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Mind the Gaps: Managing
Mutual Dependence
in Relations among Levels
of Government

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Mind the gaps: Managing mutual dependence in relations among levels of government

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This document represents the final report pertaining to the work on relations across levels of government carried out in 2007-2008.

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In its 2007-2008 programme of work, the OECD Public Governance Committee (PGC) decided to explore a series of horizontal public management themes, among them building effective relations across levels of government. This reflects the acknowledged importance to managing relationships among levels of government, regardless of whether a country is unitary or federal. These relationships become increasingly critical for effective and efficient service delivery by the local level. Furthermore, the consequences of the current financial crisis and the implementation of fiscal recovery plans in most OECD countries simply underscores the need for effective co-ordination and capacity among different levels of government.

This Working Paper emanates from the activities undertaken to address the topic as requested by the PGC. It was developed in two parts. Part One is a general overview of multi-level governance and is intended as a first step toward identifying and evaluating the challenges governments face when managing relations among levels of government. In addition, it highlights current commonly used mechanisms employed to address these challenges. This section draws upon existing OECD work on multi-level governance as well as input by member and non-member countries obtained through a questionnaire and during the PGC Multi-level Governance Symposium: *The Role of the National Level in Sub-national Capacity Building*, held in Paris on 23 October, 2008. Part Two focuses on the interaction among levels of government in fiscal relations, human resource management, regulatory management and e-government as these are areas where the challenges and mechanisms explored in Part One are clearly evident. This Working Paper is meant to illustrate how the relationship among levels of government requires attention both broadly and within specific public management activities.

The overall study on multi-level governance as requested by the PGC was co-ordinated by Ms. Claire Charbit. This working paper was co-ordinated by Ms. Claire Charbit (OECD Secretariat) and Ms. M. Varinia Michalun (OECD Secretariat). Part I was drafted and edited by the same. Part II: *Multi-level Governance Relations in Public Management Domains* represents contributions from the following OECD internal and external experts as follows:

Chapter 1: *Managing Fiscal Relations across Levels of Government* – coordinated by Ms. Claire Charbit and produced by Ms. Camila Vammalle (OECD Secretariat) based on input from Ms. Lee Mizell (OECD Secretariat), Professor Timothy J. Goodspeed (Hunter College, CUNY), and Mr. Hansjörg Bloechliger (OECD Secretariat).

Chapter 2: *Challenges of Human Resource Management for Multi-level Government – Main Conclusions* – written by Mr. Knut Rexed (consultant), under the supervision of Ms. Elsa Pilichowski (OECD Secretariat).

Chapter 3: *Multi-level Regulatory Governance Issues – Policies, institutions and tools for regulatory quality and coherence* – written by Mr. Lorenzo Allio (OECD Secretariat), Mr. Pedro Andres Amo (OECD Secretariat), Ms. Delia Rodrigo (OECD Secretariat).

Chapter 4: *E-Government Partnerships across Levels of Government* – written by Mr. Yih-Jeou Wang (OECD Secretariat) and Ms. Gwendolyn Carpenter (OECD Secretariat), with contributions by Ms. Barbara Ubaldi (OECD Secretariat), and initial research by Mr. David Osimo (consultant).

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EXECUTIVE SUMMARY

1. OECD member and non-member governments are actively looking for ways to facilitate and improve the relationships among levels of government. These relationships lie between the central and sub-national levels, as well as among peer levels (i.e., among ministries, across regions, between municipalities). They can also be seen in individual public management disciplines, such as fiscal relations, human resource management (HRM), regulatory management and e-government. This report arises from a request by the OECD's Public Governance Committee to look more closely at ways to build more effective relations among levels of government.

2. Over the past two decades countries have implemented decentralisation policies to varying degrees, allocating more, and often increasingly complex or resource-intensive competences to lower levels of government. This has resulted in a dynamic relationship with constant movement along a continuum of decentralisation and also recentralisation activity. The relationship between levels of government is characterised by mutual dependence, since a complete separation of policy responsibilities and outcomes among levels of government is not possible: executing tasks, overcoming obstacles, and/or accomplishing objectives requires co-ordination among government actors. In addition, it is a complex relationship. It is simultaneously vertical (across different levels of government), horizontal (among the same level of government) and networked, as the lines of communication, and co-ordination for a given policy objective may criss-cross, involving multiple actors and stakeholders in the public as well as the private sector and citizenry. Thus, in order to manage the relational outcome of decentralisation policies, multi-level governance is key. Multi-level governance is used here to characterise the mutually dependent relationships – be they vertical, horizontal, or networked – between public actors situated at different levels of government.

Minding the gaps...

3. When managing relations across levels of government, public actors at all levels are confronted by a series of gaps. These gaps, resulting from the fact that one level of government will depend on another – either for information, skills, resources, or competences – can exist vertically and horizontally. There are five dominant gaps that challenge multi-level governance: information, capacity, fiscal, administrative, and policy. The *information gap* is characterised by information asymmetries between levels of government when designing, implementing and delivering public policy. Broadly speaking, a *capacity gap* is created when there is a lack of human, knowledge (skill-based), or infrastructural resources available to carry out tasks, regardless of the level of government. The *fiscal gap* is represented by the difference between sub-national revenues and the required expenditures for sub-national authorities to meet their responsibilities. It indicates a direct dependence on higher levels of government for funding and for a fiscal capacity to meet obligations. An *administrative gap* arises when administrative borders do not correspond to functional economic areas at the sub-national level. And, finally, a *policy gap* results when ministries take purely vertical approaches to cross-sectoral policy (e.g., energy policy, water policy, youth policy, etc).

4. Minding these gaps represents one of the primary challenges in multi-level governance. Countries may experience each gap to a greater or lesser degree, but given the mutual dependence that arises from decentralised contexts, and the network-like dynamic of multi-level governance relations, countries are likely to face them simultaneously. The gaps are also seen in individual public management domains within a multi-level context. For example, fiscal relations will face not only a fiscal gap, but also that of information and capacity: is the national level able to allocate relevant financial resources to help

sub-national governments meet their responsibilities, and are sub-national governments able to properly manage the finances provided?

Bridging the gaps through co-ordination and capacity-building

5. Effective management of the relationship across levels of government, horizontally and vertically, requires narrowing the gaps, and bridging them as much as possible. Promoting co-ordination and capacity-building at both the national and sub-national levels is a large and critical step toward bridging these gaps and overcoming the challenges they present. In addition, it conditions effective public service delivery and effective development and growth policies at the local and national levels.

6. The public sector has become a matrix of crossing perspectives and a key issue rests on the ability to capitalise on synergies between different domains of public intervention. Thus, to accomplish policy objectives in an environment dominated by a criss-cross of vertical, horizontal, or networked contexts, a strong degree of co-ordination is required, as well as an understanding of mutual dependence. For the central government to achieve policy objectives, it depends on the co-operation of the sub-national levels. At the same time, in order to execute the demands of their competences, the sub-national level is often dependent on the collaboration or consent of higher levels. Finally in a networked system, each stakeholder depends on the other to meet their individual responsibilities which collectively help realise a larger goal.

7. At the same time, national and sub-national capacity is of primary importance in multi-level governance relations. One challenge associated with capacity stems from the allocation of competences by the national level and its subsequent support of building the capacity of the sub-national level. Capacity also refers to the ability of the sub-national level to meet its assigned obligations. Therefore, capacity is required at all levels of government, and each level can learn from another. Ultimately, the capacity question pertains to the ability of different levels of government to manage the mutual dependence that arises in a multi-level context.

8. This report finds that the line between co-ordination and capacity is not always clearly demarcated. This is most evident when looking the multi-level governance in specific public management domains. In human resource management, for example, mobility between different public administrations in a country is generally perceived positively as it can strengthen cohesion and promote the sharing of experiences. It can also help build internal networks and facilitate co-ordination. Thus one practice – mobility in the civil service – can bolster both of these key elements. In multi-level regulatory governance co-ordination can help in disseminating good practices and spreading the benefits of diversification of regulatory policy, thereby also building capacity. Among the mechanisms used by governments in multi-level governance, performance indicators are a tool to build capacity that can also facilitate co-ordinated actions across levels of government. Thus, co-operation and capacity-building go hand in hand: they are synergistic processes that can be mutually reinforcing.

Observed mechanisms for bridging the gaps

9. Member and non-member countries are developing and using a broad set of mechanisms to help bridge the gaps (information, capacity, fiscal, administrative and policy), improve the coherence of multi-level policy making, and smooth the disparities that can arise from the allocation of tasks and resources. These mechanisms, which range in form from “binding” to “soft,” not only appear relevant to multi-level governance in a broad or theoretical context but also to the practical cases seen in specific public management domains. Their successful application can depend on and simultaneously promote communication and dialogue among levels of government; an alignment of interests and timing; and transparency and accountability.

10. These mechanisms range across a broad spectrum and could begin at one end with *legal mechanisms*, possibly the most binding. Legal mechanisms are able to address the fiscal and capacity gaps, as well as promote vertical and horizontal co-ordination. *Contracts* are another effective means to help manage vertical interdependencies. One of the greatest strengths of contracts is that they are based on mutual agreement and can help bridge all five gaps. *(Quasi-)Integration mechanisms* are common throughout the OECD area and beyond. They include mergers and various methods of municipal co-operation, thereby impacting co-ordination vertically and horizontally, as well as providing a means to address multiple gaps, including those of capacity. These integration mechanisms might be considered as mid-spectrum. Very commonly used especially to promote co-ordination and capacity building are *co-ordinating bodies* such as municipal associations, thematic working groups, government agencies, and task forces. *Ad hoc and informal meetings* provide an opportunity to build communication, dialogue and networks that are horizontal, vertical and cross-networked. They could be considered the most “soft” of the mechanisms.

11. Indicators-based *performance measurement* and *experimentation* in policy design and implementation are also mechanisms to bridge the gaps mentioned. The former may become a critical component of multi-level governance, and a growing number of countries have established such systems for assessing performance. Experimentation can synthesise many of the mechanisms explored in this report, and can be an effective way for countries to work past resistance to reform, implementing a proposed policy with minimal barriers due to gaps, and a high possibility of identifying lessons and good practices.

Multi-level governance and individual public management domains

12. With respect to multi-level governance in specific areas of public management, fiscal relations, human resource management, regulatory management, and e-government are all affected by relations between levels of government.

13. Because of the mutual dependence, and especially the fiscal gap, *fiscal relations* is a crucial component to multi-level governance. There is a wide array of multi-level fiscal arrangements in the OECD arising from institutional differences, varying government size, the nature of the tasks assigned to lower levels of government, and financing possibilities. Countries can manage the fiscal relationship in different ways, for example by addressing fiscal rules and increasing efficiency through quasi-integration mechanisms or the introduction of market mechanisms. Performance indicators also can be used to improve sub-national government incentive structures, promote competitiveness among regions or municipalities, and improve the knowledge base.

14. *Human resource management* (HRM) presents an interesting case in multi-level governance, especially as efficiency at the local level is a concern. Mergers are one method countries have used to address it. Of interest is that in HRM, as in e-government, some countries are noticing that local governments may be more innovative in terms of solutions than the national level. To capitalise on this type of learning would require co-ordination and also a degree of openness by higher levels to learn from lower levels of government and help apply the lessons in relevant areas.

15. A set of common challenges is observed in *multi-level regulatory governance relations*, stemming from the fact that more than one level of government plays a role in designing, implementing and enforcing regulations. The most common problems noted are duplication of rules, overlapping and low quality regulations, and uneven enforcement, all of which can impact public service delivery and trust in government. These can also lead to increasingly complex administrative demands that may negatively impact economic activity. The development of an analytical framework for multi-level regulatory governance can help countries address several issues embedded here, including harmonising regulatory

policy, addressing the scope and influence of various levels of regulatory institutions, and identifying appropriate regulatory and policy tools. Implicit is a need for co-ordination among levels of government as well as strong capacity in regulatory matters.

16. *E-government* is both affected by multi-level governance and can help facilitate it through information technology networks linking the various levels of government, both horizontally and vertically. Therefore, it plays a unique role in multi-level governance. Despite this, it is not exempt from facing many of the same challenges as other public management domains. For e-government to be successfully implemented in a multi-level context, co-ordination is critical, as is capacity. Multi-level e-government partnerships matter in this context. They are central to improving services to citizens, improving processes that can promote public sector innovation, and renewing local democracy by increasing openness and accountability. In addition, e-government can help facilitate the establishment of businesses thereby promoting employment and economic growth. In e-government the synergies that arise from an intersection of capacity and co-ordination are clearly evident. Experience is indicating that the most successful e-government developments are found in countries where the different levels of government eventually come together to promote co-operation in a practical and operational manner.

The future of multi-level governance

17. Managing the relations between levels of government will be a necessity since almost all countries are decentralised to one degree or another. The consequence of the current fiscal crisis and the implementation of fiscal recovery plans in most OECD countries underscore the need for effective coordination among different levels of government. Therefore, identifying, developing, and sharing experiences to promote co-operation and to build capacity in order to bridge the naturally occurring gaps is increasingly important.

18. This report intends to be a first step in this direction. It is a synthesis of initial lessons regarding multi-level governance. The information it presents stems from past OECD work on the topic, new individual studies, and the observations and experiences shared by member and non-member countries. It is divided into two parts, the first presents analytical approaches and common experiences, and the second focuses on multi-level governance in different domains of public management.

PART I: THE IMPORTANCE OF MULTI-LEVEL GOVERNANCE

INTRODUCTION

19. No government is fully centralised or fully decentralised. This simple fact drives the importance of governance across levels of government. Such governance refers to the management of the relationship between levels of government that naturally arises from decentralisation and because decentralisation policies have further fragmented the implementation of public policy responsibilities. It is characterised by “mutual dependence” as each level can affect the accomplishment of responsibilities by those above and below it since a complete separation responsibilities and outcomes in policy making is not possible: executing tasks, overcoming obstacles, and/or accomplishing goals requires joint effort, co-ordination and often collaboration. Today, it may be the case that the only way governments can successfully deliver their public policy “obligations” is via multi-level governance. Multi-level governance, here, is the term used to characterise the relationship between public actors situated at different territorial levels. This creates layers of actors, and the layers interact with each other in two ways: 1) across different levels of government (vertically); 2) among other relevant actors at the same level (horizontally).¹ However, regardless of constitutional system (which broadly encompass two main forms – federal and unitary), effective multi-level governance relations face a number of challenges that can be perceived as a series of gaps: information, capacity, fiscal, administrative and policy. Bridging the gaps requires co-ordination and capacity at all levels of government and among all stakeholders.

20. Thanks to the diversity of practice in managing multi-level governance relations and the attention placed on this issue by OECD member and non-member countries, it is possible to identify a set of common tools being used. This collection of mechanisms can facilitate building and maintaining effective relations between levels of government, vertically and horizontally. It serves to enhance coherence, build capacity, and in this way helps begin to bridge co-ordination gaps. In addition, these mechanisms appear applicable to managing multi-level governance relations in specific public management domains, such as fiscal relations, human resource management (HRM), regulatory management and e-government.

21. This report on multi-level governance is the result of interest expressed by the OECD’s Public Governance Committee on this topic, particularly with respect to building effective relations across levels of government. It is divided into two parts. The first is a synthesis of analytical approaches and common experiences. The second presents multi-level governance in different domains of public management. Part one begins with a general overview of why multi-level governance is important, exploring the impact of decentralisation and the notion of mutual dependence. It then identifies and discusses four of the main gaps that arise from managing policies in a decentralised policy context; provides insight into bridging these gaps, highlighting the role of competence allocation, co-ordination and capacity; and finally looks at

¹ This definition is adapted from the original Hooghe and Marks, which originates from studies on European integration.

the most commonly used mechanisms in multi-level governance, including how countries are applying these. Part two consolidates the main body of a series of OECD reports undertaken to explore multi-level governance in specific public management contexts: fiscal relations, human resource management, regulatory management, and e-government. An annex with elements pertaining to the OECD Public Governance Committee *Multi-level Governance Symposium held* in October 2008 is found at the end of Part One.

22. This report intends to be a first step toward ongoing work in providing both OECD member and non-member countries with greater insight into effectively managing the relationship between levels of government.

WHY IS MULTI-LEVEL GOVERNANCE IMPORTANT?

