



## ORIGINAL RESEARCH PAPER

Economics

### MEASUREMENT OF PUBLIC SECTOR DECENTRALIZATION UNDER THE LIGHT OF GLOBAL TRENDS

**KEY WORDS:** Decentralization, Financial Localization, Public Finance.

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#### ABSTRACT

Changing in public finance that driven by globalization has increased the importance of the concept of decentralization. Decentralization is getting empower on subnational administration to its own public spending and utilization of tax income. By generating income flow and expenditure through subsidiarity, local government affects on both public spending and taxes. In this study, after brief explanation on concepts, their affect will be evaluated within framework of taxes and spending.

#### INTRODUCTION

Changing in public finance that driven by globalization have the concept of decentralization put forward and, caused getting importance in a broader sense. Localization phenomena emphasizes subsidiary and transfer of functions from center to local, and as a concept it connotes reconstruction of local governments and allows them self-revenue raising, borrowing and expenditure. However, this is not precise and sole definition for decentralization. Because of diversification in the level of localization among countries, evaluation to localization levels based on single criteria becomes impossible.

The term of localization has some sort of implications such as administrative (subsidiarity, transfer of functions and financial autonomy), political and financial. However, financial localization is more prominent among these implications. Local governments are financing their expenditures by funds that are being transferred from central governments. Because of their ability to prompt response to requirements of their residents, local governments might be able to alleviate central governments' burdens. Together with the said advantages, there are some disadvantages as well.

In this study, after rendering information concerning what the concept of localization is, kinds of localizations will be highlighted briefly, and the issue of financial localization will be evaluated from the standpoint of public expenditures and taxes.

#### 1. WHAT IS DECENTRALISATION?

The basic premises of arguments concerning decentralization that coined by Musgrave (1959) and Oates (1972), rather than servicing any public goods at the same proportion by central government, these must be offered by locally and different portions from the standpoint of total welfare and pareto efficiency (Acar and Kitapci; 2009: 87). Decentralization has a vast spectrum covering transfers of public functions, authorities and responsibilities from central government to semi-independent sub-governmental organizations or private sector (Rondinelli; 1998: 2).

Normative theories with relation to decentralization are being studied thoroughly by existing public finance literature.

Of salient one, is Tiebout Model and defines utilization methods from localization options in the public sector to increase effectiveness of mobile consumers' (electors) in resource allocation through their own regions (Wallis and Oates; 1988: 5). Decentralization, as a political and administrative concept, considers not only aiming at lightening center's burdens and invigorating local governments, NGOs and individuals but also, contrary to central power, attributes transferring authority downwardly in an institution.

Nation states take their characteristics from overly centralized organizations. While globalization process has been altering the traditional definition of the national state to unusual one, in the meantime it has alternatively been demanding the balance of central-local be re-arranged on the principle of decentralization and in favor of localization (Bilgiç and Gül; 2010:623).

World Bank, in its report of 1999-2000, argued that both globalization and decentralization was unavoidable and to consider a country as successful in 21. Century was depending on how these dynamics were being managed (Olgun; 2007: 115).

To World Bank, decentralization has four assortments including political, administrative and financial and privatization. According to countries and sectors, each one emerges with different combinations and forms. Market decentralization, namely privatization is not indicating transfer of authority and responsibility to lower government organization through private companies; besides political, financial and administrative decentralizations are being congested at the point of decision making and transferring administrative authority.

Political localization is the term aiming at more power delegating to citizens and their representatives in public decision making process. Furthermore, political localization is assumed as prevalent form of administrative localization. Administrative localization that implying operational authority being delegated by state during top-down structuring has three forms: deconcentration, delegation and devaluation (Crucq and Hemminga; 2007: 3).

Financial localization which is most emphasized term is addressing that any increasing in revenue and expenditures would be managed more effectual by lower levels or municipalities more than central governments.

#### 2. FINANCIAL LOCALIZATION

Financial decentralization implies a process that includes transferring the authority of financial decision-making and service responsibilities to sub-administrative units existing out of center (Kovancilar, et. al; 2007: 99). Financial responsibility constitutes pivot point of decentralization elements and, financial decentralization is accepted as sub-form of political decentralization because of having weighted responsibilities in political planning and decision making (Crucq and Hemminga; 2007: 4). Despite an authorization in decision-making for revenue generating and expenditure is provided, the room concerning is not limitless and there is an external auditing (Kovancilar, et. al; 2007: 99).

