector was defined by the "big bang" decentralization reforms that were introduced in 2001. These reforms devolved 26 key public functions—including the responsibility for the delivery of basic education, health, and other key service delivery functions—to the local (district) level. In addition, the decentralization reforms introduced legislation that provides considerable financial resources to the local level through a combination of revenue sharing, an unconditional equalization grant (the so-called *Dana Alokasi Umum*, or DAU), various earmarked grants and local own source revenues.

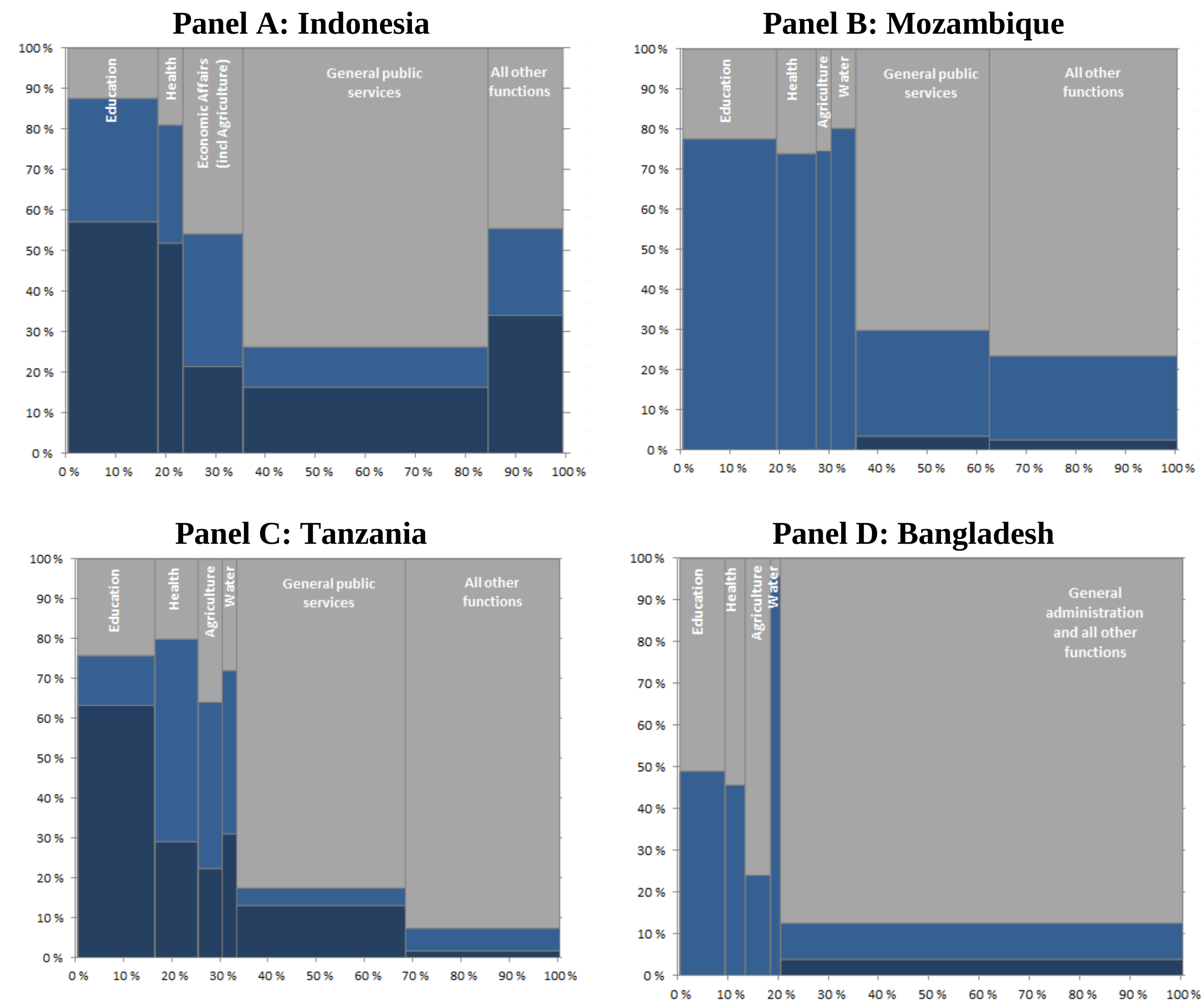
The success of Indonesia's decentralization reforms to ensure that "finances follow function" is revealed by figure 3, panel A. About half (48.3 percent) of public sector expenditures in Indonesia take place within the local public sector. This does not mean, however, that all local public sector expenditures are undertaken by the elected local government level: just under one-third (29.1 percent) of total public expenditures take place at the local (kabupaten/kota) level, while another 9.5 percent of public expenditures are made at the (elected) provincial government level. In addition to these provincial and local expenditures, central government ministries dedicate another 9.7 percent of total public expenditures to public services delivered at the local level. The national government retains 51.7 percent of public sector resources for national functions and activities that fall outside the local public sector.