23. Over the past two decades OECD countries have made a series of policy choices, particularly with respect to decentralisation, allowing for greater territorial differentiation in policy design and implementation. These policy choices are influenced by a need for governments to solve increasingly complex problems, ones for which solutions often require interaction among different levels of government. This has resulted in the need to manage a multi-faceted governance relationship: the vertical and horizontal interaction among levels of government and the challenge of ensuring that such interaction leads to coherent policy development and execution. Governments therefore, are promoting co-ordination in policy making as well as building capacity at all levels. In addition, networked relationships cannot be ignored. Today's policy actors are no longer restricted to central and sub-national government authorities, but include the private sector, non-governmental organisations, and civil society. Finally, the policy objectives that capture the attention of these actors are broad ones, encompassing both national concerns such as efficacious public service delivery, and global ones, including environmental issues.

Where does multi-level governance come from? The role of decentralisation

24. Managing the relationship between levels of government, while not new, has become increasingly complex as countries continue to decentralise and also recentralise, fiscal, political and administrative competences. Given this report's focus on the movement of resources and the allocation of responsibilities across levels of government, decentralisation here refers to the transfer of competences from the central level to elected authorities at the sub-national level,² and is generally undertaken with an eye on numerous objectives. Fiscally, governments have used decentralisation as a means to improve public spending effectiveness (efficiency in the allocation of resources and the provision of public services, and equity in access and quality). This is founded on the idea that sub-national governments have better information regarding local spending needs and preferences, and therefore are better positioned to provide an appropriate mix (in terms of composition, quality and quantity) of public goods (OECD, 2009c). Politically, decentralisation has been driven by a desire to increase democracy and representation at the local level. This is coupled with the notion that political competition among local officials rises with decentralisation, and that the impact of both elements – democracy and competition – leads to increased political accountability and transparency. There are, of course, countervailing arguments to each reason for decentralising: fiscally, sub-national governments may not show prudence or sufficient ability to manage their financial affairs; politically, corruption might be reinforced; administratively, the sub-national level may lack the capacity to properly meet its responsibilities.

25. Granted, decentralisation entails some risks:

- *A potential race to the bottom:* the healthy process of competition can become damaging and possibly transform into a race to the bottom among sub-national authorities, for instance in redistributive systems such as social welfare, or in tax rate cuts that could be set at increasingly lower levels in order to attract more investment.

² Decentralisation is not synonymous with deconcentration, which in this report is used to mean placing non-elected central government units in regions that directly provide national public services at the territorial level.

- *A failure to exploit economies of scale*: the benefits of learning from a wide range of experiences can be offset by the failure to exploit economies of scale in public service provision, thereby reducing efficiency in service delivery or by increasing costs. Decentralisation may generate excessive multiplication of administrative overhead (e.g. increased employment and expenditure) due to a duplication of tasks. This can be exacerbated by a lack of co-ordination between levels of government – for example the central level may not manage to reduce the national administration at the same pace at which the sub-national level is increasing theirs (OECD, 2008a) – thus risking the non-exploitation of possible economies of scale.
- *Difficulty in meeting national macroeconomic goals*: achieving national macroeconomic goals such as fiscal discipline and equalization³ is more complex in a decentralized context. Sub-national governments may pursue expansionary fiscal policies while national governments face tight budget constraints and subsidising poorer regions may become more explicit, thereby creating more political difficulty.
- *High transaction costs*: decentralisation reform can be confronted with co-ordination problems and transaction costs. Difficulties can arise particularly with respect to coherence across policies when provided by different levels of government, and when there are a large number of units involved, complicating processes. This can slow reform and/or lead to their non-implementation, such as in the simplification of inefficient tax systems.

26. These risks, however, are due in large part to the difficulties associated with managing inter-related, mutually dependent levels of government, and can be addressed via sound multi-level governance mechanisms.

27. There is no “black and white” answer to whether or not decentralisation is a “good idea.” (See Box 1.) Centralised and decentralised approaches can work relatively well, or relatively poorly, depending on a country’s historical, cultural and political context, as well as on its ability to exploit inherent strengths and minimize potential weaknesses (Joumard and Kongsrud, 2003). However, assuming that some pre-requisites are met, such as strong local democracy, it is generally agreed that decentralisation can have positive outcomes, including:

- Public service and investment priorities that reflect local preferences and provide well-tailored responses to problems thanks to a strong, in-depth local knowledge of policy makers.
- Progress in good practices from a process of policy innovation, thanks to a wider range of policy approaches that can stem from competition and comparison between local governments in the provision of services and investment activities. It can also nourish a rich information base for determining which policies may or may not succeed.

28. Beyond administrative and economic arguments, political stability factors are often used to support decentralisation: responding more effectively to citizens’ needs; reinforcing local democracy through citizen participation; and achieving better public service delivery in remote areas. These can be supplemented by two additional important political considerations:

³ Fiscal equalisation is a transfer of fiscal resources across jurisdictions with the aim of offsetting differences in revenue raising capacity or public service cost. Its principal objective is to allow sub-national governments to provide their citizens with similar sets of public services at a similar tax burden even if incomes differ across areas. It can be seen as the natural companion to fiscal decentralisation as it aims at correcting potential imbalances resulting from sub-national autonomy (Blöchliger and Charbit, 2008).

- Creating balance within a constitution by providing a countervailing force to the central government in order to preserve democracy and enhance liberty;
- Managing national diversity and divided societies by giving groups a degree of self-rule while maintaining the overall unity of the country.

29. The complex network of relationships that naturally arise from decentralisation policies spans various levels of government. This leads to a strong degree of mutual dependence between the levels given the interconnectedness and overlap of responsibilities and implementation activity. Because "...decentralization means not only a complex of new responsibilities but also a series of different relationships with other levels of government that have to be managed simultaneously..." (Grindle, 2007), multi-level governance and the management of such relationships is important for good governance – regardless of the country’s structural system (federal or unitary) or level of economic development.

Box 1. A brief summary of selected empirical studies on decentralisation

Most empirical studies that rely on observations over time find a positive correlation between decentralisation and government responsiveness (Faguet, 2004; Bossert *et al.*, 2003; Fisman and Gatti, 2002; and Shah, 1998). Decentralisation can help public administration become more efficient. Local administration of public services may increase their efficiency by making use of local knowledge in local decision making and problem solving. Sub-national governments have an advantage over central governments for making use of local knowledge and networks in the provision and production of public services. However, it is important to consider the nature of the specific collective goods and services. For some it may make sense for the municipal or the regional government to take increased responsibility for reasons of proximity or local knowledge, while for others it may be the central governments that for reasons of scale or capacity are in the best position to provide them efficiently.

The relationship between decentralisation and administrative efficiency is complex. A review of cross-national analyses of decentralisation and its effects on administrative efficiency showed that at the aggregate level, this relationship is highly dependent on the specific context. A case in point is a 2006 quantitative analysis of 35 countries which showed a difference in the effect of political decentralisation on government efficiency in rich and poor countries. The authors detected a positive relationship between political decentralisation and efficiency in rich countries but a (non-significant) negative effect in poor countries. The institutional set-ups in developed countries may not work in developing countries (O’Dwyer and Ziblatt, 2006).

Literature abounds with arguments for and against decentralisation as a means of promoting economic growth. Economists who favour decentralisation often assume that it leads to better resource allocation and a more productive, and possibly smaller, public sector (Oates, 1972, 1999; Shah, 1998; Tiebout, 1956). Their logic is that locally determined policies are better able to take account of local conditions for the provision of public goods, such as infrastructure, health and education. Others assume that decentralisation will produce healthy competition among different levels of government, which in turn will promote lower tax rates and the efficient delivery of public goods and services (Brennan and Buchanan, 1980). Still others have argued that decentralisation may also give local governments incentives to innovate in the production and supply of public goods and services (Vasquez and McNab, 2003, cited in Thornton, 2007).

Economists who are more sceptical about the economic benefits of decentralisation argue that it poses many difficulties for managing macroeconomic policy, especially in terms of ensuring fiscal coordination and implementing stabilisation policies (e.g. Prud’homme, 1995; Tanzi, 1996). More specifically, several studies question the desirability of transferring responsibility for revenue and expenditure functions to local levels because a tax assigned to local governments might be more efficiently managed centrally – it depends on the nature of the function and the problems that the government seeks to address. Other research also reveals the potential reinforcement of territorial disparities as a result of decentralisation owing to pre-existing inequalities, especially when decentralisation is not accompanied by reallocation of funds and institutional and technical support to match the new responsibilities (Rodríguez-Pose and Gill, 2003; Sanchez Reaza and Rodríguez Pose, 2002). Finally, arguments that link decentralisation and economic

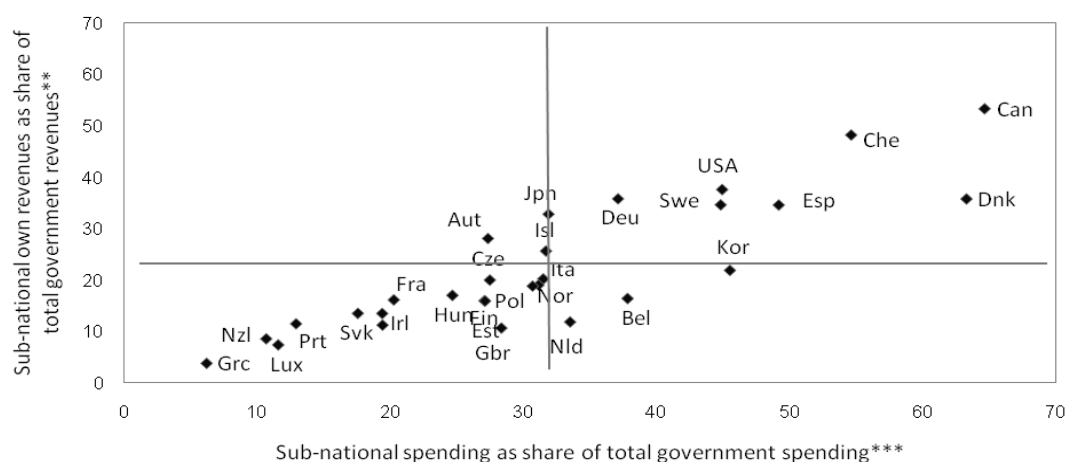
growth assume that the decentralised units have sufficient institutional skills to carry out the delegated competences, but this is not always the case.

Sources: Various, including OECD (2009d)

Decentralisation: Increasing responsibility for the sub-national level

30. Across OECD countries (including some federal countries and those that are not already very decentralised) the transfer of competencies and revenues at the sub-national level over the past three decades has addressed the different motives for decentralisation already explored, particularly the political/democratic (closeness to citizens), and economic and social (improved provision of public services). While the objectives behind decentralisation may be similar, a wide variety of situations with respect to degrees of decentralisation is apparent, illustrated by Figure 1. Adding to this diversity, sub-national governments responsible for the delivery of public services often do not always have the competence to decide on the resource allocation required to meet these needs, or to generate local public revenues, or to spend the available resources at their discretion, for example because of established standards of service provision (OECD, 2009c). In addition, responsibilities may be imperfectly assigned among levels of government, resulting in an overlap or sharing of responsibilities. Any of these situations, alone or combined, makes meeting obligations a challenge. Meanwhile, the ability of the central level to promote and control performance in local public service delivery may also face obstacles: setting a strategy for development cannot be done without information coming from the sub-national level.

Figure 1. Sub-national governments' share in general government revenues and expenditures (2006*)⁴



Source: National Accounts of OECD countries; US Bureau of Economic Analysis

⁴ Note: Decentralisation is measured by the changes in the share of sub-national governments in total public revenues and spending.

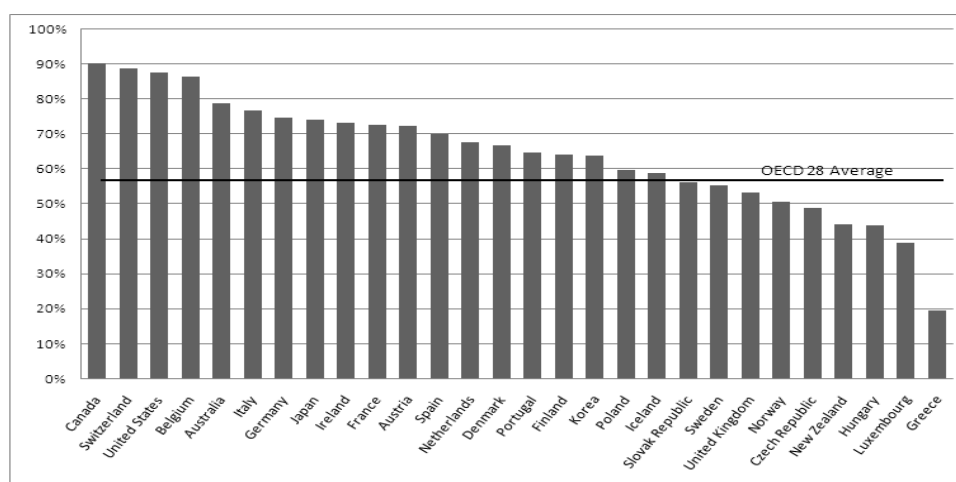
* 2006 or latest year available: 2005 for Korea, New Zealand and Poland;

**revenues excludes transfers received from other levels of government

***spending excludes transfers paid to other levels of government; the share of sub-national revenues is expressed in percent of total government mainland revenues.

31. The sub-national level's public expenditures must be complemented by the fact that it is responsible for a large percentage of public investment. For example, among OECD economies, this percentage reaches an average of approximately 60%. (See Figure 2.) The indication therefore, is that sub-national governments are playing a greater role in public investment and public expenditure, reflecting the increased devolution of responsibilities to the sub-national level (OECD, 2009b).

Figure 2. Share of sub-national governments in public investment (2007)



Source: OECD National Account Statistics. This figure uses Gross Fixed Capital Formation as a measure of public investment

Characterising multi-level governance relations: Mutual dependence

32. Decentralisation results in a strong degree of mutual dependence among policy actors since executing tasks, overcoming obstacles and/or accomplishing goals requires joint effort and co-ordination. In such an environment, therefore, policy programmes, be they focused on innovation, economic growth, cohesion or improved public service delivery, can be more efficiently and effectively implemented when resources are pooled and information is shared.

33. This is particularly true in multi-level governance relations since a full separation of responsibilities and outcomes in policy making is not possible (OECD, 2009b). Thus, in a governance framework characterised by mutual dependence, managing the relationship across levels of government is required for implementing public policy. Interdependencies exist horizontally at the central level, where they are generally confronted with co-ordination challenges. Interdependencies also exist between levels of government, where they assume a different nature: institutional, when the allocation of responsibilities remains unclear; financial, when central and sub-national governments are co-funders of public spending in regions; and socio-economic, when issues and/or outcomes of public policy at one level impact peer authorities at the same level, at another sub-national level and/or at the national level (OECD, 2009b). In addition, managing the relationship among various levels of government is necessary for a very practical “social contract” reason in a great majority of OECD countries: equity. Citizens, regardless of where they are located, should be able to enjoy equivalent access to a basic set of public goods and services (OECD, 2005).

34. Policy co-ordination is a key issue facing all levels of government in a decentralised context. When approaches are fragmented, some of the aims of the different public authorities responsible are likely

to overlap or conflict. This fragmentation can impact policy effectiveness at all levels of government. It also impacts specific public management areas, such as multi-level regulatory governance and e-government. One concern shared by most OECD countries is the fact that high quality regulation at one level can be undermined or reversed by poor regulatory policies and practices at other levels. This is compounded by the fact that in most countries there are complex layers of regulation stemming from the sub-national and national levels, which causes concern with respect to the efficiency of national economies and the effectiveness of government action (OECD, 2008d). In the case of e-government, because of the significant role played by sub-national governments in this area, there is risk of fragmentation as well as the uneven treatment of citizens based on their place of residence. The level of e-government service provision can vary extensively between different local authorities and especially small remote municipalities may struggle to be effective, not to mention innovative, in this process (OECD, 2008b).

35. This issue of fragmentation becomes more acute due to on the variety of actors and interests (including those of citizens) embedded in policy delivery in a multi-level context. Given this, how can policy actors find a coherent and effective approach to policy implementation? (OECD, 2009b). Through multi-level governance and capitalising on the relationship of mutual dependence, governments at all levels may find tools to begin overcoming co-ordination challenges between national and sub-national level policy priorities and objectives.