Financial decentralization covers two inter-related issues. First one is getting revenue resources and expenditure responsibilities be divided among national, regional and local governments and the second is discretion size in revenue and expenditure decisions of local and regional governments (Crucq and Hemminga; 2007: 4). According to premises of financial autonomy, this situation points out an arbitrium for local governments to increase revenue and determine expenditure priorities without any intervention by central government. In other words, this means that local governments not only are determining tax-base and ratios and collecting taxes but also they are able to determine fees and fares by their own (Ulusoy and Akdemir; 2009: 264).

Public expenditures apparently are basic determining factor of localization and centralization. But without power of tax,

localization of expenditures will prevent tax competition that arising from Leviathan model.

By repealing relations between tax and benefits and only from the standpoint of the public expenditures, localization will stimulate over spending tendency for the said competitor local governments and, will cause again public expenditures being met from collective-pool.

Furthermore, this situation will lead to requirements for significative mutual country analysis through ever evaluated local taxes, income distribution and data of income transfers (Rodden; 2003: 698). Financial localization should be managed from expenditures and influences of localization perspective as well as financial localizations.

### 3. FINANCIAL LOCALIZATION FROM TAXES STANDPOINT

Recognition of taxation autonomy for local governments' points out the rights of levy and determination of rates independently but the said independency is not absolute and it is limited to a degree as several taxes, administrative efficiency and local boundaries (Ulusoy and Akdemir; 2009: 274).

To what extent taxation authority is being used by local government is an important issue. Authority level that transferred to local governments by central government ensures extended income resources for local governments. At this point, above mentioned relation of financial autonomy and taxation authority becomes important.

Because of different tax regulations and socioeconomic conditions, transferred authority to local governments by states is internalized by them with different aspects (Egeli and Diril; 2012: 32). Because, even though localization conditions theoretically reveal similarity, in practices, geographic and politic reasons cause diversities as well. Thus, the localization of taxation that brought about by the localization of public services delivery may induce unfavorable effects. Because, to levy and collection is a must and an indicator for independent states. Consequently, localization must have achieved within the borderline which is depicted by central government (Kovancilar, et. al; 2009: 114).

To do this, three methods concerning resources allocation are discussed. First one allows local government to levy with full authorization and, the second method is to distribute low and ineffective taxes among governments; the last is a kind of mixed one of above mentioned methods and proposes giving local governments a share in collected taxes by central government. By indicating the transfers emerged as a result of central taxation, giving share in tax incomes aims at remediation of problems that might be arose from local governments.

In brief, localization of services is a preferred request rather than localization of taxation (Saking; 2000: 117).

While income, corporate, added value and custom taxes are deployed by central government; taxes such as estate, motor vehicle and environment taxes are of in local government's use (Egeli and Diril; 2012: 33). But, albeit added value tax (AVT) is counted one among the taxes of central government provision, it is a good sample for common taxes. Because of its collectible characteristics at local and national levels, AVT is an abundant resource for local and regional governments (Kee; 2003: 26).

### 4. FINANCIAL LOCALIZATION FROM PUBLIC EXPENDITURE STANDPOINT

As is believed to generate competition in public sector via politic parties which are broadly similar to firms in free market may prevent over expansion of public sector, citizens as voter may corner the governments in any unsatisfied case of public services or in over spending issues (Özdemir; 2007).

It is argued that financial localization is an answerability transfer in which attached with responsibility to local governments. This implies an encouragement for local governments not only be contented with public preferences but also be innovative in supply

and production of public goods and services actively (Thiessen; 2001: 4).

Influences of financial localization on public spendings are being held in two ways as level of financial localization and differences in distribution of public spending (Kovancilar, et. al; 2009: 115).

### 5. APPROACHES IN FINANCIAL LOCALIZATION

Oates from public economics perspective argues financial localization out in two ways as first and second belt theories. Samuelson who describes natural public goods; Arrow who conceptualizes the roles of private and public sectors and Musgrave who studies on income distribution of state, healing market failures and functions of states such as macroeconomic stability are of first contributors to the first belt theories.

Because of local governments are more easily able to determine local preferences, local public goods may be offered in best ways is basic argument of the first belt theories. At that point, if there is negative externalities that affect other local governments, central governments should be equalizer and controller in supplying local public goods (Dziobek, et. al; 2011: 4). This approach is based on Oates's affinity principle in which argues that localization in spending accountability spurs wealth attainments.

In the second belt theories, state is seen as a market stimulator and a guarantor to protect markets. This argument has two basics. Both politic actors and voters are in an endeavor to maximize their interest functions in politic process are first basic assumption and, other one is asymmetric information.