Beyond the generous share of public sector finances that is spent by the local public sector in Indonesia, it is notable that local public sector expenditures are not limited to the "typical"

[14] Whenever possible, data were collected for 2010 or the closest budget year for which budget execution data were available.

sectoral functions assigned to the local level, such as education and health; instead, local public sector expenditures are relatively high across all functional areas, including public administration (general public services).

Figure 3. Size and composition of LPS expenditures in four countries: Indonesia, Mozambique, Tanzania, and Bangladesh



Mozambique. As revealed by figure 3 (panel B), the organizational structure of Mozambique's public sector is considerably different than Indonesia's public sector structure. Mozambique's Law on Local State Organs (Law 8/2003) defines the country's provinces, districts, administrative posts and localities as deconcentrated local state organs. This law designates the (unelected) district level in Mozambique as "the principal territorial unit of the organization and functioning of the local administration of the State and the base of the planning of the economical social and cultural development of the Republic of Mozambique". In addition to the deconcentrated state structure, 43 politically autonomous, elected municipalities (*autarquias*) deliver urban public services in the country's urban areas.

Despite the virtual lack of political decentralization in Mozambique, a considerable share of local public sector expenditures take place below the central administration level (figure 3, panel B). Guided by a highly detailed and transparent national treasury system that covers all tiers of the public sector, 44.1 percent of public sector finances are spent at the provincial, district, or municipal levels. Similar to Indonesia, and in seeming contrast to the country's centralized political structure, local public sector entities (provinces, districts, and municipalities) are involved in the provision of public services across the board.

Tanzania (Mainland). The United Republic of Tanzania is a federation of Tanzania Mainland and Zanzibar. Elected local governments were (re-)established in Tanzania Mainland in 1982. Since adopting a Policy Paper on Local Government Reform in 1998, the government has been pursuing an incremental strategy of "decentralization by devolution." Although local governments at the district level form the frontline in the delivery of key public services, central authorities continue to play an important role in the local decision-making and in local service delivery processes.

Even though district and urban authorities are assigned many important social and economic public service delivery responsibilities, spending by local government authorities accounts for only 20.2 percent of public sector expenditures. In addition, regional administrations are responsible for 2.0 percent of public expenditures, while central line ministry expenditures on frontline service delivery at the local level account for 11.5 percent of total public spending. In total, therefore, local public sector expenditures in Tanzania account for only about 33.7 percent of total public expenditures. This means that almost two-third of public sector resources (66.3 percent) is retained at the central level without finding its way to the local public sector.

Unlike Indonesia and Mozambique, there is a greater contrast in Tanzania between the role of the local public sector in the main social sector functions (which receive sectoral grant support from the central government: education, health, agriculture, and water) and all other public sector functions (figure 3, panel C).[15] A noticeably smaller share of general public services (i.e., local administration expenditures) takes place in Tanzania (17.5 percent) when compared to Indonesia and Mozambique (26.2 percent and 29.9 percent, respectively).

Bangladesh. The government of Bangladesh has committed to bringing "basic public services to people's doorsteps." However, with a population of around 150 million people and a highly centralized and hierarchical government structure, the country is widely considered to be among the most centralized in the world. However, the government has been pursuing a series of reforms since 2006 to strengthen the role of local bodies in the public sector. While local elections were held in 2008, most of the recent legislation empowering local bodies has yet to be fully implemented.

[15] Local road maintenance and local administration also receive sectoral grants from the center.