Achieving policy goals efficiently and effectively through multi-level governance

36. Decentralisation puts pressure on both national and local policy makers to find ways to achieve economic efficiency; to provide high quality local public goods; to build and programme a strategic vision at the relevant level; and, in the case of sub-national actors, to negotiate with peers and higher levels of government (OECD, 2009b). This also results, as mentioned, in a constantly expanding and interdependent network of diverse actors and relationships.⁵ Thus, multi-level governance becomes essential in order to harness the synergies created by policy actor networks and to achieve policy aims. There are, however, a series of “gaps” (in terms of specific deficiencies) that governments face in multi-level governance relations. Based on OECD experience these are shared to greater or lesser degrees across countries and within specific public management domains such as fiscal relations, human resource management, regulatory management and e-government.

⁵ Within the public sector alone these actors can be ministries and departments at the central level, agencies, regional authorities, provincial/state governments, county governments, municipal governments. To this one must add NGOs, civil society, the private sector, etc.

MIND THE GAPS

37. The gaps confronting multi-level governance stem from asymmetries that arise because no single entity can operate completely independently of another. Again, the specific gap is a result of one level depending on the other – either for skills, resources, or competences – and can exist vertically and horizontally. These gaps are most evident in five areas: information, capacity, fiscal, administrative, and policy.

The information gap

38. The information gap, also called the “knowledge gap,” is characterised by information asymmetry between the national and the sub-national level when designing, implementing, and delivering public policy. National and even sub-national strategies for achieving public policy objectives might face an information deficit if sub-national authorities and actors do not actively share their knowledge of what is happening “on the ground.” Sub-national governments will tend to have more information about local needs and preferences, and also about the implementation and costs of local policies and public service delivery. Despite this possible wealth of information, unless the sub-national level generates and publishes quality data on a timely basis *and* communicates it to the central level, an information gap is generated.

39. Information is needed at all levels of government in order to effectively co-operate and capitalise on individual knowledge centres, thereby creating a stronger whole. While the sub-national level provides information, its views are only ‘partial’ – limited to its own area or territory. Thus the central government plays an indispensable role in managing the information in such a way as to support a broader vision that can link to accomplishing public policy objectives. Information can also be used to identify capacity deficiencies in order to start correcting these. Once again, this indicates a relationship of mutual dependence as relevant information (e.g., quantity of primary school students, number of hospital beds, etc.) does not lie exclusively with one level of government, and actors depend on each other’s knowledge to disseminate information to and from the relevant levels.

The capacity gap

40. The capacity gap, in a broad sense, occurs when there is lack of human, financial, knowledge (skill-based), or infrastructural resources between levels of government. It can be clearly illustrated by a fundamental sequencing question faced by many countries when deciding on decentralisation approaches: at what point is the sub-national level ‘ready’ or sufficiently ‘mature’ to assume responsibilities associated with devolved or decentralised tasks? Is it a matter of learning by doing or is it essential to first build capacity in order to properly deliver on assigned competences?

41. There is no right or wrong answer to these questions. Capacity-development needs can vary with the pre-existing levels of public administration infrastructure. Long standing sub-national governments with well-developed institutions may require little in terms of capacity-building to assume new responsibilities. But, where sub-national governments or related institutions must be created or have historically a limited role, capacity-building needs will be greater. This is highlighted in human resource management (HRM) within a multi-level governance context where it appears that countries with a history

of devolved responsibilities have found ways to manage HRM issues across levels of government in a fashion that is appropriate given the national context. However, in countries where decentralisation is a more recent phenomenon, the transfer of responsibilities and competences to the sub-national level is undertaken carefully and within the confines of existing employment arrangements (OECD, 2008a). Thus, while transferring responsibility to sub-national governments may be a way to induce capacity as “learning by doing,” some governments prefer a more gradual approach where first there is a deconcentration of responsibilities to central government units in regions until sub-national authorities prove capable to assume these tasks (OECD, 2006c).

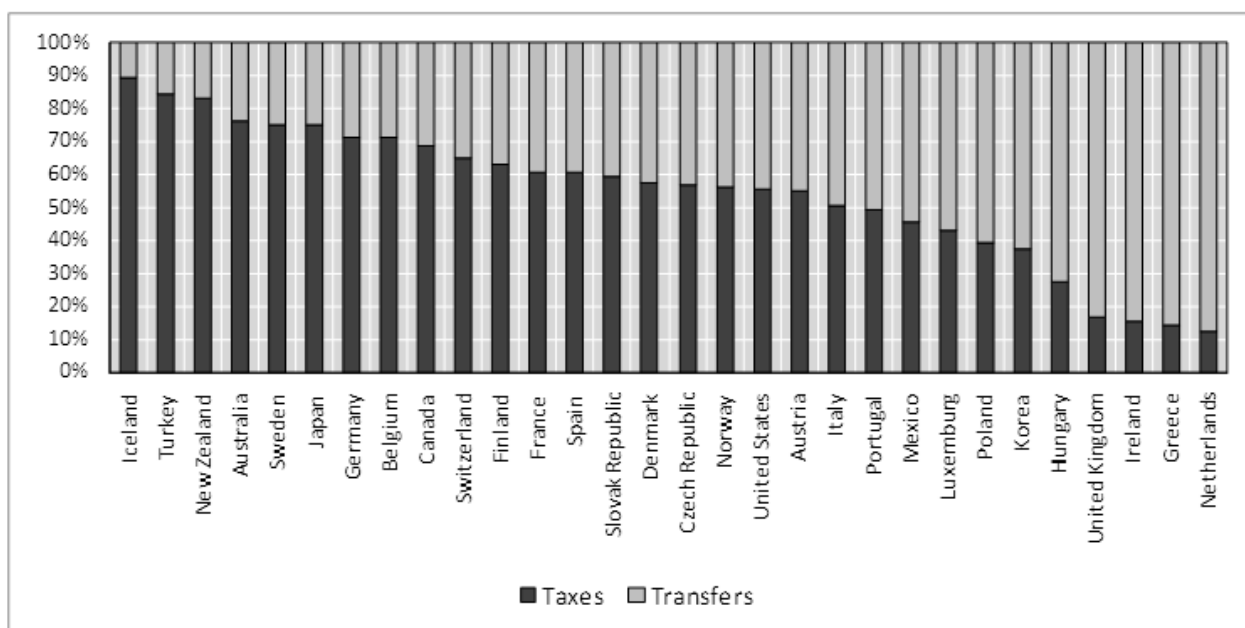
42. The capacity gap is not restricted to the sub-national level, however. It also applies to the national level in terms of managing multi-level relations, allocating responsibilities and funds, and ensuring co-ordinated, coherent policy approaches among central level actors. There are instances where it is the sub-national level that devises and implements innovative approaches that are then “learned,” and capacity is built by peer-levels or from the sub-national level toward the central one. There is some evidence that local authorities may be more innovative than the central level in HRM practices (OECD, 2008a). According to a French country note prepared for the OECD, its sub-national governments have prompted the central government to establish a more managerial attitude to HRM and also states that most sub-national authorities have a more dynamic approach to public employment (OECD, 2008a). A study conducted in the U.S. indicates that “...Multiple examples of HRM innovations...can readily be found...Every conceivable nook and cranny of the HRM function is being probed, dissected, sliced and diced by someone, somewhere in state and local agencies....” (OECD, 2008a)

The fiscal gap

43. The difference between sub-national governments’ own revenues (taxes and fees) and their expenditure responsibilities represents the fiscal gap. (See Figure 3). This gap is managed via intergovernmental transfers that can be either vertical (from the central to the sub-central level) or horizontal (wealth redistribution across peer-levels, e.g. between regions or municipalities). These transfers can also be conditional or for general spending.

Figure 3. The fiscal gap in OECD countries

Share of transfers in total sub-national revenues (2005 figures)



Source : Source: OECD, 2008c

44. The existence of a fiscal gap between the revenues and required expenditures of sub-national governments results in financial dependence by the sub-national level on the central level. This dependence is further increased when equalisation is a national objective, requiring not only vertical transfers but also horizontal ones from wealthier to poorer regions. Thus, regardless of the transfer type, the sub-national level remains dependant on the national level for funding and for a fiscal capacity to meet its obligations. Meanwhile, the central government depends on the sub-national level to deliver more and increasingly costly public services and meet both national and sub-national policy priorities.

The administrative gap

45. An administrative gap arises when administrative borders and functional economic areas at the sub-national level do not correspond to one another. This is clearly evidenced in metropolitan areas where there is an agglomeration effect arising from a set of municipalities that alone are much smaller than the metropolitan whole. Individually their influence may be limited, but as a group, they can be a strong player in the relationship among levels of government. Greater London, Greater Sydney and California's Silicon Valley are examples. They are functional economic areas, comprised of numerous individual municipalities or smaller reasonably close cities that are well connected, each with unique administrative borders. The implementation of effective programmes, therefore, can require a minimum scale that can sometimes only be obtained through specific policies favouring horizontal co-operation. This gap is felt when dealing with new challenges such as environmental issues, which, given the possibility of externalities, often require larger scale approaches accomplished by reducing territorial fragmentation.

46. The administrative gap is an excellent example of multi-level governance relationships based on horizontal mutual dependence, as this gap often generates the need for co-operation among sub-national governments in order to develop and manage effective and efficient approaches for policy implementation and service delivery. Using the Silicon Valley as an example, each individual county (or the municipalities

therein) may have limited administrative power and limited negotiating power with higher levels of government, but the group of municipalities and counties that constitute the Silicon Valley can form a strong administrative unit and have stronger bargaining capacity with higher levels of government.

The policy gap

47. The policy gap results when there is incoherence between sub-national policy needs and national level policy initiatives. It can occur when ministries take a purely vertical approach to policy issues that are inherently cross-sectoral (e.g., water, energy, youth, investment, etc). Neglecting to consider a sub-national logic can reduce the possibility for successful cross-sector policy development and implementation at the sub-national level. If individual ministries apply their individual logic to cross-sectoral initiatives that impact or are implemented at the sub-national level, then the opportunity for “joined-up” or “whole-of-government” approaches is minimised. At the same time, possibilities for maximising efficiency and effectiveness in public services that are cross-sectoral in nature may be lost and sub-national development adversely impacted.

48. Policy initiatives that begin at the central level for application at the sub-national level are symbolic of the necessary co-ordination between ministries. Overcoming this gap requires co-ordination at the central level, and on-going consultation with the sub-national level to determine needs, implementation capacity, and to maintain open channels of information exchange in order monitor and evaluate policy impact.

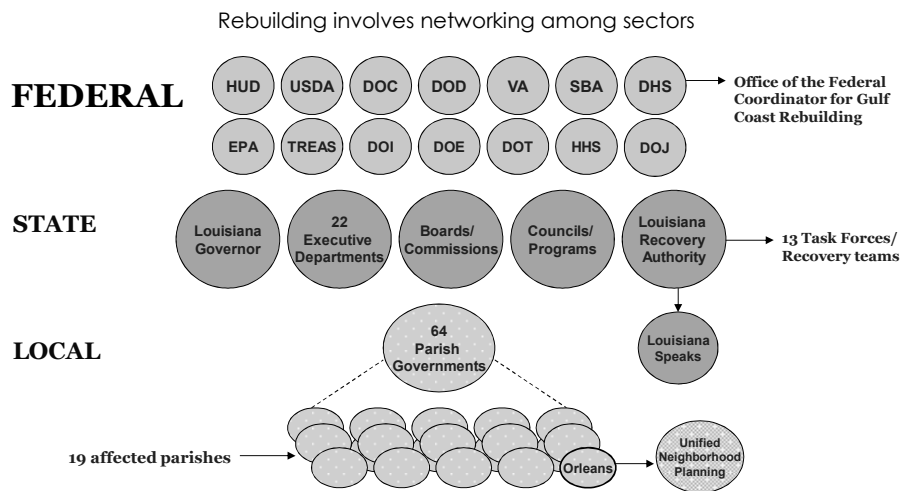
A final note on the gaps

49. These gaps are also evidenced in multi-level governance relations within such public management domains as fiscal relations, regulatory management, human resource management, and e-government. Fiscal relations will face not only the fiscal gap, but also that of information and capacity: is the national level able to allocate relevant financial resources to help sub-national governments meet their responsibilities, and are sub-national governments able to properly manage the finances provided? Regulatory management might confront capacity and information gaps plus the administrative and policy gaps. When e-government is a national level policy objective it may run up against information, fiscal and policy gaps, as well as the capacity gap in the form of resource allocation. In such cases it can be compounded by an administrative gap: often the resources available for e-government solutions depend upon local political priorities, economic capabilities, socio-economic composition and demographic needs (OECD, 2008b). Meanwhile HRM can face an information gap and also a capacity gap when staffing and other resource levels at the sub-national or central levels are not adequate to meet the responsibilities of public administration or public service delivery (OECD, 2008a).

50. Countries may experience each gap to a greater or lesser degree, but given the mutual dependence that arises from decentralised contexts, and the network-like dynamic of multi-level governance relations, countries are likely to face them simultaneously. This can be highlighted by the U.S. experience in dealing with public investment and action in the aftermath of hurricane Katrina in Louisiana. Figure 4 illustrates the number of stakeholders in this situation, the various levels across which relationships must be managed, and where gaps may be found (OECD, 2009b): given the severity of the disaster the State and local levels would be dependent on higher levels for fiscal assistance (fiscal gap); all levels will require information not only for disaster management but for allocating resources and investment (information gap); the disaster does not follow administrative boundaries but rather territorial ones (administrative gap); all levels require capacity in terms of skills and network management (capacity gap); policy initiatives to be most effective would require a coherent approach over a variety of areas, within the jurisdiction of diverse government Departments and Agencies (policy gap). This example also

illustrates the importance of vertical and horizontal co-ordination, as well as the role of networks in overcoming the gaps.

Figure 4. Minding the gaps among government stakeholders in Louisiana



Source : Government Accounting Office, United States

51. Minding and managing the gaps may be a daunting proposition, but evidence indicates that OECD member and non-member countries are using a set of mechanisms to bridge the gaps by promoting vertical and horizontal co-ordination and emphasising capacity building.

BRIDGING THE GAPS: ASSIGNING COMPETENCES AND FAVOURING CO-OPERATION AND CAPACITY BUILDING

52. One key element behind the gaps is the allocation of competences and adequate resources. When responsibilities are appropriately assigned, efforts are vertically and horizontally co-ordinated, and there is capacity to plan and perform tasks, then policy outcomes are enhanced and national policy goals more easily realised. Mutual dependence, however, remains.

Competence and resource allocation

53. Although there is no master plan for assigning competencies across levels of government, some common trends across countries are noticeable. Examples from EU countries show that environmental responsibilities (water, waste, roads, urban planning) are very often managed at the local level with sub-national spending in this area accounting for 75% of total government expenditure (Dexia, 2008). Economic development, culture and tourism are often shared more or less equally among levels of government, with the sub-national share rising somewhat. In 2004, primary and secondary school buildings were the responsibility of sub-national governments but remuneration of teaching staff was a central responsibility in half of the European countries. Public health is also often shared (for example, in 2004, hospitals were a sub-national government responsibility in just six EU countries). While the actual delineation is somewhat blurred, it has been noticed that municipalities are generally responsible for providing and managing proximity services, while higher-tier local governments (e.g., regions, counties, departments) are responsible for competences associated with spillover effects such as health, roads or economic development. Some basic theoretical criteria relevant to the allocation of competences are given in Table 1. However, the reality of responsibilities assignment is more due to historical and political factors than economic rationale and it is rarely possible to implement these theoretical principles. In addition, allocating responsibilities to sub-national authorities has been shown to have limited impact on the differentiation of strategies implemented in each place.⁶

Table 1. Criteria for the allocation of competences

Criteria	Decentralisation	Centralisation
1. Preferences	Heterogonous	Homogenous
2. Scale economies	No	Yes
3. Spillover effects	No	Yes
4. Congestion effects	Yes	No
5. Decision costs	If they increase in function of the size of the group	If they decrease in function of the group

Source: Décentralisation dans les pays en développement: quelques principes issus de la théorie du fédéralisme financier. Bernard Dafflon & Thierry Madies pour l'Agence Française de Développement (AFD)

Co-ordination

54. The public sector has become a matrix of crossing perspectives and the key issue rests on the ability to capitalise on synergies between the different domains of public intervention. This becomes

⁶ This is illustrated by Madies (2001), with respect to local aid to firms and “mimetic” choices about sub-national tax rates.

particularly important for effective and efficient public service delivery which often that authorities at various levels of government work in concert within the parameters of existing institutions and a pre-determined allocation of responsibilities (OECD, 2008b). These responsibilities, however, may be imperfectly assigned among levels of government, resulting in an overlap or sharing of responsibilities. Some instances, such as broad-based public policy challenges (e.g., social cohesion) will involve multiple actors across levels of government (and among line ministries at the central level). In these cases, where there is no single entity responsible and a co-ordinated course of action will yield more efficient and effective results, dialogue and a sharing of experiences becomes key for identifying and agreeing to a coherent allocation of tasks and responsibilities. Co-ordination is essential for the effective provision of public services. Joining together and striking a balance between the interests, capacities, and objectives of both the national and sub-national levels can help overcome fragmentation and overlap and thus increase efficiency and efficacy. Given this, vertical relations among levels of government often requires horizontal co-ordination between line ministries in charge of public policy fields that have an impact at the sub-national level (OECD, 2009b). Such co-ordination, in turn, can promote coherent socio and economic systems at different levels of government.