By offering local public goods from central will cause intergovernmental externalities be internalized through intergovernmental transfers (Karabacak; 2012: 393)?

### 6. MEASURING PROBLEM OF DECENTRALIZED PUBLIC SECTOR

The term of decentralization is a concept which is difficult to describe and measure. Supposedly reliable a very few quantitative and qualitative instruments have been using to measure to reciprocal decentralization levels (political, administrative and especially financial aspects). Despite some improving in utilization coverage, somewhat its low capacity and comparability problems are causing troubles today. Not having been prepared a global data base that providing reliable, comparable and consistent knowledge regarding political, institutional and financial achievements of central and local governments in the world, our understandings regarding cause and effects of decentralization in developing countries are narrowed importantly. Even IMF's Government Finance Statistics (GFS) which is most referred data base in measuring financial decentralization has a limited capacity among developed countries (Abdelhak, et. al; 2012: 1).

Despite providing economic and functional classification of spendings, GFS data is not predicating autonomy scopes of local spendings and, not differentiating tax and tax exempt incomes, intergovernmental financial transfers and resource of other grants. Above mentioned problems are limiting usages of local governments' statistics in GFS data base. Thus, although GFS has consistent definitions across countries and over time, the subnational expenditure and revenue figures have little relevance in the decentralization context because the data fail to address properly the intergovernmental fiscal structure of countries and ignore the degree of central government control over local tax rates and tax bases (Ebel and Yilmaz; 2002: 7).

As for OECD identifies the elements that indicating the degree of financial decentralization as expenditure sharing, income sharing, hybrid, autonomy, decentralization of taxation.

First measurement to determine degree in financial decentralization is regarding to distribution of spendings. Thus, first measurement focuses on spending side and, as a portion of total spendings of central government, keeps spending distribution of local government. Measurement of spending distribution may not determine the degree of financial decentralization effectively.

Measurement concerning income distribution focuses on income/revenue side and, interprets distribution of local governments' own incomes.

Incomes collected by local governments are simply used for funding local expenditures and contrary to incomes generated by intergovernmental grants, local governments have discretion authority to use whole income/revenue collected by them.

In measurement that called as mixed sharing, difference between the spendings and income distribution reveals the amounts that transferred from upper levels of government. If transferred amount is less then diversity between two measurements will be less. Therefore, the measurement reaching decentralization degree is depending on characteristics of transfers. Namely, if the said transfers include both methods that could be used freely to fulfill local requirements by local governments, degree of financial localization and discretion authority will be extended. In this case, spending distribution will be an appropriate measurement to estimate financial localization.

Autonomy in spending decision that described as independency or discretion is another means for measurement. In this case, basic ratio in literature is local incomes/local spending. If total spendings are financed by incomes of local governments, this become equal to autonomy 1 and localization degree will scale up.

As to measurement of localization of taxation power is a new scale developed by OECD in 1999 that focused on tax control degree to by central and local government's levels. Classical approach basing income side assumes central government controls indirectly whole local taxes (Akai; 2013: 64).

**Table 1: Income and Spending Ratio of Local Governments in Turkey (%)**

	2008	2009	2010	2011	2012
<b>Total incomes</b>	3,20	3,37	3,63	3,73	3,72
<b>Taxes</b>	2,15	2,20	2,53	2,45	2,47
<b>Incomes exluding taxes</b>	0,37	0,51	0,42	0,48	0,48
<b>Total expenses</b>	3,84	3,82	3,39	3,69	3,76
<b>Current expenses</b>	2,18	2,21	2,16	2,21	2,19
<b>Investment Spendings</b>	1,50	1,26	1,03	1,23	1,30
<b>Current transfers</b>	0,21	0,32	-0,10	0,27	0,27

Source: TEPAV; 2012: 11.

## CONCLUSION

Changing in public finance because of globalization brought out localization thoughts. Localization notion is evaluated from three perspectives as political, administrative and financial but financial aspect is more prominent. Cause of this is of being financed the services to be delivered by local government by resources of central governments. Therefore, financial localization has been evaluating from the stand point of expenditures. However, issue must be evaluated not only spending side also from taxation aspect.

Because of decentralization, localization concept points out difficulties in implementation process for the countries having unitary states. It is clear that subsidiarity, especially in levying, is not in those states. Moreover, as a means, levying authority implies sovereignty power of state. Thus, in the case of transferring levying authority to local governments may cause tax burden for individuals because of spilling raised tax ratios over region. At this point, autonomy concept that anticipated as localization requires an autonomy that is to provide effective and productive public services (at local level) rather than financial issues.

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