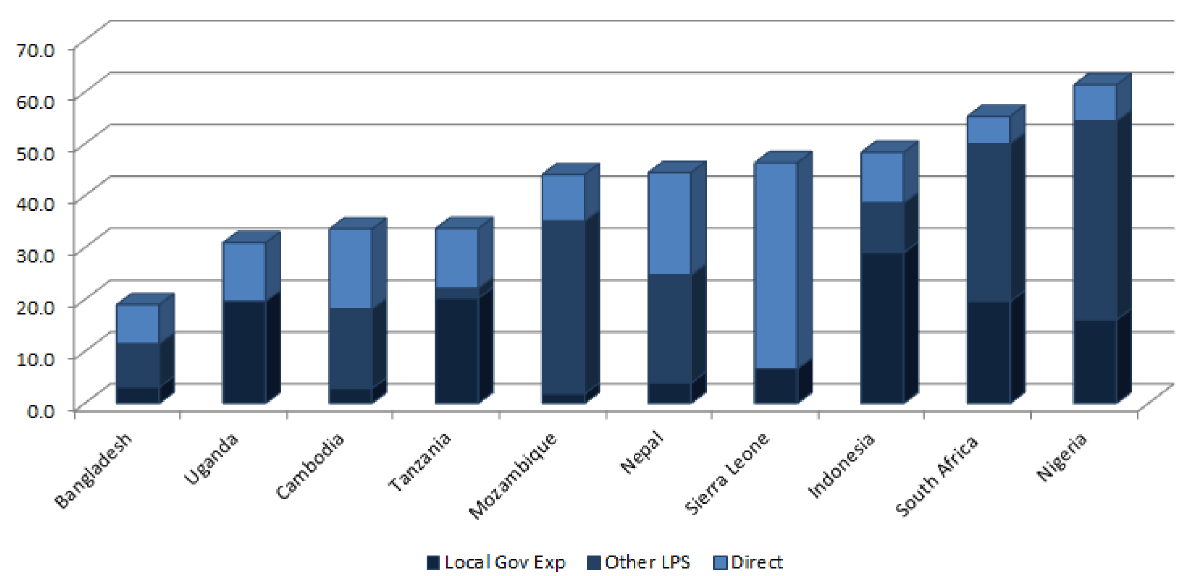
The absence of detailed budget data sources makes it difficult to disentangle exactly what share of public sector expenditures finds its way to the local public sector to fund frontline public services in Bangladesh. Estimates for FY 2010–11 suggest that approximately 3.1 percent of public spending in the country is done by Union Councils and urban local bodies. In addition, roughly 8.3 percent of public expenditures take place through deconcentrated bodies at the Zila and Upazila level, whereas an additional 7.5 percent of spending is contained in central line ministries budgets in direct support of 'local' front line service delivery. These estimates suggest that in total, only about 18.9 percent of public expenditures are devoted to the local public sector.

Beyond the overall much smaller share of the local public sector in the country, the visual depiction of Bangladesh's local public sector expenditure profile (figure 3, panel D) shows three trends. First, the total share of spending on the main social sectors (education, health, agriculture, and water) is much smaller in Bangladesh than in the other countries highlighted. Second, in these social sectors, the share of public spending that flows down to the local level appears to be considerably smaller than in the other countries reviewed. Third, extremely limited financial resources appear to be available at the sub-national level in all other functional areas, including general administrative services).

The level of detail in national budget documents hindered the process of identifying all funding flows and financial resources that may find their way to the local public sector to fund frontline public services.

Comparison of selected countries. What do we find when we analyze the size and composition of all ten countries for which local public sector expenditure profiles were completed as part of this study? This analysis is presented in figure 4 below.

Figure 4. Size and composition of local public sector expenditures: comparison of selected countries



The small size of the sample means that no definitive conclusions can be drawn based on this initial sample. Nonetheless, the preliminary findings are an important step in achieving a better understanding of the local public sector, and for guiding future research

Finding 1. There is considerable variation in the size and composition of local public sector expenditures between countries.

The first finding revealed by the comparative analysis of local public sector finances is that there is considerable variation in the size and composition of local public sector expenditures between countries. Based on the sample of developing countries analyzed, it appears that in a "typical" developing country (to the degree that such a country exists) roughly 30-40 percent of public resources is spent at the local level. Around this average, the share of local public expenditures ranges widely from around 20 percent (e.g., Bangladesh) to around 55-60 percent (e.g., South Africa, Nigeria). It is hard to imagine that such huge variations in expenditure patterns do not have an important impact on the respective countries' development and service delivery patterns.

The LPS expenditure profile methodology further reveals the size and composition of local public sector expenditures in predominantly deconcentrated countries which—until now—were hidden from view. The comparison in figure 3 indicates that a wide range of practices exist in the vertical allocation of resources among deconcentrated countries, ranging from around 20 percent in Bangladesh to approximately twice that in Mozambique.