55. This is the case with the *Contrat de Plan Etat Région* (CPER) in France (now *Contrat de Projet Etat-Régions*) aiming to support regional development. In the previous generation of CPER (2000-06) there were nearly 20 ministries participating, all contributing to varying degrees. The ministries that contributed most to the regional programmes under these contracts were the Ministry of Infrastructure, Transportation and Housing, followed by the Ministry of Education and the Ministry of Agriculture. Co-ordination of the various ministries' actions in regions is the responsibility of both the inter-ministerial role of the DIACT (*Délégation Inter-ministerielle à l'Amenagement et la Compétitivité du Territoire*, under the authority of the Prime Ministry) and the "prefect" role of contract negotiator who refers to the various ministries that are stakeholders of the contract (with the participation of their deconcentrated services in regions). The other party is the president of the regional council.

56. Such co-ordination, however, can be very challenging. This was the case for Poland with respect to the allocation of EU funds. The Ministry of Regional Development in Poland is the managing authority for all operational programmes (including sectoral ones), but in practice conflict has occurred between ministries, and arbitration mechanisms to help ministries overcome their differences are lacking. The lack of co-ordination at the central level and the lack of mechanisms to ensure it, can negatively impact other levels of government as, in the case above, it could impact the timely receipt of funds (OECD, 2009b).

57. As the responsibilities facing sub-national authorities increase in complexity, additional actors are pulled in, resulting in a matrix of crossing perspectives. This is seen in large scale, integrated policy or service delivery programmes where a network of stakeholders, including non-government (often private sector) parties become relevant network players for consultation. All stakeholders need to be considered if the approach is to be collaborative and synergies maximised.

58. Accomplishing policy objectives in any of these contexts – vertical, horizontal or networked – requires a strong degree of co-ordination, and an understanding of mutual dependence. For the central government to achieve policy objectives, it depends on the co-operation of the sub-national levels. At the same time, in order to execute the demands of their competences, sub-national governments are often dependent on the collaboration or consent of higher levels. Finally in a network system, each stakeholder depends on the other to meet their individual responsibilities, which collectively help realise a larger goal. A basic example can be built using water provision where the acting stakeholders are the national and sub-national governments and a private or non-government operator. In this case, the national government depends on the sub-national level to ensure that the operator complies with policy objectives and regulations, the sub-national level depends on the operator for the efficient and effective delivery of water to citizens, and the operator depends on all levels for a supporting environment. Meanwhile, citizens

expect seamless, equitable and efficient water delivery. None of these parties can reach the water provision policy objective alone. Often, however, it is the case that final responsibility for the outcome rests with the central level especially vis-à-vis citizens. This is particularly so with respect to public service delivery, as citizens often do not distinguish whose responsibility it is to provide the service, they expect public services to function properly, and to be relatively equal in terms of accessibility and quality nationwide.

Capacity

59. National and sub-national capacity is of primary importance in multi-level governance relations. This is rooted in the fact that all the elements necessary to promote co-ordinated activity require actors that are capacitated to manage the assigned responsibilities. Without capacity, delegation and effective action are hindered, if not impossible. Capacity, however, needs to be built. It is not inherent.

60. Part of the challenge associated with capacity stems from the allocation of competences by the national level and the subsequent role of central governments in supporting capacity building of the sub-national level, for financial support, and for orienting local policies toward successful outcomes (OECD, 2009b). Water policy also clearly illustrates this. It requires an integrated approach wherein the sub-national level is assigned a responsibility to oversee water provision in a highly complex environment and under circumstances potentially beyond their control. Such is the case, for instance, when a public-private partnership contract is negotiated between the central level and a private provider, and its implementation and administration rests with the sub-national level. Additionally, if the central government is unable to co-ordinate horizontally given the number of ministries and agencies that are involved in water policy, then it is less likely that resources will be effectively managed at the local level.

61. Capacity also refers to the ability of the sub-national level to meet its responsibilities. Capacity, therefore, is required at all levels of government, and each level can learn from others. Ultimately, the capacity question pertains to the ability throughout levels of government to manage the mutual dependence that arises in a multi-level context.

62. As mentioned, capacity is faced with a sequencing syndrome: is capacity at the sub-national level required before devolving competences from higher to lower levels of government, or is governance a “learning-by-doing” exercise where sub-national governments acquire capacity once they are faced with the responsibility of delivering on specific competences. (See Box 2.)

Box 2: National examples of capacity-building approaches

A number of countries support the “learning-by-doing” approach to public service delivery in a variety of manners, including through fiscal mechanisms. Other countries prefer a more gradual approach.

The UK’s national strategy for building e-government capacity at the sub-national level succeeded in putting all government services on line between 2001 and 2005. This is significant given the fact that 80% of all services delivered in the UK are through municipalities. The UK’s challenge was to see real impact and sustained improvement over time as a result of the fiscal investment. The solution was a bottom-up approach based on a strategy founded on five principles: partnership, co-ordination, trust, equity, and risk management. The transfer was not only of competence – the provision of e-services – but also of fiscal resources. The funding structure was a flat-rate, grant-based model that rewarded smaller municipalities. Funds were allocated over a five year period, and receipt of funds from year to year depended on the results obtained from the implementation of the e-government services. In its Local and Regional Government Reform, Denmark did something similar: it promoted support of the reform in part by promising municipalities new tasks, effectively increasing their responsibility, while simultaneously promising more funds and more influence in working with common methods. However, some governments, such as Chile, prefer a more gradual approach where first there is a temporary deconcentration of responsibilities until sub-national authorities prove the capacity to assume the associated tasks on a more permanent basis.

Source: presentations by Denmark and the UK at the Symposium on Multi-level Governance. October, 2008; OECD(2008a)

63. With appropriate capacity to perform assigned tasks and competences, it is possible to enhance public policy effectiveness and realise national and sub-national public policy goals, including those linked to public service delivery. Ensuring capacity can also help achieve more equal levels of access and quality in the services delivered to citizens nationwide. Conversely, a lack of capacity is often cited as a key problem in the ability of sub-national governments to exercise responsibility for service delivery. Some countries prefer to use earmarked grants for funding sub-national specific service delivery in order to influence local policy making when there is doubt about local performance (OECD, 2009c). Another strategy rests on the definition of standards for local public service delivery which will favour more uniform quality in the provision of public services (OECD, 2008d).

64. Capacity challenges can arise when the capacity gap and the fiscal gap intersect. Often, resource allocation – fiscal, human and/or infrastructural – is a key concern in capacity building. This is clearly illustrated by e-government. When there is a lack of infrastructure, or a lack of funding to build infrastructure, or a lack of skilled human capital to build and maintain infrastructure, e-government development and implementation efforts can be compromised. Services might not be effectively or efficiently delivered, and efforts toward ensuring inter-operability may be stalled. Tension may also arise from incoherence between the assignment of tasks and the provision of appropriate funding levels to accomplish these. If a sub-national government is mandated with certain responsibilities then it requires the means to assume these either by an ability to generate resources on its own, benefit from resources coming from higher levels of government, or a combination of both. At times, the lower level is at least partially endowed with the necessary resources: it may have the appropriate infrastructure for example, or the human capital, but it may not have sufficient funding capacity.

65. Differences among levels of government are not limited to costs and resources. They may also be related to the level of education of municipal staff, weaknesses in project management and budgetary practices, or difficulties in responding to local citizens' preferences and firms' needs (OECD, 2009b). Capacity challenges not only concern the ability of governments to implement national policies but also to define their own strategy for long-term development. This is an increasingly visible dimension to the capacity challenge: sub-national governments are demonstrating a strong ability to accomplish functional tasks, but as demands become more strategic, for example in strategic planning for development, or local strategies to meet national policy goals related to global topics such as environmental concerns, the capacity of the sub-national level often remains to be built.

When co-ordination and capacity meet: mutually reinforcing

66. In practice, the line between co-ordination and capacity is not always clear cut. In human resource management, mobility between different public administrations in a country is generally looked upon in a positive manner as it can strengthen cohesion, and promote the sharing of experiences (OECD, 2008a). It can also help build internal networks. Thus, one practice – mobility in the civil service – can bolster both of these key elements in multi-level governance. It raises the question, however, of how the public sector can promote mobility. In e-government, co-ordination among levels of government can help advance local innovation capacity and economic vitality since modern communications infrastructure, a skilled workforce and the active promotion of e-business⁷ can help local and region authorities promote

⁷ *E-Business* is broadly understood as the use of ICT in support of all activities of business. It was defined in *OECD Information Technology Outlook 2004*, Chapter 3, as: "...ICT-enabled intra- and inter-firm business processes over computer-mediated networks". It refers in a footnote to a number of different definitions and understandings which in general can be summarised as the use of ICT in business organisations including also business processes and functions as well as broader aspects of ICT-supported and enabled processes with stakeholders (customers, authorities, other business organisations).

employment in their areas and the employability of their citizens (OECD, 2008b). Co-ordination among levels of government is also essential for multi-level regulatory governance where it can assist in the sharing of good practices and in spreading the benefits of diversification of regulatory policies (OECD, 2008d). Promoting co-operation and building capacity therefore go hand in hand: they are synergistic processes that can be mutually reinforcing.

67. Given the significance of co-ordination and capacity in multi-level governance relations, and the fact that the gaps explored are universal, what tools do countries use to promote co-ordination and capacity and in the process help bridge the gaps?

MECHANISMS FOR BRIDGING THE GAPS

68. Evident among OECD member and non-member countries is a set of multi-level governance mechanisms to help bridge the gaps (information, capacity, fiscal, administrative and policy) and improve the coherence of policy making throughout the country. These mechanisms share certain characteristics: sufficient flexibility to promote vertical and horizontal co-ordination; an ability to help build capacity; and broad applicability regardless of the country's constitutional structure.

69. The set of tools is extensive and ranges from binding mechanisms such as laws and municipal mergers, to “softer” techniques such as ad hoc meetings and harnessing the work of coordinating bodies. Based on country responses to a questionnaire on multi-level governance for the *PGC Symposium on Multi-level Governance*, countries use at least two different mechanisms among those that follow for managing the relationship across levels of government.⁸

70. The successful application of these tools, however, can depend on – and simultaneously promote – several factors, including communication and dialogue; an alignment of interests and timing; and transparency and accountability. By sharing experiences, lessons, and challenges, communication and dialogue can promote capacity-building, co-operation, collaboration and stakeholder involvement in multi-level policy design and implementation. In addition, it establishes, expands and strengthens networks, which can better support moves for change. When Denmark undertook its extensive and successful Local and Regional Government Reform initiative, the government ensured involvement of multiple stakeholders at various levels, and communicated to the sub-national levels the importance of reform, creating a sense of urgency for change and a need to “do it together.” (Hvas, 2008)

71. Each level of government has a policy agenda and a ranking set of priorities. While the list of activities may be shared, the prioritisation may vary vertically – from the national to sub-national level – and horizontally – by peer group (i.e. line ministries, regions/states, municipalities, etc.). Therefore, if public policy objectives are to be met, aligning interests and timeframes or at least striking a balance among the various parties is essential. If this is not accomplished, the ability to achieve policy objectives in an effective manner may be hampered. Transparent and accountable behaviour by all parties facilitates managing multi-level governance relations because each party understands what is expected of it, and of the others, and can meet its responsibilities accordingly. It is also easier to hold concerned parties accountable if commitments are not met.

72. Finally, in order to build effective multi-level governance relations, there must be a desire by all parties to do so. While voluntary desire among all levels of government is the ideal, it may be unrealistic and in fact naïve to assume. Therefore, incentives play a decisive role. Incentives are designed to induce and facilitate co-ordinated activity to achieve public policy goals. One of their roles in multi-level governance relations is to promote the adoption of more efficient behaviours by all parties and ensure that mutual obligations be understood. This requires clarity in both objectives and accountability (OECD, 2007a), and can help minimise an overlap of responsibilities.

73. The following sections highlight mechanisms OECD member and non-member countries use to bridge the various gaps mentioned and to facilitate multi-level governance relations. It explores the gaps

⁸ See Annex for the questionnaire and a synthesis of responses.

each tool addresses, why it may be used, the challenges it may present, and provides examples of its use either in specific countries or within individual public management domains.

Legal mechanisms and standard setting

74. Legal mechanisms could be considered the strongest method for promoting multi-level governance relations given that they are legally binding, and in some cases may require constitutional change, particularly in the case of federal states. They are one of the four most commonly used tools by OECD member and non-member countries to manage multi-level governance relations.⁹ For example, Chile uses legislation within the context of multi-level human resource management: all decisions relating to the creation or elimination of public posts, regardless of the level of government, require national legislation (OECD, 2008a). This mechanism is very often used to establish fiscal resources, and to allocate competences, thus also serving as a tool to reduce overlap in responsibilities between national and sub-national levels.

75. Legal mechanisms can address the fiscal and capacity gaps, but in the case of the former may represent a double-edged sword. On the one hand, they can mandate the availability of resources for new and existing competences that are devolved to lower levels of government, thereby increasing fiscal capacity. On the other hand, however, if the technique used to provide the funds limits the willingness of the sub-national level to raise own revenues, and increases its dependence on transfers, then laws and legislation can serve to widen the fiscal gap.

76. With respect to the capacity gap, legislation can be used to help establish frameworks or parameters that build sub-national capacity by allocating competences and resources. This can be accomplished by the central (national) level as well as a state/regional level in federal countries for example. If roles and responsibilities are clearly defined, legislation can help overcome problems of duplication and overlap, and can represent a successful mechanism for managing problems of resource allocation with respect to task allocation versus funding. This provides sub-national authorities with an opportunity for “learning-by-doing” which can increase their overall capacity in the medium and long run. Conversely, since laws and legislation are a strong mechanism for devolving competences, the higher level of government vested with the authority to create and pass laws could use them as a means to hold back competence allocation, thereby potentially reinforcing the capacity gap.

77. Not only do laws and legislation address issues of vertical co-ordination through the binding allocation of competences, they can also promote horizontal co-ordination, particularly across the sub-national level. The Dutch Law on Mutual Agreements regulates the co-operation between municipalities, provinces and other sub-national public bodies. In principle the co-operation is voluntary, however, under certain conditions and procedures, the national government can force sub-national authorities to co-operate for a well-defined public cause of great importance.¹⁰ Another example is found in Brazil where the Law of Consortiums regulates a specific constitutional provision that aims to incentive the co-operation and co-ordination among sub-national authorities, and to promote inter-municipal co-operation as well as the decentralisation of services.¹¹ The question of co-ordination vis-à-vis laws and legislation is a driving factor in multi-level regulatory governance where high quality regulation at one level can be undermined or reversed by poor regulatory policies and practices at other levels (OECD, 2008d). If applied to tax regulations and codes, it could lead to a race to the bottom. Conversely, it is possible in some systems for the sub-national level (e.g., a state or a province) to also impose stricter regulations than what is mandated by the central level, or than what is applied by authorities around them (CO₂ emissions control in

⁹ As reported by member countries when responding to the *Questionnaire on Multi-level Governance Relations*. N=19

¹⁰ From the Netherlands' response to the *Questionnaire on Multi-level Governance Relations*

¹¹ From Brazil's response to the *Questionnaire on Multi-level Governance Relations*

California for example is more stringent than in many other US states or what is required by the central government), sometimes resulting in a race to the top.

78. Multi-level relations in specific public management domains are also facilitated by legal mechanisms. Austria, Hungary and Portugal, for example, use legislative tools for promoting e-government: they have all passed specific e-government legislation aimed at removing barriers for e-government development within the country and impacting all levels of government (OECD, 2008b). In Spain, the Basic Statute of the Public Employee is legislation that imposes compulsory co-operation between the public administrations in three levels of government within the realm of HRM (OECD, 2008a).

