

# **Revising the Allocation of Functions**

- **1. Guiding principles**
- **2. Type of functions and legal regulation**
- **3. Allocation of costs**
- **4. Allocation of taxes and grants**
- **5. Organization of the reform process**

# 1. Guiding principles

From a public finance management perspective, the following principles are crucial:

- (1) Disentangle responsibilities wherever possible.** Create clear responsibilities; avoid double responsibilities.
- (2) Subsidiarity principle:** Allocate the function at the lowest possible state level, i.e. as close as possible to the citizens.
- (3) Institutional symmetry:** It is important that there is an overlap of the three circles, service users, decision makers and financier. This means that decisions are made by the ones who pay. But the ones who pay must be those who have the benefit.

## 2. Type of functions and legal regulation

- Define clear types of functions.
- For each type, guiding considerations for the allocation are required.
- 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. Then, the question should be asked how it should look like in the future.

## **2.Type of functions and legal regulation**

- **Local Functions (L)**
- **Vertical Collaboration Functions (V)**
- **Horizontal Collaboration Functions (H)**
- **Central State Functions (C)**

## **2.Type of functions and legal regulation**

- **Local Functions (L)**

- **Description**

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

- **Considerations for the allocation**

The function can be carried by the LGU independently.

There are two variants:

- **L1 Voluntary local function**
    - **L2 Mandatory local function**

# L1 Voluntary local function

## *Legal regulation*

- LGUs can carry out this function based on local decision making but they are not obliged to provide services in this particular policy area by a higher state level. Norms from the higher state level do not exist.

Examples: Local museum, sport events.

# **L2 Mandatory local function**

## ***Legal regulation***

- LGUs are required to carry out the function, based on legal provisions of a higher state level.
- There are three versions, A, B, and C.

# L2 Mandatory local function

## Version A

- Minimal standards set by a higher state level.
- The higher state level applies a management by objectives approach.
- There are no norms regarding the operation set by the higher state level.

Examples: Waste collection.



# L2 Mandatory local function

## Version B

- Concessionary law.
- Legal provisions enacted by the higher state level are the default rule.
- LGUs can regulate the operation of the function differently if they find it appropriate.

Example: Local elections.

# **L2 Mandatory local function**

## **Version C**

- Mandatory norms.
- LGUs are obliged to carry out the function as required by prescriptive norms enacted at a higher state level.

Example: Civil registry.

# Vertical Collaboration Functions (V)

- They must be financed jointly in accordance with the principle of institutional symmetry. 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. Negotiation on this important issue is needed before the upper state level takes the decision.

There are two broad variants:

- **V1 Vertical collaboration functions with partial flexibility**
- **V2 Vertical collaboration functions with little flexibility**

# V1 Vertical collaboration functions with partial flexibility

The higher state level enacts general binding norms 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***

- Strong common interest for mandatory norms with country-wide applicability. Reasons could be legal equality including equal opportunities or social security.
- The regulation may require a high degree of specific knowledge.
- If central regulation was lacking, free rider behaviour could not be avoided.
- The service should be provided locally because of frequent contacts with the local clients. LGUs do have the necessary capacities to implement the function appropriately.
- There is no need that the function is implemented in each LGU 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.

# V2 Vertical collaboration functions with little flexibility

The higher state level enacts the policy norms in detail and leaves only limited discretion for the implementation by LGUs.

- ***Considerations for the allocation***

The same considerations for central state regulation apply as for V1. 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.

# Horizontal Collaboration Functions (H)

This collaboration may take place for two reasons: making use of a synergy potential 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.

- ***Considerations for the allocation***

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

- ***Legal regulation***

- Collaboration is not voluntary.
- sub-national governments have discretion on how the collaboration should be organized.
- the collaboration arrangement should respect the principle of institutional symmetry.
- The higher state level can intervene when individual sub-national governments refuse to collaborate.

Examples: Higher pre-university education, inter-LGU public transportation, waste disposal, water protection of lakes and rivers, tourism.

# Central State Functions (C)

- **Description of the function**
  - Functions are exclusively allocated to the higher state level responsible for policy planning, implementation and financing,
  - it is required that services are delivered country-wide at the same standard,
  - the function requires a connected and inter-linked system,
  - highly specialized capacities are needed to regulate and implement this function.

Two variants are given:

- **C1 Central state function with centralized implementation**
- **C2 Central state function with decentralized implementation**

# C1 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: National tribunal, high-end medicine, national defence, social security, highways.



# C2 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: de-concentrated units of line ministries, contracts with local or regional governments, PPP.

Examples: Unemployment offices, universities, hospitals, prefects.

# **2.Type of functions and legal regulation**

- **Local Functions (L)**
  - L1 Voluntary local function
  - L2 Mandatory local function (Versions A, B, C)
- **Vertical Collaboration Functions (V)**
  - V1 Vertical collaboration functions with partial flexibility
  - V2 Vertical collaboration functions with little flexibility
- **Horizontal Collaboration Functions (H)**
- **Central State Functions (C)**
  - C1 Central state function with centralized implementation
  - C2 Central state function with decentralized implementation

### 3. Allocation of costs

- When functions are shifted from one state level to another, this implies that costs are shifted in the same way to another level.
- The process should start with the allocation of functions and then, it is needed to calculate the cost for each function that was transferred.
- Calculation should be based on the consolidated costs of both, the central and the sub-national level in a consolidated way, preferably based on figures of the last three years. With this information, it should be possible to calculate the cost per unit and to estimate the costs for the starting year, when the new system of functional allocation enters into force.
- This calculation is needed for each individual function transferred. By summing up the results, the total of transferred costs can be quantified.

## 4. Allocation of taxes and grants

- Taxes with a high fluctuation over time should not belong to the local level.
- It is highly recommended not to allocate taxes with high horizontal variance at the local level.
- Earmarking of grants should be reserved for shared functions, i.e. where vertical collaboration is required. In all other cases, earmarking of grants is not functional.
- Earmarked grants should be agreed in multi-year performance contracts while, according to good practice, non-earmarked grants should be formula-based block grants.
- When functions - and therefore costs - are reallocated, it is required that revenues follow suit.

## 5. Organization of the reform process 1

- The process for the allocation of functions should be organized as a project with clear and broadly agreed goals and timeframes.
- A project organization with strong political leadership is needed.
- The steering committee should be well anchored in the core ministries and include the sub-national level as well.
- An operational structure should work out the details of the reform. This operational structure should be composed of a project management group and mixed working groups per broad policy area.

## 5. Organization of the reform process 2

- The project management group should be headed by a strong technical project manager; his task would be to coordinate the project.
- He could be supported by a group of experts. However, for revisiting the allocation of functions, mixed working groups should be formed per policy area.
- In each group, it is recommended to have national and sub-national policy specialists, one or two each side; at least one expert for public finances and a legal adviser should complete each working group.
- Finally, a communication strategy is needed which makes sure that the major stakeholders can continuously follow and validate the project.

# 5. Organization of the reform process 3