Figure 3 also confirms the importance of looking beyond just the expenditures of elected local governments, and emphasizes that, in reality, countries pursue a multi-level approach to service delivery and development. This is revealed in the graph by the considerable differences between the level of devolved (local government) expenditures on one hand (in dark blue) and the total size of the local public sector on the other hand. One would get an extremely incomplete sense about a country's local public sector by looking exclusively at devolved local government expenditures rather than by looking at the total size of the local public sector. While, as expected, we find this to be true for predominantly deconcentrated countries (where the existing metric for local government finance overlooks the majority of local public sector spending), we also find this to be true for predominantly devolved countries, where it is not unusual for non-devolved funding streams to account for 25 percent or more of local public sector expenditures.

The pattern confirms the notion that local government sector expenditures (as currently measured by the IMF [2001], and frequently used as a measure of expenditure decentralization) are unlikely to be a satisfactory measure of (fiscal) decentralization in the developing world given the wide variety of mechanisms with which local public sector entities and services are being financed. As a result, any empirical analysis that has looked at the question of fiscal decentralization and economic development exclusively on the basis of the devolved expenditures is, at best, looking at only part of the picture.

Analysis and discussion: additional findings regarding the size and composition of local public sector finances

Given the observed variations between different countries in the size of their local public sector, what clues—if any—can we find as to why the local public sector in some countries is larger than in other countries? Similarly, does the size of the local public sector have an impact on development outcomes? Even based on a relatively small sample of ten local public sector expenditure profiles, a number of initial findings or lessons can be drawn from a basic analysis regarding the size and composition of local public sector expenditures. Of course, these findings are influenced by the selection of the sample, and it would be desirable to collect more LPS expenditure profiles in order to verify whether these initial findings would still hold in a larger, more representative sample. As such, this section presents four additional findings from the current research phase.

Finding 2. The organizational structure of the subnational public sector seems to have some impact on the size of the local public sector (but is not a dominant factor.)

The pattern revealed in figure 4 suggests that the organizational structure of a country's public sector—whether it is predominantly deconcentrated or devolved—is probably not as decisive of a factor in determining the size or functioning of the local public sector as the conventional wisdom may have suggested. Local public sectors that fall in the range from roughly 30 percent to 45 percent of total public expenditures reflect a mix of devolved and deconcentrated country systems. Thus, the organizational structure of the subnational public sector does not seem to have a decisive impact on the size of the local public sector.

That said, a pattern appears to be detectable at the extremes of the spectrum in figure 4: predominantly deconcentrated countries lean from the center of the graph towards the smaller size of the spectrum, whereas devolved countries occupy the right-hand side of the spectrum containing larger-sized local public sectors. As such, the political and institutional forces that have led to a certain organizational structure also seem to provide a floor or a ceiling to the level of sub-central spending in a country. Whereas it seems it would be difficult for countries with a devolved public sector structure to fall below local public sector spending less than 30 percent of public sector resources, countries that spend in excess of 45 percent of total public spending at the local level seem to prefer a devolved organizational structure.

Another common assumption related to the organization of the local public sector—that countries with one or more intermediate (government or administrative) levels have higher levels of local public sector spending—does not appear to be supported by the current sample of countries. While it is true that the three countries with the highest shares of local public spending (Indonesia, South Africa, and Nigeria) each have a robust regional government level, virtually all countries in the sample have two or more subnational levels or tiers, including those countries with the smallest local public sectors (Bangladesh, Uganda Tanzania, Cambodia, and Nepal).[16]

[16] However, it is notable that three countries with the highest share of local public sector spending—in contrast to the other countries—each have more than one *elected* subnational level.