79. Less binding than laws and legislation, but still effective, standard setting can be used to ensure similar levels of service quality across levels of government. Denmark's National Board of Health, a central government agency within the Ministry of Health and Prevention, defines the level of formal competence required to perform certain medical functions, surgery for example, thereby setting national level standards and defining capacity levels (OECD, 2008a). The UK's Local Better Regulation Office was established by the Government to improve the capacity of local authorities to enforce environmental health, trading, and licensing standards (OECD, 2008d). Standard setting can be particularly useful within certain public management domains, human resource management as the Danish example illustrates, and in regulatory enforcement. Standards are also used to manage multi-level governance relations in e-government. Often these are defined in a collaborative fashion between the national and sub-national levels, and are generally elaborated in order to ensure interoperability in the back office and maintain a consistent user experience in the front office (OECD, 2008b).

Contracts

80. Contracts among levels of government are frequently used in multi-level governance relations to help manage interdependencies and solve some institutional weaknesses (OECD, 2007a). In a contractual arrangement, parties commit either to take action or to follow the guidelines of a mutually agreed upon decision mechanism wherein decision-making rights have been transferred between parties (OECD, 2007a). Contracts enjoy a degree of flexibility of use and diversity of application, permitting governments to reorganise rights and duties without requiring a constitutional or legislative change.

81. There are many possible types of contractual arrangements and the OECD has developed an approach for assessing their efficiency based on the distinction between "transactional" and "relational" types of contracts (OECD, 2009b). (See Box 3.)

Box 3. Typology of contractual arrangements among levels of government

A contract between levels of government is any arrangement re-organising, along with the constitution, the rights and duties of government. The specificities of such contracts (compared with those which imply private actors' participation) are the absence of regulation by competition (the choice of the partner, especially the central one, is rather limited, and contracting is frequently mandatory) and the fact that contracting parties have no recourse to "vertical integration." Consequently, contractual choices are more limited than in the case of contracts in general and the logic of contracting is strongly influenced by the need to organise an unavoidable co-operation. Assessment of such contracts should focus on learning and seeking efficiency rather than on exit strategies.

Contract theories highlight the existence of the various types of logic of contracting from "transactional" to "relational" (there are many possibilities for mixing between these two "extremes"):

- *Transactional*: the respective duties of both parties can be stated in advance (contracting means to implement incentive mechanisms and check how to constrain parties' behaviour).

- *Relational*: the parties commit mutually to co-operate ex-post (after the signature of the contract) and design governance mechanisms for that purpose. Here contracting means to implement bilateral negotiation mechanisms and to guarantee in the long run the dynamics of co-operation.

The choice of the contract type must be adapted to contrasted co-ordination contexts, which depend on four dimensions:

1. The respective expertise of both parties.
2. The complexity of the policy domain, meaning that information is revealed only through policy implementation.
3. The degree of vertical interdependency between national and regional policies.
4. Characteristics of the enforcement context that warrant commitments' credibility (independent administrative justice, clear delimitation of responsibilities).

Source: OECD (2009b)

82. Complex policy domains, principally those which are multi-issue and involve multiple stakeholders, are often of the “relational” type. For example, relational contracts may be preceded by calls for tenders to reduce uncertainty, elicit information about possibilities, and help develop selection criteria. Relational contracts can also contain specific tasks to be handled by “transactional” contracts. Finally, mixes of both are seen as decentralisation takes place (OECD, 2009b).

83. The OECD findings on the efficiency of contracts (OECD, 2009b)¹², based on theory and case studies, show that:

- Explicit contracts among levels of government are unavoidable because of vertical interdependencies between issues and outcomes among levels of government, and because there may otherwise be either duplication of effort or policy gaps.
- Contracts allow a customised management of interdependencies, useful in unitary states as an instrument in decentralisation policies. They exist also in many OECD federal countries, known as *convenios* in Spain; “arrangements” in Canada; “joint tasks” in Germany; and *accordi* in Italy. They are often broad in scope with multiple goals (framework contracts complemented by a set of implementation contracts as seen in France and Italy, for example). In federal states, contracts are tools for allowing co-operation because interdependences between levels of government remain even if the distribution of prerogatives is very clear.
- Contracts are tools for dialogue, for experimenting and clarifying responsibilities and thus for learning. Impact evaluation should be encouraged, so as to make use of the results in adjusting the policy.
- Bilateral commitments validated by contracts among levels of government must be as verifiable as possible.
- Collaboration through contracts makes the need for strategic leadership at the sub-national level more obvious.

¹² While these findings are specifically for regional development policy, the results can hold true regardless of the policy area.

- Contracts have also “drawbacks” related to:
 - the possible high cost attached to consultation and negotiation steps as well as to their execution;
 - their trend towards proliferation;
 - ministries in central government in charge can be reluctant to give up their prerogatives;
 - limited flexibility when the parties are rigidly committed to fixed long-term programmes;
 - possible tension between levels of government in the acknowledgment of the respective parties/responsibilities of the contract;
 - difficulties in specifying regional strategy when national goals are too broadly defined.

84. One of the greatest strengths of contracts is that they are based on mutual agreement and can help bridge all five gaps. Explicit contracts among levels of government are unavoidable because of vertical interdependencies between issues and outcomes among levels of government, and because there may otherwise be either duplication of effort or policy gaps (OECD 2009b). When a requirement for performance information is built into the contract, different levels of government acquire knowledge and share learning. In addition, the systematic, contractually-based gathering of performance information can help identify and evaluate sources of effective and innovative governance practices. Thus, a contract can help bridge an information or knowledge gap, and it simultaneously addresses a capacity gap: the more information that is had, the easier it is to assess and adjust for capacity strengths and weaknesses regardless of the level of government. Contracts can also help overcome an administrative gap if they are used to integrate the conditions to incentive the co-ordination of local actors in a functional economic area. Finally, depending on their design and purpose, contracts can address a fiscal gap by allocating additional resources for a specific (i.e., contractual) purpose.

85. There are several advantages associated with contracts in multi-level governance. While their design and implementation requires negotiation and time, they create strong ties between the interested parties. Contracts can promote dialogue, and provide a formal means to enhance transparency and accountability by making explicit the bargains among levels of government. The public nature of contracts may also permit citizens to more easily identify the responsibilities of each party, thereby increasing accountability. Such citizen oversight could result in a strong incentive for each party to undertake the means necessary for achieving objectives, including co-ordination with other levels of government. With increased accountability, cheating is more difficult and thus contracts become a tool to control the behaviour of each party involved (OECD, 2007a).

Vertical and horizontal (quasi-)integration mechanisms

86. (Quasi-)Integration mechanisms are used vertically and horizontally to promote co-operation and build capacity. While they may be used centrally for co-ordination – for example consolidating HRM functions into one ministry or having one central unit responsible for e-government – they are more frequently employed to advance vertical and horizontal co-operation at the sub-national level. One perceived advantage to promote more integrated approaches is the possibility of building critical mass for better public policy results.

87. Reaching this “critical mass” for the local delivery of public policies remains a challenging issue. When confronted with integration options, most OECD countries are concerned with the question of

relevant municipal scale for public services. The issue of a ‘perfect size’ for municipalities has been a long-standing – and endless – economic debate. The driving idea is that there exists an optimal size that would allow both optimal conditions for political representation and management efficiency for local public services. However, detecting the presence of economies of scale at the municipal level and identifying an “optimal,” or “perfect,” size is difficult (OECD, 2006c) and varies greatly across countries. Some analysis shows that the optimal size would be 150,000 inhabitants in Japan; between 10,000 to 50,000 in Canada; and 5,000 in Spain (OECD, 2006a). In practice, however, there is limited evidence regarding economies of scale in local government service provision (OECD, 2006c).

88. In light of this uncertainty or lack of evident efficiency, in some areas there are moves towards at least limited recentralisation of certain responsibilities to a higher government level that does demonstrate economies of scale. This is seen in especially in the case of hospitals: Norway since 2002; Australia where possible reform is discussed; Finland where municipalities have to belong to a joint municipal body which has the responsibility for managing hospitals at a regional level (OECD, 2009b). (See Box 4.)

Box 4. Reversing decentralisation? The example of healthcare policy in some European countries.

Decentralisation as an applied policy is not irreversible. A government’s choice to decentralise a particular policy sector does not prohibit that government from changing its mind in the future and adjusting its policy decision. A look the development path of European health policy over the past twenty years illustrates this point, showing that decentralisation is a dynamic rather than a static policy option. After decentralising, governments are recentralising health policy activities in a variety of ways.

Historically, European health policy strategy was strongly oriented toward decentralisation processes that gave authority to lower levels of government and/or to private sector organisations. This policy was applied in tax-funded systems (e.g., Nordic and Southern European) and social health insurance systems (e.g., Continental European). In addition, decentralisation policy focused on any combination of three dimensions: who decides (political authority), who pays (fiscal authority), and who implements (daily administrative/managerial authority).

Depending on the funding system and individual country context, decentralisation ran downward from the central government to regional and/or municipal levels. In the Nordic countries decentralisation touched administrative/managerial authority, as well as political and fiscal authority to varying degrees. In some cases decentralisation went from the national to the regional level (mental hospitals in Sweden, 1967, and somatic hospitals in Norway, 1970), in others from the regional to the municipal level (elderly residential care in Sweden, 1992) and in still others decentralisation by-passed the regional level with the national government decentralising directly to the municipal level (central hospitals in Finland, 1993). In these cases two or all three of the dimensions were targeted. Meanwhile, in Southern European countries, particularly Italy and Spain, decentralisation went from the national to the regional level and impacted primarily the implementation and political functions but not the fiscal ones. Finally, continental European countries had a long-established decentralised mechanism to manage implementation and a percentage of fiscal decision-making: responsibility was placed with private, not-for-profit entities. Over time, a result of all of this decentralisation activity was the perception that the national level was becoming less relevant when compared to the regional and supra-national levels.

Since approximately 2000, this trend is being reversed. Central governments are re-asserting themselves, particularly in the political and fiscal authority dimensions. What is behind this policy shift? Saltman identifies four key concerns of government as they enter the new century: structural, administrative, economic and technical. Governments are experiencing structural pressures coming from an aging population, increasing costs of healthcare, funding constraints and market globalisation. This is combined with an administrative assessment that, at least in some countries, decentralisation has only served to heighten rather than reduce disparities in service and outcomes. An economic efficiency concern exists wherein local financial capacities are inadequate and implementation capacities are redundant. Central governments may be seeing few lower-level government mechanisms available to address these concerns, and are placing the appropriate organisational tools in the hands national level policy makers. Another key reason for this trend is the increasing technical capacity at the central level to oversee the health system’s performance.

Recentralisation however, does not seem to impact all dimensions equally. Just as in the case of decentralisation, when they recentralise, countries take a varied approach. Norway for example recentralised the political and administrative authority for all hospitals, nationwide (2002). Denmark recentralised political and fiscal activities after reducing the number of regional governments. Germany appears to be focusing only on fiscal responsibility. Spain and Italy seem to be exceptions to recentralisation, but closer inspection shows the trend persisting: while recentralisation up toward the central level may not be occurring, there is some evidence that recentralisation up toward the regional government level is.

There is no one way to decentralise, and once accomplished a government can reverse its course, though this may depend heavily on other multi-level governance arrangements. As noted above, recentralisation in health policy may be more difficult for Spain and Italy than for Norway and Germany, and hence context dependency plays a role. What might be learned from this example is that decentralisation is not a policy end but rather a policy process from which governments phase in and out over time according to structural and political objectives. It took decades to identify and assess the impact of decentralisation in order to adjust and correct appropriately. Therefore, recentralisation's causal impacts may not be felt for a long time. Governments striving to "fix" or solve concerns emanating from decentralisation ought to do so with long-term vision.

Source: Adapted from Saltman, Richard B. "Decentralisation, re-centralisation and future European health policy." *European Journal of Public Health*. Vol 18, No. 2, 2008 pp 104-106

89. While individual public management domains may not intentionally promote integration to facilitate governance in their area (human resources or e-government, for instance) they can use integration initiatives or precedence to promote co-operation and capacity building at the local level. In the case of human resource management, for example, municipal co-operation can lead to pooling resources which may positively impact the capacity of local governments to delivery services in a more effective manner and with lower cost (OECD, 2008a). To this effect, Icelandic municipalities often join forces to deal with specific services in areas where co-operation increases efficiency and effectiveness, including homes and care for the elderly, waste management, pollution prevention, public transport, fire services, environmental health, water, electricity and central heat, etc. (OECD, 2008a). A pooling of resources is also seen in Germany where also municipalities are increasingly co-operating in management and administration, having a direct human resource management impact (OECD, 2008a). Not only does this type of co-operation increase co-ordination, it also helps bridge the capacity gap.

90. Horizontal co-operation at the local level can also have a positive impact in e-government when local governments share tools developed by other local authorities and/or join forces to improve development efficiencies and economies of scale. Italy's Piedmont region has used inter-municipal collaboration in order to overcome three e-government obstacles: impossibility in achieving economies of scale in the launch of innovation processes; a lack of adequate professional skills; and a lack of financial resources (OECD, 2008b). Political agreements between municipalities to "share resources" in specific areas or specific projects have encouraged inter-municipal joint e-government development and implementation (OECD, 2008b).

91. More commonly, however, (quasi-)integration mechanisms are used to promote horizontal co-ordination at the sub-national level. At one extreme would be integration in the form of mergers – a *de facto* means to promote horizontal co-ordination. Less extreme would be various forms of municipal co-operation. While these mechanisms are very different, they can both be used to bridge a number of gaps, including capacity, administrative, and fiscal, though the fiscal gap may not be addressed by increasing financial resource allocation but by creating greater efficiencies through co-ordination and a sharing of resources.

Mergers

92. Municipal mergers are typically promoted based on the idea that larger municipalities are often more efficient because they can benefit from economies of scale, and thus are more effective providers of public services (OECD, 2006c).

93. With respect to how countries approach mergers, there appears to be a continuum of national policies related to the obligation to merge that ranges from voluntary mergers in the face of “disincentives” to mandatory mergers with a specific target size. (See Box 5.) In this case “disincentives” refer to the unintended consequences of other policy actions which have the effect of discouraging municipalities from merging. All countries fall along this continuum, with the vast majority clustered at the voluntary end of the spectrum (OECD, 2009b; OECD, 2006c).

Box 5. Examples of mergers policies: the case of Denmark and Japan

Denmark

On January 1, 2007, after a 4-year reform process, the number of Danish municipalities was reduced from 270 to 98, with an average size of 56 000 inhabitants. After a series of public hearings and discussions in the second half of 2004, all Danish municipalities were asked to select the neighbouring municipalities with which they wanted to merge. The threshold size for the new municipalities was set at 20 000 inhabitants. The deadline for selecting partner municipalities was 1 January 2005, two years prior to the actual mergers. Thirty-two municipalities (located largely around Copenhagen) remain the same as in the past because their total inhabitants exceeded 20 000 and so they were not obliged to merge. Between mid-2004 and the end of the year, municipalities negotiated with potential partner municipalities and citizens were given the opportunity to articulate their preference through a series of local referenda. Municipal amalgamations were voluntary in the sense that the municipalities were able to choose their partners. The central government had the possibility to intervene in cases where voluntary agreements could not be reached. Ultimately, however, the central government intervened in only two cases. The primary goal of the merger process has been to improve the quality of the municipal services by transferring new responsibilities from county level to municipalities and, by increasing their size, to ensure that they can assume these new responsibilities, which include environmental control, adult education and specialised social services. Municipalities will also transfer responsibilities for assessing and administering taxes to the national level. Efficiency concerns were also among the reasons that municipalities were merged. It assumed, for example, that the new municipalities will benefit from economies of scale. However, this consideration was generally secondary to the larger concern regarding the quality of service provision.

Japan

Japan is a unitary country with a two-tiered sub-national system comprising 47 prefectures and 1 795 municipalities as of March 2008. The country has experienced three periods of major municipal mergers since the late 19th century. During the Meiji era the number of municipalities dropped from 71 314 in 1889 to 15 859 by the following year. In the 1950s, during the Showa era, mergers reduced the number from 9 868 to 3 472 municipalities. Finally, during the Heisei era the number of local entities dropped again from 3 232 in 1999 to 1 820 in 2006. The primary motivations for the recent round of mergers, where to: 1) promote further decentralisation, 2) address demographic shifts and, in particular, the ageing population, 3) to encourage mobility, and 4) to address serious fiscal constraints at the central and sub-central levels. The total long-term debt of both central and sub-central government totalled approximately JPY 775 trillion (approximately USD 7 trillion, or 180% of GDP, by far the highest ratio among OECD countries), with the portion held by local government expected to exceed JPY 204 trillion at the end of 2006. Municipal mergers are seen as a way to enhance the efficiency of local government.

While the Japanese government did not target an optimal size as part of the merger process, it did set a target of 1 000 municipalities. Local governments were encouraged to merge prior to 31 March 2005 (the expiration of the Special Merger Law), when localities would no longer be eligible for national subsidies for amalgamation. Currently, based on the New Special Merger Law of 2005, some incentives will still be given to the merged municipalities until the end of March of 2010, to further promote municipal mergers.

Japan encountered a variety of challenges during the last merger period. The four major problems represented the concerns of communities about the following: the naming of the new municipality, deciding whether to absorb or be absorbed by a municipality, determining the location of the new city hall,

and setting the merger date. These problems often led to suspicion of the mergers and municipalities among citizens, mayors and councillors. As such, explaining the context, justifications, and benefits of mergers was important.

With respect to efficiency gains due to amalgamation, one study optimistically estimates an overall reduction in expenditures of JPY 1.8 trillion (USD 16 billion) after 2016. Savings would come from reduction in personnel costs and investment savings. However, short-term expenditures are expected to rise for the next 10 years, due to the costs of integration in areas such as information systems and infrastructure development.

Source : OECD 2009b

94. Mergers face an “acceptance challenge” and they could be considered a politically charged option. Many municipalities argue a loss of identity (expressed for example in Austria and Estonia); a loss of democratic representation (one reason for the increasing number of municipalities in Slovenia); and loss of funding via transfers. There are also arguments that if two weak municipalities chose to merge, it will not necessarily result in one strong one, but rather one large weak one. From a central government political perspective, mergers, if unpopular locally, could result in a loss of votes. Despite this, mergers remain a viable mechanism for inducing horizontal co-operation, and there is some evidence of associated economies of scale in specific services (e.g., schools and hospitals), as experienced by Finland and Denmark (OECD, 2006c).

Municipal Co-operation

95. Municipal co-operation is an alternative to mergers, especially if the goal is to build critical mass and increase efficiency and efficacy in public service delivery. These are a less politically and culturally charged option for promoting co-ordination and enhancing capacity. Thus, such partnerships may face less resistance and potentially greater political will at the local level than mergers. There are numerous examples among OECD members of policies to support municipal co-operation.

96. Neither France nor Finland has a tradition of mergers. In France, for example, mergers are unpopular with local politicians and the more than 36,000 municipalities, and the central government does not propose them. Thus, municipal co-operation is facilitated by the central government through the creation of inter-communal structures which are legally recognized and partially subsidized by the State (OECD, 2006c). (See Box 6.)

97. In Finland, the number of services that municipalities must provide is high and the average size of municipalities in 2005 was slightly above 12,000 inhabitants.¹³ As such, jurisdictions tend to co-operate in order to fulfil their service duties and as a means to avoid mergers. Co-operation may take a variety of forms, but it is common for municipalities to set up a separate organisation (a joint municipal authority) that performs the joint functions. These functions tend to be education, social services, and health care services. The central government does not provide incentives for municipal co-operation; however, each municipality is required by law to participate in a joint municipal authority of a hospital district, which provides specialized medical care. There have been discussions regarding the creation of compulsory co-operation areas, particularly around big cities where spill-over problems are most severe and land use is not efficient. There have also been discussions in Finland regarding the possibility of creating an intermediate level of government between the central level and municipalities (OECD, 2006c).

¹³ Dexia. (2008)

Box 6. Municipal co-operation: the case of France

France is characterised by voluntary co-operation at the local level. It has more than 36,000 communes (the basic unit of local governance). Although France has resisted municipal mergers, the need for local co-operation is clear. As such, the communes are united by approximately 19,000 inter-communal structures (which includes 2525 EPCI and other forms of syndicates) aimed specifically at facilitating horizontal co-operation.

The current system of inter-communal structures was first established in 1992 and reformed in 1999 such that there are now three main types of supra-communal structures: communities of communes (groupings of small rural communes), "agglomeration" communities (groups of 50,000 inhabitants subject to a single business tax), and the urban communities (groupings of 500,000 inhabitants or more). "Single purpose inter-communal associations" ("syndicates") first established in 1890 and multi-purpose syndicates which date back to 1959 are also still in existence.

Each grouping of communes constitutes a "public establishment for inter-communal co-operation" (EPCI). The EPCIs assume limited, specialised, and exclusive powers transferred to them by member communes. Unlike the communes themselves, the EPCI is not governed by elected officials but by delegates of municipal councils. This essentially shifts power away from elected officials to civil servants in the areas of competence ceded by the municipalities. Although the EPCI are created by the communes directly, there are two notable roles for the central government. First, EPCIs must be approved by the State in order to exist legally. Second, to encourage municipalities to form an EPCI, the central government provides a basic grant plus an "inter-communality grant" to those communes that accept a single business tax, which is established to preclude competition on tax rates among participating municipalities in order to attract business. EPCIs draw on two sources of financial resources: budgetary contributions from member communes (for the syndicates) and/or their own tax revenues (for the EPCIs)

There are some indications that inter-communal co-operation has produced efficiency gains. On the one hand, some outdated governance structure disappeared after the 1999 reforms and communes tend to collaborate in areas such as public works, which are likely to exhibit economies of scale. On the other hand, growth in inter-communal spending has not been accompanied by a decline in communal spending, transfers of personnel from communes to communities are associated with a rise in payroll costs and local tax increases, and the presence of communal and inter-communal governance structure results in overlaps and extra costs. Overall, however, measuring the efficiency and effectiveness of municipal co-operation is difficult in France, as there is no culture or institutional structure for evaluation of public policies in this regard (see Cour des Comptes (2005) L'intercommunalité en France, Rapport au Président de la République, novembre www.comptes.fr/cour-des-comptes/publications/rapports/intercommunalite/rapport.pdf)

Sources: Workshop presentation by France; OECD (2006), Territorial Review of France (Extract submitted for the workshop), OECD, Paris; Hernu, Paul, "Co-operation between municipalities in France: The search for greater effectiveness of public action at the local level." Chambre régionale des comptes de Nord-Pas-de-Calais (submitted for the workshop).

98. As in France, financial support for municipal co-operation is also provided in Norway, which promotes this via economic support for innovative ways to co-operate, by spreading examples of successful strategies through conferences and a database (see Box 9), and through laws and regulations. Municipal co-operation is most prevalent in areas such as information technology and administration. Co-operation in areas such as education, social services, and healthcare is less widespread. Two drawbacks to co-operation mechanisms such as these could be reduced clarity in lines of responsibility for service delivery and a diminished ability for services tailored to local needs, thereby also reducing citizen influence in which services are delivered and how (OECD, 2009c). (See Box 7.)

Box 7. Improving public service through merging administrative units: findings from OECD comparisons

Neither academic research nor evaluations made by public or para-public bodies have shown strong consistent evidence that merging municipalities leads to economies of scale. Thus, the promotion of co-ordination through mergers or co-operation cannot be justified purely on the basis of economies of scale. Economic gains require time-consuming changes in work processes and municipal organisation, and spending rises in the short-term for investment decisions that were not possible before pooling funds.

Instead, issues such as standardisation of services, strategic alliances for development, financial constraints, community life and equity should be considered.

Since the efficiency case for amalgamations and co-operation is weak, other aspects must be taken into account. In particular, there can be a "democracy cost" if mergers or co-operative arrangements shift power away from locally elected officials to civil servants or elected officials of other municipalities.

In addition, merging competitive municipalities may lead to the loss of benefits previously associated with competition. Co-operation could lead to awkward situations, as when municipalities collaborate in some public service areas but remain competitors in terms of territorial attractiveness. There could also be a loss of flexibility and responsiveness to changing conditions, as small municipalities may have an advantage in this regard over large municipalities.

Whether governments choose mergers or co-operation, arrangements need to be structured to take account of potential problems. As gains from co-operation and amalgamation appear to be positively associated with organisational restructuring (e.g. reductions in administration), policy makers should identify mechanisms to minimise the difficulty in reducing the number of civil servants. Without commitment to restructuring, there is no incentive to re-organise the number of civil servants, which can prove costly over the long-run. Other problems, which result from perverse incentives, include opportunistic and superficial co-operative arrangements which serve largely to attract central government funding, but do not function to maximise efficiency or quality of local government services.

Source: OECD, 2009b

Co-ordinating bodies

99. Co-ordinating bodies are government or non-government groups that help promote co-operation and collaboration among levels of government. They are also a key force for building capacity and sharing good practices at the sub-national level. Ultimately, their work targets the capacity and knowledge gaps, though in some instances they may be able to address the policy gap as well. Most often, co-ordinating bodies are municipal associations, but they can also be working groups (in Canada), government agencies, or specific government offices. The latter is seen in Mexico where the Federal Commission for Better Regulation, COFEMER (*Comisión Federal de Mejora Regulatoria*), develops guidelines in regulatory management for municipalities, as well as provides advice and training through hands-on and distance learning courses for sub-national actors (Quevedo, 2008).

100. Co-ordinating bodies can serve as forums for overcoming communication and dialogue challenges. In addition, co-ordinating bodies can help align interests and timing, especially with respect to implementing public policy at a horizontal level. While co-ordinating bodies do not necessarily promote the physical integration of government bodies or municipalities, they can help consolidate and disseminate knowledge about good practices in each. In the Czech Republic, the Union of Municipalities and the Association of Regions have representatives on the Board for Regulatory Reform and on the Board for Effective Public Administration. These Boards co-ordinate projects relating to the modernisation of public administration and they are the central bodies responsible for the quality of impact assessment studies.¹⁴ In Luxembourg, where it is becoming increasingly difficult to guarantee the delivery of high quality services given the size of municipalities (sometimes less than 10,000 people), administrative reform is under discussion. Within this, one point being considered is the creation of a new category of agencies (*établissements publics de co-operation intercommunale*) to help strengthen inter-municipal co-operation for improved use of human and financial resources, as well as a qualitative and quantitative improvement

¹⁴ From the Czech Republic's response to the *Questionnaire on Multi-level Governance Relations*

in the delivery of public service.¹⁵ Finally, in Hungary, it is a constitutional right for municipalities to establish and join representational bodies, of which there are seven.¹⁶

101. In some countries, co-ordinating bodies are leading actors in fiscal capacity building by representing the interests of the local or regional level to national level decision makers. In Norway, the Association of Local and Regional Authorities plays a role as a national members association for municipalities, counties, and public enterprises under municipal or county ownership. There are ongoing contacts between central and local government authorities and the Association provides a forum to discuss the framework for distribution of revenues in relation to the tasks carried out by local governments, the financial situation of local government and efficiency measures.¹⁷

102. In Hungary a reconciliation forum – “Government-Local governments Reconciliation Forum” – established in 2006 provides a platform for dialogue between the national government and the local levels (represented by their national associations). The objective is to generate innovative initiatives and build consensus across levels of government for public governance reforms.¹⁸

103. In addition, as drivers in communication, dialogue, and training programmes, municipal associations help their members identify ways to more effectively meet their responsibilities. As such, they are often instrumental for organizing events where skills-training is provided. Such meetings can also promote consultation, dialogue, and peer-learning by providing a forum to exchange experiences and good practices either broadly or in specific areas. This is seen in regulatory management where regulatory co-ordination among municipalities and between different levels of government is promoted by associations and local authorities (OECD, 2008d). In Denmark, consultations on political issues pertaining to HRM practice are handled between the central level and the association of Danish municipalities, with the dialogue between the State Employers Authority and the associations of municipalities and regions being ongoing and informal (OECD, 2008a).

104. Working groups are an alternative form of co-ordinating body, and tend to focus on a specific topic. Canada established a working group on regulatory reform that included representatives from the federal, provincial, and local levels. It was created to help build a shared approach to regulatory reform, and aims to enhance the governments’ capacity to produce quality regulation and encourage regulatory co-operation across jurisdictions (OECD, 2008d). Also within the realm of regulatory management, Italy’s Inter-regional Legislative Observatory (*Osservatorio Legislativo Interregionale OLI*) serves as a tool for exchange and training among all the legislative offices of the national Parliament, regional councils and regional executives. In 2002, the OLI published a manual on legislative techniques that contains rules and suggestions for the drafting of legal instruments, which is also used by some Italian regions as a point of reference to harmonise practices in legal drafting (OECD, 2008d). It has been noted that regulatory co-ordination has been improved primarily by special bodies and institutional mechanisms that permit the lower levels of government to submit comments, put forward specific measure and to negotiate with the central level (OECD, 2008d).

105. Joint management bodies or task forces in e-government help break down stove-piping. In Denmark, all concerned parties (central and sub-national) have agreed to meet in a management board/steering group and agreements are obtained in the group and implemented in respective jurisdictions. Agreements stemming from these groups are trust based, and no sanctions are possible in case of a breach. In Germany, e-government agreements are reached politically between the Federal and state levels, and then implemented voluntarily.

¹⁵ From Luxembourg’s response to the *Questionnaire on Multi-level Governance Relations*

¹⁶ From Hungary’s response to the *Questionnaire on Multi-level Governance Relations*

¹⁷ From Norway’s response to the *Questionnaire on Multi-level Governance Relations*

¹⁸ From Hungary’s response to the *Questionnaire on Multi-level Governance Relations*

Ad hoc/informal meetings

106. Meetings comprised of representatives from various levels of government also provide an opportunity for communication and dialogue, and help build networks that are horizontal, vertical and cross-disciplinary. Among those responsible for the operational aspect of e-government, there often exists a common understanding for the need for operational collaboration and co-operation, and, in addition to formal channels, it is not uncommon that informal channels of communication be used. This is seen in Australia, Belgium and the Netherlands. In Belgium also, there is a results-based approach to such collaboration where actors meet informally and on an *ad hoc* basis (OECD, 2008b).

107. At first glance, it may seem that such a mechanism is most appropriate for smaller countries where there is greater likelihood that individual members of government, regardless of level, know each other personally. While size may facilitate ad hoc gatherings, this mechanism appears to be valuable regardless of a country's geographic size or its population level – Australia, Luxembourg, Brazil and Slovenia all use this mechanism to help manage multi-level governance relations.¹⁹ The challenge of such a mechanism could be its informality which might reduce transparency and accountability of decisions or outcomes, and not provide sufficient incentive for long-term co-ordination by the parties involved.

Performance measurement

108. Indicators-based performance measurement is a critical component of multi-level governance relations and an increasing number of OECD countries have established indicator systems for assessing performance, particularly by monitoring and evaluation sub-national public service provision. (See Table 2.)

¹⁹ From country responses to the *Questionnaire on Multi-level Governance Relations*

Table 2. Examples of indicators used by different OECD countries to measure sub-national service

	Category	Examples	Country/system
context	<i>Demographics</i>	<ul style="list-style-type: none"> Population, gender, age, marital status, births, deaths 	
	<i>Service context</i>	<ul style="list-style-type: none"> Irregularities in water distribution Per capita average expenses for theatre and concerts Air pollution due to transportation 	Italy (regional policy)
inputs	<i>Materials</i>	<ul style="list-style-type: none"> Municipal nursing home beds 	Finland
	<i>Staff</i>	<ul style="list-style-type: none"> Number of required staff for the service Numbers and qualifications of teachers 	Turkey/BEPER Finland
	<i>Finances</i>	<ul style="list-style-type: none"> Net operating expenditures Education expenditures Deflated expenditures and revenues 	Norway/KOSTRA Finland Netherlands
	<i>Policy effort</i>	<ul style="list-style-type: none"> Capital expenditure by level of government and sector Preparation and approval of territorial and landscape programming documents 	Italy (regional policy)
outputs	<i>Policy outputs</i>	<ul style="list-style-type: none"> Number of inhabitants served Amount of solid waste collected Visits to physician, dental care visits Building permits issued Number of passports, drivers licenses issued 	Turkey / BEPER Finland Australia Netherlands
	<i>Service coverage</i>	<ul style="list-style-type: none"> Percent of aged inhabitants receiving home services Percent of children enrolled in kindergarten Recipients of social services as percent of the population 	Norway/KOSTRA
	<i>Efficiency</i>	<ul style="list-style-type: none"> Government funding per unit of output delivered Spending efficiency: achievement of payment level equal to 100% of previous year's financial appropriation Children 1-5 years in kindergartens per full time equivalent Number of children per teacher Cost per user 	Australia Italy (regional policy) Norway/KOSTRA Sweden (education) Sweden (elder care)
outcomes	<i>Policy outcomes</i>	<ul style="list-style-type: none"> Education transition rates Response times to structure fires Improved language skills of immigrants 	Norway/KOSTRA Australia Netherlands
	<i>Effectiveness</i>	<ul style="list-style-type: none"> Effectiveness of outputs according to characteristics important for the service (e.g. timeliness, affordability) Disease-specific cost-effectiveness measures Passengers Share of completion of students in secondary schools 	Australia Finland (hospitals) Netherlands (transport) Sweden (education)
	<i>Equity</i>	<ul style="list-style-type: none"> Geographic variation in the use of services Units per 1,000 members of target group Recipients of home based care as a of share inhabitants in different age groups 	Finland (hospitals) Germany (Berlin) Norway/KOSTRA
	<i>Quality</i>	<ul style="list-style-type: none"> Number of days taken to provide an individual with needed assistance Number of different care-givers providing home care for the elderly to a single individual 	Netherlands Denmark
	<i>Public opinion</i>	<ul style="list-style-type: none"> User satisfaction with local services 	Netherlands

Source: OECD (2006c); 2007 OECD Fiscal Network questionnaire, quoted in "Promoting Performance: Using Indicators to Enhance the Effectiveness of Sub Central Spending", COM/CTPA/ECO/GOV(2007)4.