Figure 5. LPS Expenditures and Per Capita GDP

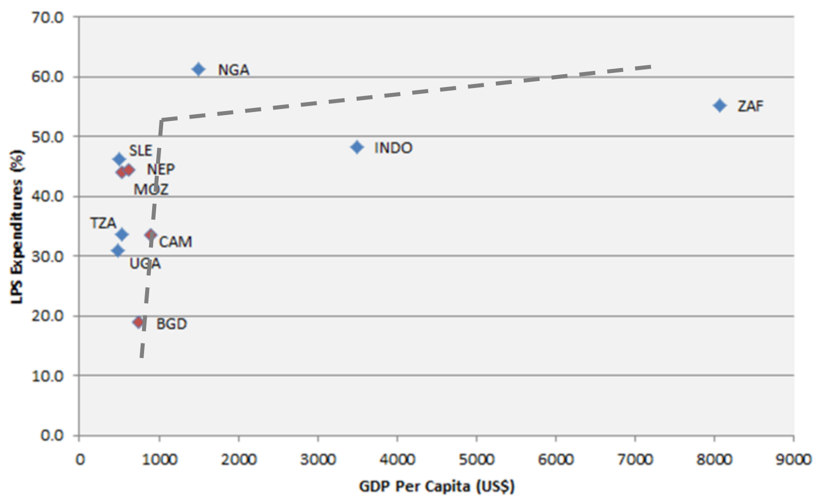


Figure 6. LPS Expenditures and Freedom House Score

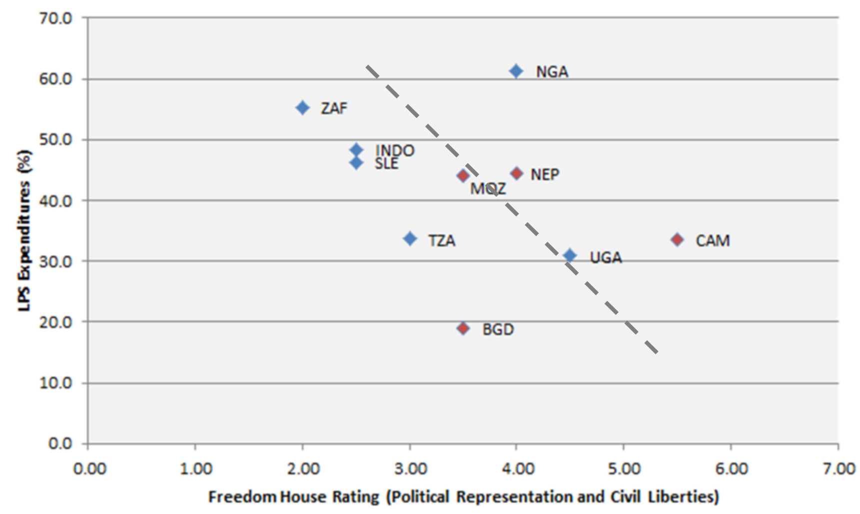


Figure 7. LPS Expenditures and Government Effectiveness

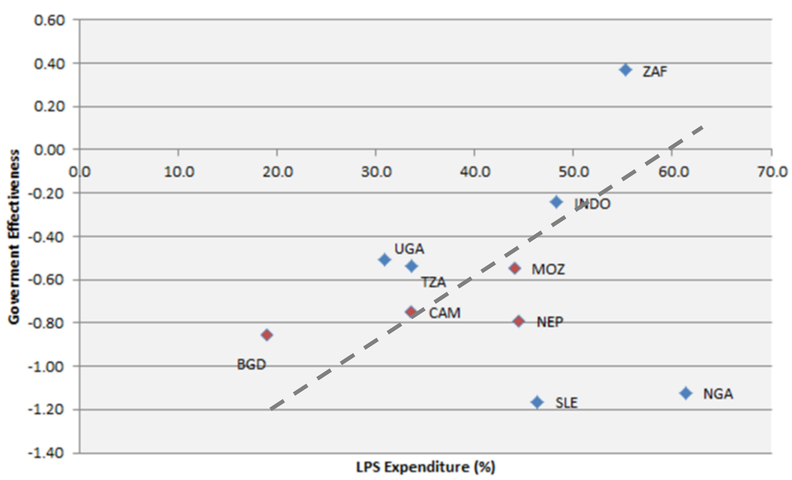
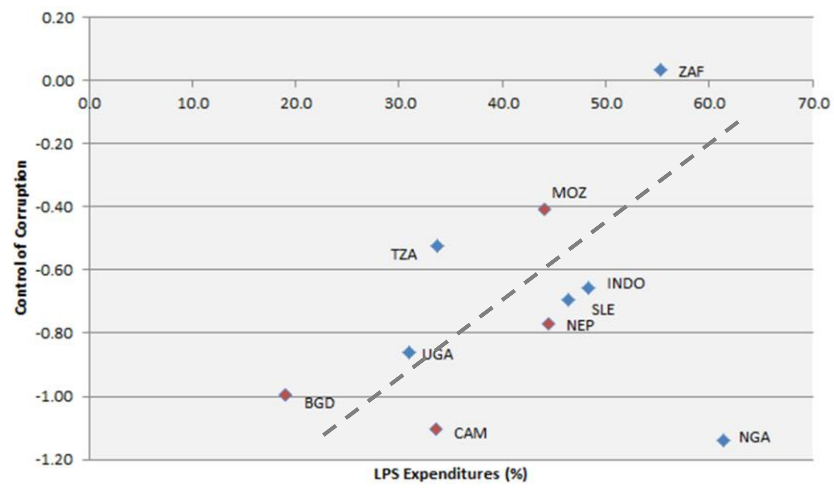


Figure 8. LPS Expenditures and Corruption Control



Based on our sample, however, it appears that predominantly deconcentrated countries tend to have somewhat different public sector structure in terms of the number and size of subnational jurisdictions at the lowest local government level. Bangladesh, Cambodia, and Nepal each have a formal village level that plays an important political economy role in the public sector, even though these jurisdictions typically have little or no service delivery responsibility.

Finding 3. For low-income countries, there appears to be no relationship between per capita GDP and the size of the local public sector.

Figure 5 explores whether the size of the local public sector in a country is related to a country's income level, as measured by (per capita) GDP.[17] As noted earlier, public finance theory would suggest that if the demand for (localized) public services is income elastic (or at least, more income elastic than centralized public services), than the demand for localized public services would rise more than proportionally with income growth, resulting in higher-income countries having a larger local public sector. Instead of a consistent linear relationship, our limited sample suggests that two separate patterns may exist.

On one hand, for countries above a certain per capita GDP threshold, higher incomes seem to result in a larger local public sector. Nigeria, Indonesia and South Africa (the three highest income countries in the sample, each exceeding a GDP of US $ 1000 per capita) all have a local public sector close to (or exceeding) 50 percent of public spending. However, it is unclear whether this is the direct result of the rising demand for localized public services as income goes up, or whether increases in the size of the local public sector above a certain income threshold (and, possibly, impacts of domestic income on the organization of the public sector) are the result of an increase in the demand for good governance associated with higher income levels.

On the other hand, the available empirical results do not suggest that there is a similar positive relationship between GDP levels and the size of the local public sector for low-income countries (with GDP per capita below US $1000 per capita per year). In fact, for low-income countries in the sample, there appears to be no relationship whatsoever between per capita GDP and the size of the local public sector (figure 5).

The finding of an apparent threshold effect is consistent with Collier's (2009) argument that the benefits of participatory governance institutions are likely to vary with a country's income level. Specifically, Collier notes that for middle-income countries, democratic governance systematically reduces the risk of political violence, whereas for low-income countries, the introduction of democratic institutions may make society more prone to political violence. Collier identifies a per capita GDP of $2,700 per annum as a tipping point, below which the preconditions for accountability and legitimacy for a responsive, democratic society may be missing.

[17] Note that in figures 5–8, predominantly devolved countries are indicated with blue markers, while predominantly non-devolved (e.g., deconcentrated) countries are indicated with red markers.

Finding 4. Central (political/bureaucracy) monopoly power seems to be an important factor in determining the size of the local public sector.

A factor that seems to play a more consistent role in determining the size of the local public sector is national political contestability. Above, we hypothesized that countries where central authorities have an uncontestable hold on state power, center-level stakeholders (be they political or bureaucratic) are likely to retain a greater share of public resources for themselves. In effect, if state power is not contestable at the central level, central regimes (whether the political leadership itself or the central bureaucracy) may end up exploiting this lack of contestability by retaining resources for themselves, resulting in behavior that is much like a predatory state. The evidence presented in figure 6 seems to support this hypothesis.

Figure 6 reveals a relatively consistent, positive relationship between the degree of political representation and civil liberty in a country (as judged by the Freedom House rating) and the size of the local public sector. Countries that have fewer political rights and civil liberties (reflected by a higher score on Freedom House's seven-point rating scale) typically have a larger central public sector. In turn, freer societies (with a lower score on the Freedom House rating) tend to have larger local public sector, as hypothesized.

As far as the causality of the relationship shown in figure 6, it is likely that the presence of central monopolistic power over the public sector (reflected by an absence of central political representation and civil liberties) is indeed a causal determinant of the size of the local public sector. Although central authorities are clearly able to control the size of the local public sector, the exogenous paths through which the size of the local public sector would be able to directly (or indirectly) cause greater political representation and civil liberties are much more tenuous.[18]

Finding 5. There is a positive correlation between the size of the local public sector and perceived government effectiveness and control of corruption.