109. Indicator systems also promote learning and orient stakeholders towards results, thereby addressing the information gap. When carefully coupled with specific incentive mechanisms and realistic targets, indicators can stimulate and focus actors' efforts in critical areas. Thus, they help promote capacity development and good management practices. In addition, they are effective tools for reinforcing accountability of stakeholders at all levels of government by improving transparency. Assessing a variety

of such performance indicators systems has led to a better identification of benefits and “costs” attached to their implementation. (See Box 8.)

110. The main impact of performance indicators is their ability to reinforce linkages among policy stakeholders at different levels of government, and their contribution to learning and capacity building. Thus, such measurement becomes an invaluable tool for all levels of government, as well as for other stakeholders in a multi-level governance context including private sector providers of public services. It is a basis for dialogue, discussion and learning, and helps a community of actors identify common reference points. The benefit of indicator systems is that stakeholders can be oriented toward learning and results, focusing attention and efforts on critical areas (OECD, 2009a).

Box 8. Examples of performance indicators systems and incentives as developed for regional policy

The European Union (EU) Structural Funds: This case examines mechanisms for monitoring the performance of EU Structural Funds during the 2000-06 programming period, with a specific focus on the “performance reserve”. The reserve was an incentive mechanism to encourage performance improvement by attaching explicit financial incentives to indicators and targets. It was implemented in a larger context of monitoring and evaluation activities by the EU that included a mid-term evaluation process and a decommitment (N+2) rule. The reserve set aside 4% of a programme’s total budget and distributed it only if some specific objectives were achieved. In consultation with the European Commission, member states selected their own indicators, chose their own approach to assessment, and used the mechanism differently. The case study reveals the political and technical challenges of implementing such a system, while also highlighting the learning effects which took place. Although the mechanism is no longer compulsory, it helped to raise awareness of the importance of monitoring and evaluation, as well as the need to improve monitoring systems and capacities. It was a learning experience at both the EU and national levels in terms of designing systems, selecting indicators, achieving targets, and using explicit financial incentives.

The Italian national performance reserve: Italy is a unique national example of the use of explicit incentives to improve the performance of regional development policy. During the 2000-06 programming period for the EU Structural Funds, Italy extended and reinforced the logic of the EU performance reserve by adopting a national performance reserve aimed at promoting the modernisation of public administration. This reserve, which set aside 6% of the programme’s budget, was developed collaboratively between the central government and regional actors. Specific arrangements were made to ensure transparency and enforcement of the approach. The extent to which the results of the national performance reserve translated into improved regional economic performance is unclear. However, Italy was sufficiently satisfied with the results that it has since developed a new incentive mechanism that moves beyond process and output targets, and focuses on rewarding achievement of outcomes.

The monitoring system for **England’s Regional Development Agencies (RDAs):** The case of England highlights the dynamic nature of performance indicator systems. Since being established in 1998, the English RDAs have been subject to a number of different approaches to monitoring. With each change, the national government has aimed to enhance the quality of the monitoring process. Over time, the system has become increasingly flexible and accommodated feedback from the RDAs themselves. The most recent shift has been to allow RDAs to decide how best to measure their progress towards overall regional policy targets. Under this new approach, outputs are expected to demonstrate short term results and form the basis for impact information gained through evaluation.

The monitoring system for **the US Economic Development Administration (EDA):** The case of the US EDA demonstrates the importance of using indicators to generate information that can be used for decision making on both a short- and a long-term basis. As a national agency, the EDA is subject to the US Government Performance and Results Act, which requires all federal agencies to report to Congress regarding the achievement of specific goals. As the results of EDA investments often materialise over a number of years, the Administration projects and reports on indicators which track outcomes three, six and nine years after programme investments have been made. However, these and other data produced for GPRA have limited use for short to medium term decision making. To meet their strategic information needs, the EDA couples reporting to Congress with the use of an internal Balanced Scorecard to monitor short term progress.

Source: OECD (2009a).

111. There are two different, equally relevant angles to performance measurement: monitoring and evaluation. Performance monitoring is an ongoing process. It requires collecting and assessing both quantitative and qualitative information, building a picture on the functioning and outputs of public policies and programmes. Performance evaluation uses qualitative and quantitative data to assess whether or not objectives have been met and occurs at specific points in the project cycle (OECD, 2009a). Data from each element, comprising a performance measurement package, helps identify areas where co-ordination can be improved, supports dialogue and negotiation for better allocation of resources or competences, and facilitates negotiating contractual arrangements. Governments may use it as a means to build capacity by pinpointing weak-spots in sub-national (or national) performance, and then establish mechanisms that will strengthen and resolve the problem. Ultimately the objective of performance measurement is to "...provide information which can be used to enhance the effectiveness of decisions regarding policy priorities, strategies and resource allocation." (OECD, 2009a)

112. Performance information facilitates the dissemination of information across levels of government, as well, helping actors identify objectives and improving the strategic effectiveness (OECD, 2009a). This could be particularly critical when mergers or co-operative partnerships are being negotiated. If two or more municipalities are negotiating an arrangement to share tasks associated with the delivery of a specific service, performance measurement information can help each party understand the capacity level of its neighbours and develop an arrangement where the co-ordination is optimized based on capacity in terms of resources and skill. This has been one of the benefits municipalities can see from Norway's KOSTRA system, which publishes the data results electronically, within a month of receipt from the municipalities (OECD, 2009a). (See Box 9.)

Box 9. KOSTRA: data reporting and information system in Norway

Since 2001, KOSTRA has formed the centrepiece of the Norwegian performance indicator system. KOSTRA is an information system for conveying data from the municipalities to the central government, between municipalities, and to the public. In Norway, the sub-national authorities (counties [19] and municipalities [431]) account for approximately 50% of public spending. However, the decentralisation of expenditure does not accurately reflect the role these entities play in resource allocation. In some areas, earmarked transfers constrain the room to manoeuvre. Municipalities also have limited room for raising revenue through taxes. This means that the central government plays a large role in the transfer and allocation of public funds, and that it requires substantial amounts of information (indicators) in order to execute this role effectively.

Previous to the development of KOSTRA, the system of information gathering in Norway was organized by themes which reflected the responsibilities of the various ministries in the central government. This approach to collecting data was not very efficient. Moreover, the data were time consuming to process and report, difficult to use at the local level, and placed a heavy administrative burden on municipalities.

The introduction of KOSTRA in 2001 made significant changes to the collection, processing, and dissemination of statistical information by local governments. Whereas previously data were sometimes redundant, today the central government combines financial data, data on services, and socio-demographic and demographic data into key indicators for use at a central and sub-central level. Whereas the lag between collection and reporting was approximately one year, today data are collected electronically and reported within one month. Whereas collection previously placed a high administrative burden on local authorities, the more efficient use of data, combined with effective electronic reporting, has contributed to a more efficient data collection.

The development of KOSTRA has been, and is, a collaborative process. An important motivation for the changes was to make the production of information more effective both for the central and the local governments. As such, representatives from both levels played active roles in the development of the new system. Today, KOSTRA is overseen by a government appointed commission, along with 16 task forces that focus on the different areas of data collection which make up the overall system.

Various types of data are collected and reported via KOSTRA. Most data are objective data that are reported from the sub-national level. The combination of these data provides key indicators on financial

figures, productivity, coverage rates, and priorities. These key indicators are aggregated at three levels. At the municipal level there are approximately 40 key indicators and an additional 1000 indicators covering 16 service areas. The primary data from which the aggregates were developed are also available for interested parties to construct additional indicators of their choosing.

How has the introduction of KOSTRA benefited the central and sub-central levels of government? For the central government, the system has rationalized data collection and processing, contributed to uniform standards thereby enhancing the comparability of municipalities and service sectors, helped the central government to determine if municipalities are complying with national standards and regulations, and facilitated a common assessment of the local economic situation which is used as the basis of a parliamentary discussion on the transfer of resources to municipalities. For the municipalities, KOSTRA lessened the administrative burden of reporting. It also provided a tool for internal planning, budgeting, and communication at the local level. In addition, it facilitated the sharing of knowledge between municipalities which are able to use indicators for the purpose of benchmarking performance.

While KOSTRA has brought benefits to both the central government and sub-national authorities, there are limitations in the current system. First, the large amount of data collected makes ensuring quality challenging. Second, there is a tendency for the central government to request more and more data, causing both the administrative burden and the costs of data collection to rise in municipalities. Municipalities also receive much more data than in the past.

Overall, KOSTRA has been perceived as a very successful information system with potential for further refinement. Looking forward, focus is being placed on collecting data regarding quality of public services and developing indicators of quality. "Soft data" collected outside of KOSTRA (test scores, reading proficiency and user satisfaction for various service, etc.) are gradually being used in combination with data from the KOSTRA-system. This will permit policy makers and citizens to assess outcomes as well as outputs. Norway also anticipates the launch of a similar system for the state service providers in 2007. KOSTRA may thus benefit from improvements in methodologies and reporting that will be built into the new system.

OECD (2006c).

113. Indicator systems are associated with strong benefits. There are, however, some factors which could be considered drawbacks. Indicator systems are costly, both in a direct manner (i.e., the cost of development and implementation) and in an indirect manner (i.e., opportunity costs and a possible inadvertent generation of unintended consequences). They can also increase administrative burden for the reporting organisation and individuals therein. It is difficult to capture complexity with data and indicators, which can lead to developing too many indicators rather than concentrating on a core group. There can be a temptation on the part of the centre of government to substitute ex ante control of service delivery with performance indicators. This can lead to retaining control of how sub-national authorities implement policy, as these authorities will likely make choices and decisions permitting them to perform well within the parameters of the indicator system at the expense of other elements (OECD, 2009a).

114. While there is no optimal design for an indicator-based performance measurement system, its development should be a collaborative effort between the national and sub-national level, and the information it yields ought to cover inputs, processes and outputs that are relevant for ongoing activities (OECD, 2009a). For such information to be utilised in an optimal fashion, clear objectives for the data need to be established and proper indicators selected. It is necessary to have systems that can generate, validate and distribute the data; the capacity to use the information in a suitable and timely fashion; incentive mechanisms to encourage actors to follow a particular course of action; and appropriate planning for how the performance information will be used. Despite the drawbacks, performance measurement systems that are well that are well-designed, developed with stakeholder consultation, and are transparent in themselves permit all levels of government to monitor and evaluate performance, identify and reward good practices, and could be useful for promoting bottom-up, innovative solutions to public policy challenges.

Other methods for sharing good practices

115. Experimentation in policy design and implementation can synthesise many of the tools explored in this report and they also serve to promote co-ordination and build capacity thanks to partnerships with the local areas concerned. Experimentation often occurs at a specific territorial level (local, regional, etc.) with an eye to its potential application in equivalent areas. Countries that perceive a potential resistance to reform may select to undertake an experimental practice supported by specific contracts, performance evaluation mechanisms, and often co-funding possibilities. In this way, they may implement a proposed policy with minimal barriers due to gaps, and a higher possibility of identifying lessons that can be shared and good practices that can be adapted to other areas.

116. Pilot programmes are an example of experimentation, and are another method that can promote innovative solutions. In the US for example, the Department of Housing and Urban Development used a pilot phase to test a new approach to monitoring formal grants administered by the Office of Community Planning and Development. The approach was tested in eight locations of the country. Regional forums allowed stakeholders to provide feedback in the pilot phase before the full system was rolled-out in 2006 (OECD, 2009a). Pilot projects can help identify the good practices that lead to the success of an initiative, and provide early insight into the challenges that could be faced when a programme is more widely implemented. In this way, efforts can be made to help build capacity before a capacity deficit becomes detrimental to the accomplishment of objectives.

CONCLUSION

117. Multi-level governance is characterised by mutual dependence among different levels of government. This is due to the fact that no level of government can successfully meet its obligations independently of the levels above or below it. While effective management of mutual dependence can lead to more successful outcomes in decentralisation and public policy as a whole, it is a challenge that countries grapple with regardless if they are federal or unitary.

118. The challenges that multi-level governance poses may be perceived as a series of gaps – information, capacity, fiscal, administrative and policy – which impact governance relationships and the effective delivery of public services. As the governance playing field becomes increasingly complex with more actors and stakeholders both in the public and private sectors (including citizens), the need for coherence in policy design and implementation heightens in importance. Thus, co-ordination across and between levels of government, and capacity at all levels can go a long way in bridging these gaps and facilitating multi-level governance.

119. This study identifies a series of mechanisms being applied by OECD member and non-member countries for managing the relationship across levels of government. Primary among these are legal mechanisms, contracts, quasi-integration mechanisms, co-ordinating bodies and performance measurement. Most countries appear to use at least two different mechanisms for managing the relationship among levels of government, and some use almost all. Each tool can help bridge a gap, and also serve to promote co-ordination and capacity building.

120. The need for co-ordination and capacity across levels of government, as well as the mutual dependence that characterises multi-level governance, is present in such areas as fiscal relations, human resource management, regulatory management and e-government. Fortunately, the mechanisms presented here are equally applicable to multi-level governance as experienced in these specific public management domains. Legal mechanisms may serve to set the broad parameters for fiscal relations which can also be strengthened with contracts, for example. In human resource management, where the capacity gap is often evident, quasi-integration mechanisms – particularly municipal co-ordination – can be of value. Regulatory management faces multiple complex challenges, and while countries make use of many of the tools discussed, co-ordinating bodies appear to be a good means to maintain dialogue and address specific topics. These bodies are also used successfully for managing e-government on an informal basis, as are ad hoc meetings. Within a multi-level governance context, quasi-integration – be it via mergers or municipal co-operation can also help further e-government, especially as this domain can face a weighty capacity gap.

121. The mutual dependence experienced by different levels of government, the need to favour developing the means to bridge the gaps, and the flexibility of the tools explored in this report are also illustrated by their use in individual public management domains as explored in the studies presented in Part Two.

ANNEXES

Annex 1: Tabulation of Country Responses to PGC Multi-level Governance Symposium: Questionnaire on Multi-level Governance Relations

This questionnaire was made available to all countries (member and observer) participating at the October 2008 Public Governance Committee meeting, in preparation for PGC Symposium on Multi-level Governance. Nineteen countries responded.

Q.1a. Have there been recent reforms regarding decentralisation in your country?

Yes	63%
No	37%

Q1b. Are reforms planned?

Yes	84%
No	16%

Q2. What are the primary mechanisms for coordinating relations between the national government and sub-national governments in your country? Please check all that apply:

Legislation/laws	95%
Formal contractual agreements	53%
Established co-ordinating bodies (e.g., municipal associations)	79%
Judicial review	21%
Informal or <i>ad hoc</i> meetings	63%
No specific mechanism	0
Other	32%

Q3. Does the central government have an indicator system for monitoring sub-national public service provision?

Yes	63%
No	32%
Does not apply	5%

Q4. Does your government have instruments in place that can provide specific incentives for enhancing coordination among sub-national authorities, and promote inter-municipal cooperation.

Yes	68%
No	26%
Does not apply	5%

Q5. How would you qualify the nature of the inter-governmental arrangements that exist between central and sub-national authorities, please check all that apply:

Co-operative	90%
Conflictual	26%
Competitive	5%
Limited	5%
Strong	16%
Other	16%

Q6. Would you consider sub-national capacity building as an issue for efficient and effective sub-national service delivery?