Perhaps the most relevant policy question addressed by this study is not necessarily what causes the size of local public sector expenditures to differ between different countries, but rather, whether variations in the size and composition of local public sector finances cause the public sector to be more effective or efficient in achieving its policy objectives. In a similar vein, what does the analysis of local public sector finances reveal, if anything, about whether countries with a more decentralized public sector (countries that spend a greater share of their public finances within the local public sector) are more prone to corruption?

One of the empirical challenges faced in answering this question is the difficulty in measuring government effectiveness: the (local) public sector produces a complex and multi-dimensional basket of outputs across a range of functions and sectors. Although the United Nations has been tracking countries' progress on the Millennium Development Goals (MDGs) over time based on

[18] The Freedom House rating for political representation (and civil liberties) exclusively focuses on political representation at the central or national level, and does not measure the absence of subnational political representation.

a set of MDG indicators, these indicators are difficult to aggregate or collapse into a single variable.

For the purpose of this study, we rely on two governance indicators prepared by the World Bank (Kaufmann, Kraay, and Mastruzzi 2010), namely *government effectiveness*, which reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, and the quality of policy, and *control of corruption*, which reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests. Although these measures reflect perceptions about government effectiveness and corruption rather than objective measures of public sector performance (such as the number of pupils enrolled in public schools or the number of patients treated by public health facilities), these measures should be considered consistent and relevant indicators measures of public sector performance for the purpose at hand. A higher value for these indicators reflects a better governance outcome (i.e., a more effective government or better control over corruption).

Although it worth repeating the caveat that the number of countries included in our initial analysis of local public sector finances is small and not necessarily representative, figure 7 reveals a fairly strong, positive correlation between size of the local public sector and government effectiveness. Likewise, figure 8 reflects a clear, positive correlation between size of the local public sector and control of corruption, suggested that countries that have a large public sector (i.e., more decentralized) are *less corrupt* than more centralized countries.[19] These findings seem to go against the warnings issued by critics saying that fiscal decentralization is a road full of dangers and pitfalls. Of course, correlation does not necessarily mean causality, and the established relationships are not linear, suggesting that (as expected) there are other variables that help determine the degree of government effectiveness and control of corruption. In particular, the data suggests that Nigeria (and to a lesser extent, Sierra Leone) is an outlier.

These results are consistent with our theory of change, which states that the effective and equitable delivery of localized public services is likely to be achieved in a sustainable manner when the local public sector is given the necessary resources to do its job well, relative to total available public resources and the public sector's priorities. This initial result is also consistent with the basic argument made by the fiscal federalism literature—that increased local government spending is generally a force for good in improving public services. The empirical evidence presented in figures 7 and 8 suggest that this conclusion is not limited to devolved local government expenditures and can likely be extended to include other local public sector expenditures as well.

Although it is clear that a large local public sector is generally associated with greater government effectiveness and better control of corruption, care should be taken not to over-interpret this initial evidence. After all, it is possible that the causality runs in the opposite direction, and that countries with more effective government systems (and countries with more robust accountability mechanisms) are able to allocate a greater share of public sector resources

[19] In both of these cases, Nigeria proves to be a clear outlier.

below the central level.[20] It is important to note that many of the impediments to government effectiveness and corruption control, however, are endogenously determined by public sector officials (often referred to as "political will"), rather than being exogenously determined by factors beyond a country's control (such as a country's income level).[21]

Clearly, the relationship between size of the local public sector (on one hand) and government effectiveness and corruption control (on the other hand) requires further exploration beyond the bivariate analysis presented here. A multivariate analysis based on a greater number of observations would be able to more definitively answer whether government effectiveness is improved by greater local public sector spending or vice versa. Such analysis could further explore to what degree other factors, such as differences in subnational organization, discretion, accountability, or incentives, contribute to differences in government effectiveness and to differences in other public sector performance indicators.

Conclusions and next steps

This study reflects the first-ever comprehensive attempt to look at local public sector expenditures by going beyond the conventional wisdom that the only type of local spending that matters is the expenditures of elected local and regional governments. Though elected local governments are key providers of local public services in countries with a predominantly devolved public sector structure, this study looks at all different types of financial resources available at the local level across devolved as well as non-devolved countries. For instance, in addition to local government expenditures, the local public sector expenditure profiles upon which our analysis is based take into account deconcentrated expenditures (expenditures made by regional and local administrative bodies or departments) as well as central line ministry expenditures made directly (or through delegation) in support of public services delivered in a localized manner.

The comparative analysis of local public sector finances reveals that there is considerable variation in the size and composition of local public sector expenditures between countries. Based on the sample of developing countries analyzed, the share of local public expenditures across countries ranges from around 20 percent (e.g., Bangladesh) to around 55–60 percent (e.g., South Africa, Nigeria). Defying conventional wisdom, the observed variation does not allow us to neatly divide countries into devolved versus deconcentrated categories solely based on the size of their local public sector.

In addition to revealing the size and composition of local public sector expenditures in predominantly deconcentrated countries which—until now—were hidden from view, the analysis of local public sector expenditures also confirms the importance of looking beyond the

[20] It should be noted that the measures of good governance relied on here—government effectiveness and control of corruption—measure governance outcomes that apply to the public sector as a whole, rather than exclusively capturing government effectiveness or corruption at either the central or the local level.
[21] For instance, Mozambique is good example of a low-income country that spends a considerable share of public resources subnationally (largely in a deconcentrated manner) through highly transparent national budget and treasury systems.

expenditures of elected local governments, even in countries that are predominantly devolved. The analysis finds that most—if not all—countries pursue service delivery and development through a multi-level approach by which different elements of frontline services are supported and delivered by different government levels through a range of different funding modalities.

Based on our initial sample, the analysis pursued in this study further suggests that central political contestability seems to be an important factor in determining the size of the local public sector, as countries where central regimes have a stronger monopoly on power tend to spend less at the local level. Likewise, the study uncovered a positive correlation between the size of the local public sector and perceived government effectiveness and control of corruption. Although the direction of causality of these relationships is unclear, our results provide initial evidence that more effective (and less corrupt) public sectors spend a greater share of their resources at the local level.

However, our initial conclusions are limited by a relatively small number of countries for which we were able to prepare local public sector expenditure profiles. A larger sample of country profiles will be needed to make firmer conclusions about the impact of the local public sector on government effectiveness, and in order to make other inferences about the impact of the local public sector on service delivery performance and development outcomes. For instance, while our preliminary results suggest that greater government effectiveness is associated with greater spending at the local level, it is clear that more money at the local level is not enough. An important unresolved challenge that requires additional data to resolve is the determination of what (local and intergovernmental) institutional factors matter in achieving effective and inclusive delivery of local public services. One question in particular that is likely to garner great interest is whether the impact of devolved expenditures on service delivery performance and development outcomes is greater or equal than the impact of non-devolved expenditures on public sector performance.

Whether more spending at the local level results in better development outcomes may also vary from sector to sector. As such, further study is needed to determine whether more local-level spending results in better service delivery outcomes for local services such as basic education, primary health services, water supply, or other pro-poor public services. An effort to address some of these questions is already underway, as development agencies are keen to understand whether it is possible to unlock the potential of the local public sector in order to achieve the health and education objectives to be pursued as part of the post-2015 global development agenda (DELOG 2013).

References

Abdelhak, Faigy, Jihyun Chung, Jingqiang Du, and Valerie Stevens. 2012." Measuring Decentralization and the Local Public Sector: A Survey of Current Methodologies." IDG Working Paper No. 2012–01. Washington, DC: The Urban Institute.

Boex, Jamie. 2013. *Measuring the Local Public Sector: A Conceptual and Methodological Framework* (Local Public Sector Country Profile Handbook). Washington, DC: The Urban Institute.

Collier, Paul. 2009. *Wars, Guns, and Votes: Democracy in Dangerous Places.* New York: Harper Collins Publishers.

Development Partners Working Group on Decentralisation and Local Governance (DELOG). 2013. "The Local Public Sector's Role in Achieving 'The World We Want': Subnational Governance, Finance, and the Post-2015 Global Development Goals."

Dziobek, Claudia, C. Gutierrez Mangas, and P. Kufa. 2011. "Measuring Fiscal Decentralization—Exploring the IMF's Databases." Washington, DC: IMF Working Paper WP/11/126.

Freedom House. 2013. "Freedom in the World 2013: Democratic Breakthroughs In the Balance." Washington, DC: Freedom House.

International Monetary Fund (IMF). 2001. "IMF Government Finance Statistics Manual." Washington, DC: The Fund.

Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. 2010. "The Worldwide Governance Indicators : A Summary of Methodology, Data and Analytical Issues". World Bank Policy Research Working Paper No. 5430.