Yes	90%
No	5%
Does not apply	5%

Annex 2: PGC Multi-level Governance Symposium: Questionnaire on Multi-level Governance Relations

The efficient and effective management of intergovernmental relations is a timely and challenging subject, and was selected by the Committee as a horizontal theme for the 2007-2008 Programme of Work. It appears to be a concern in both OCED member and non-member countries as governments strive to improve the functioning of their public administrations at all levels, improve public service delivery, and seek new ways to engage citizens in policy dialogue and participation. In addition, it is a whole-of-government issue. Intergovernmental relations are top-down and bottom-up; but they are also subject to horizontal linkages and play a role in many public management disciplines, including budget/fiscal management, human resource management, regulatory management and information flows (managed often through e-government and information technology).

Given the breadth of the topic, for the PGC Symposium it was decided to focus on the issue of capacity, and specifically the role of the national level in sub-national capacity building, as efficient behaviour and upholding mutual obligations on the part of both central and sub-national authorities – part of good governance – needs capacity at the sub-national level.

In order for the Secretariat to further clarify the picture with respect to inter-governmental relations in your country, below is a short set of questions that would be very helpful in setting specific national contexts for the Symposium. We would be grateful if you could please ensure that these questions are completed and returned to Andrea Uhrhammer (andrea.uhrhammer@oecd.org) no later than **8 October 2008**.

Please note when discussing intergovernmental relationships in decentralised contexts we are focusing on a definition of decentralisation that also encompasses delegation and devolution arrangements but that **does not** incorporate deconcentration (sub national agencies of central government). Questions below that refer to decentralisation reforms encompass a broad set of public administration changes, such as: new allocation of responsibilities, local reform, new arrangements between levels of government, introducing performance measurement for sub-national policy measures, sub national tax reforms, etc.

Q.1a. Have there been recent reforms regarding decentralisation in your country?

- Yes
 No

If yes, please briefly explain:

Q1b. Are reforms planned?

- Yes
 No

If yes please briefly explain:

Q2. What are the primary mechanisms for coordinating relations between the national government and sub-national governments in your country? Please check all that apply:

- Legislation/laws
 Formal contractual agreements between levels of government

- Established coordinating bodies (e.g. associations of municipalities or other sub-national levels that officially represent sub-national governments). *If so, please describe below.*
- Judicial review
- Informal or ad hoc meetings
- No specific mechanism
- Other (please describe):

Q3. Does the central government have an indicator system for monitoring sub-national public service provision?

- Yes
- No
- Does not apply

If yes please briefly explain:

Q4. Does your government have instruments in place that can provide specific incentives for enhancing co-ordination among sub-national authorities, and promote inter-municipal co-operation.

- Yes
- No
- Does not apply

If yes please briefly explain:

Q5. How would you qualify the nature of the inter-governmental arrangements that exist between central and sub-national authorities, please check all that apply:

- Cooperative
- Conflictual
- Competitive
- Limited
- Strong
- Other (please describe):

Q6. Would you consider sub-national capacity building as an issue for efficient and effective sub-national service delivery?

- Yes
- No

If yes, please provide an example of how it is an issue in your government and the instrument(s) used for addressing the issue.

Annex 3: Selected list of OECD GOV Multi-level Governance Sources and Publications

OECD (Forthcoming) *Assessing the Economic Impact of Economic Liberalisation in Italy: The challenges towards improving the long term growth prospects*. (Contains specific insights on regulatory coherence across levels of government through sectoral examples.)

OECD (2009). *OECD e-Government Studies: Belgium*. OECD Publishing. Paris, France.

OECD (2009). *Governing Regional Development Policy: The use of performance indicators*. OECD Publishing. Paris, France.

OECD (2008). *The Challenges of Human Resource Management Across Levels of Government*. Internal OECD Document. [GOV/PGC/PEM(2008)6]

OECD (2008). *Employment in Government in the Perspective of the Production Costs of Goods and Services in the Public Domain*. OECD Publishing. Paris, France.

OECD (2008). *Multi-level Regulatory Governance Issues: Policies, institutions and tools for regulatory quality and coherence*. Internal OECD Document. [GOV/PGC/REG(2008)10]

OECD (2005). *Promoting Performance: Using indicators to enhance the efficacy of sub-central spending*. Working paper 5: The OECD Network on Fiscal Relations across Levels of Government

OECD (2007). *PGC Building Blocks and Guiding Elements for Public Governance and Management*. Internal OECD Document. GOV/PGC(2007)16

OECD (2007). *Linking Regions and Central Governments: Contracts for regional development*. OECD Publishing. Paris, France.

OECD. (2007) *Regulatory Management Systems Across OECD Countries: Indicators of recent achievements and challenges*. Working paper 7: OECD Project on quality indicators in government. Internal OECD Document.

OECD (2007) OECD Reviews of Regulatory Reform. *Italy: Ensuring regulatory quality across levels of government*. OECD Publishing. Paris, France.

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OECD (2005). *Building Competitive Regions: Strategies and governance*. OECD Publishing. Paris, France.

OECD. *OECD Network on Fiscal Relations across Levels of Government*. Additional information on the Fiscal Network and its publications can be found at:

OECD. *OECD Territorial Reviews*. Chapter 3 of these reviews is dedicated to multi-level governance issues. A complete list of OECD Territorial Reviews can be found at: www.oecd.org/gov/regional/publications

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PART II: MULTI-LEVEL GOVERNANCE RELATIONS IN PUBLIC MANAGEMENT DOMAINS

Part II presents elements of four studies of multi-level governance in the context of specific public management domains, including their bibliographies. Chapter 1, *Managing Fiscal Relations across Levels of Government* explores the challenges of multi-level fiscal relations, as well as key issues and challenges associated with managing the fiscal relationship among government levels. Chapter 2, *Challenges of Human Resource Management for Multi-level Government* presents the findings of a study based on OECD country experiences, focusing on national strategies and policies with respect to human resource management in sub-national administrations. Chapter 3, *Multi-level Regulatory Governance Issues: Policies, institutions and tools for regulatory quality and coherence*, identifies policy issues related to multi-level regulatory governance and contributes to an analytical framework that uses as its basis the concept of high quality regulation following the OECD Guiding Principles for Regulatory Quality and Performance as well as preview analytical work on this topic. Chapter 4, *E-government Partnerships across Levels of Government*, is an overview of the challenges and approaches to creating a collaborative and co-operative partnership across levels of government for e-government development and implementation.

CHAPTER 1: MANAGING FISCAL RELATIONS ACROSS LEVELS OF GOVERNMENT

This chapter explores the challenges of managing the fiscal relationship among government levels, and presents the key issues associated with multi-level fiscal relations. It presents how key instruments, such as expenditure assignment, revenue assignment and performance indicators can be used in order to promote efficiency, equity and stability objectives.

Coordinated by Ms. Claire Charbit, and produced by Ms. Camila Vammalle, based on input from Ms. Lee Mizell, Professor Timothy J. Goodspeed (Hunter College, CUNY), and Mr. Hansjörg Bloechliger.

INTRODUCTION

122. These last years have seen a general movement in OECD countries towards a greater delegation of spending responsibilities to sub-national levels of governments, while at the same time, macroeconomic pressures on central governments have increased. Sub-national governments thus face increased responsibilities in terms of public services delivery, but they do not always have the discretion about the level of their resources, nor about how to spend these. This leads to a situation of mutual dependency between levels of government, where central governments need the cooperation of sub-national governments in order to achieve their nationwide macroeconomic objectives, while sub-national governments need to negotiate the allocation of resources, spending responsibilities and expected results with central governments. Sound fiscal relations between levels of government and proper multi-level governance arrangements are therefore crucial both for central sub-national governments. Still, there is very little research about fiscal relations management across levels of government, public governance discussions usually concentrating only on central levels. This paper aims at making up for this lack of attention, by focusing precisely on governance relationships between levels of government.

123. The design of intergovernmental fiscal relations bears multiple - possibly conflicting - objectives in mind, such as macroeconomic stability, efficiency of spending and redistribution concerns. The main instruments to achieve these goals are fiscal rules, taxes and grants. This paper addresses some of the key policy issues associated with managing fiscal relations across levels of government, by presenting the key findings of the *OECD Network on Fiscal Relations Across Levels of Government*, which has conducted research on the following policy issues: fiscal rules for sub-national governments, intergovernmental transfers and decentralised public spending, fiscal autonomy of sub-national governments, fiscal equalisation in OECD countries, and mechanisms to increase the efficiency of sub-national spending.

124. The remainder of the paper is organized in three sections. The first highlights the main challenges of multi-level fiscal relations, and stresses the size of fiscal relations across levels of government. The second section presents the key issues associated with managing fiscal relations across levels of government. It presents how the key instruments such as expenditure assignment, revenue assignment rules and performance indicators are used in order to achieve the efficiency, equity and stability objectives. The last section lays out particular challenges that require ongoing attention before presenting final conclusions.

THE IMPORTANCE OF FISCAL RELATIONS MANAGEMENT IN A MULTI-LEVEL CONTEXT

1. A balance between several tradeoffs

125. Today's trend towards the devolution of spending and revenue raising capacities to sub-national governments follows the idea that decentralisation of spending responsibilities can improve efficiency in the allocation of resources and welfare, because local governments have better information about local needs and preferences, and can therefore provide a composition, quantity and quality of public goods closer to the preferences of their beneficiaries²⁰. But decentralisation has also its drawbacks, aggravating regional differences, undermining distributional equity, and making macroeconomic management more delicate, as sub-national governments actions can go against central government's macroeconomic objectives²¹.

126. To achieve these objectives, the design of fiscal relations across levels of government has three main policy tools: the share, composition and autonomy of sub-national governments expenditures, the share, composition and autonomy of sub-national governments revenues, and fiscal rules.

127. Allocation efficiency concerns are mainly addressed in the assignment of spending responsibilities. The general rule is that to increase efficiency in the allocation of resources, the responsibility for each type of public expenditure should be assigned to the level of government that most closely represents the beneficiaries of these services. Therefore, in general terms, the more spending autonomy is given to sub-national governments, the greater the allocation efficiency. But the efficiency benefits from spending delegation must be balanced with possible negative impacts of spending decentralisation on other objectives, such as equity (as poorer regions will not be able to provide the same level of public goods than more developed regions) and macroeconomic stability (as the addition of all sub-national governments spending might lead to over-spending on a global level). Besides, as some locally provided goods and services might have externalities which will not be taken into account by sub-national governments, the aggregate level of public goods provided might not be optimal. An example of such goods is education or basic health care, which affect the overall stock of human capital, and therefore the potential for growth at national level.

128. Equity (income redistribution) concerns are one of the key elements in the allocation of revenues. The main sources of financing for sub-national governments are own taxes, and inter-governmental transfers (tax-sharing and grants). The larger the reliance of sub-national governments on own taxes, the larger the potential discrepancies between poorer and richer regions. Inter-governmental transfers are thus needed to increase distributional equalisation. These can take the form of tax-sharing, where the coefficients are calculated on redistribution criteria, such as population, regional income per capita, indicators of backwardness, etc., or they can take the form of grants. The drawback of equalisation is that if incentives are not designed properly, it might lead to moral hazard issues, where sub-national governments

²⁰ See for instance Tiebout (1961), Musgrave (1969), Oates (1972) or Ter-Minassian (1997).

²¹ See Prud'Homme (1995) and Tanzi (1996).

will not be encouraged to increase tax pressure, as their lower revenues are compensated by intergovernmental transfers.

129. Finally, stability (macroeconomic management) issues are mainly addressed through fiscal rules such as golden rules, balanced budget rules or borrowing rules. These fiscal rules should allow sub-national governments to provide the most efficient level of public goods, while making sure that sub-national governments' policies are consistent with national macroeconomic objectives.

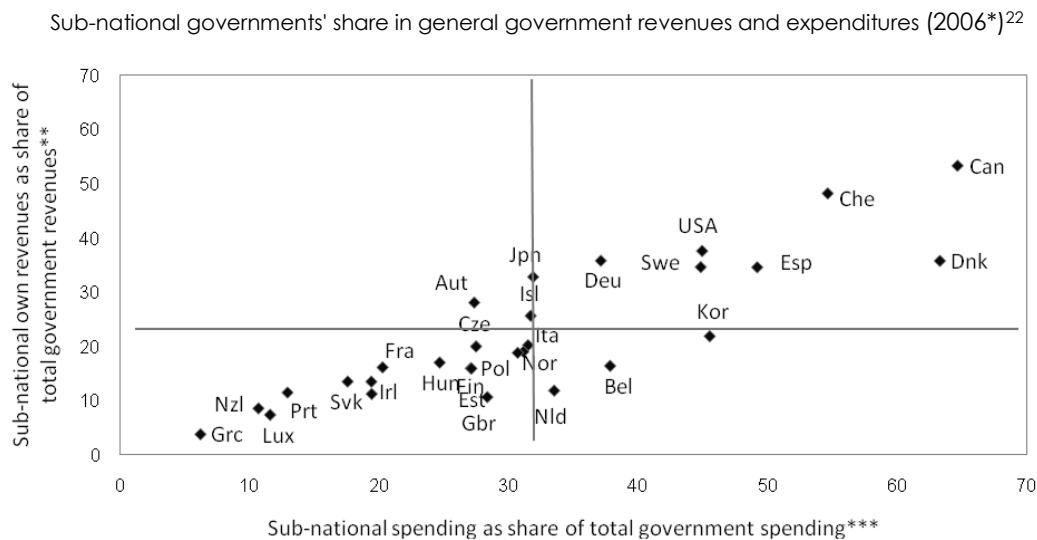
130. National fiscal arrangements between levels of government vary widely, as they necessarily incorporate local economic, but also political, social and cultural factors. In the remainder of this paper, we will give a picture of these choices in the OECD countries, based on the research conducted by the OECD *Network on Fiscal Relations across Levels of Government*.

2. Measures of decentralisation across OECD countries

131. The increased responsibilities of sub-national governments in financing and delivering public goods have magnified vertical inter-dependencies between levels of government, and therefore the importance of multi-level governance. Sub-national governments have two main sources of revenues: own taxes and intergovernmental grants. Figure 1 shows that sub-national governments account for a large share in total public expenditures and revenue, both in federal and unitary countries.

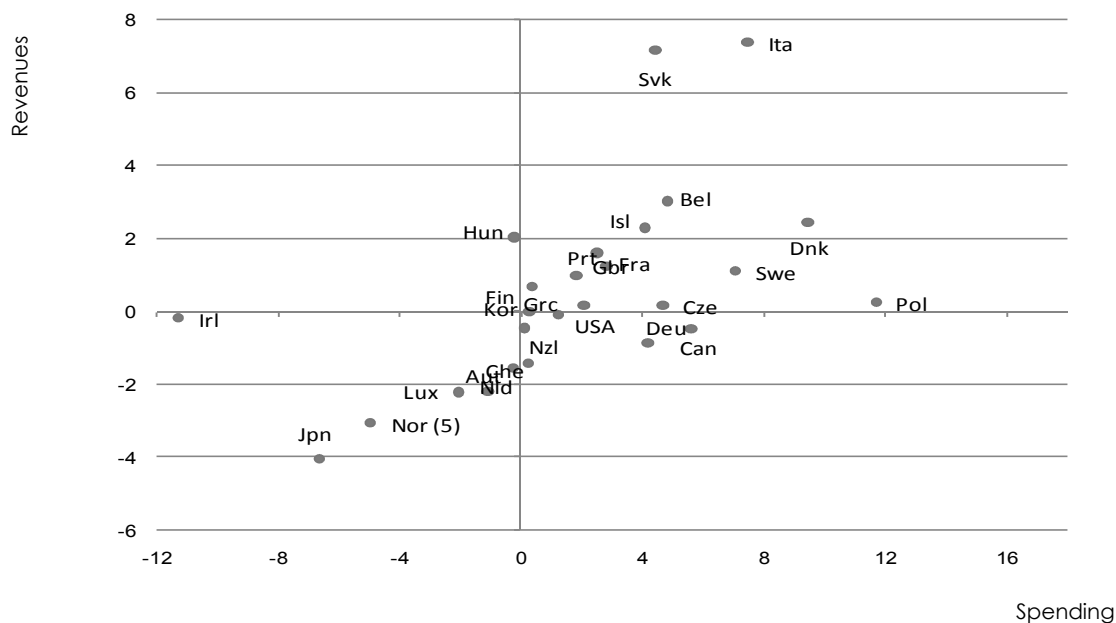
132. Figure 1 shows decentralisation ratios across OECD countries by plotting on the vertical axis, the share of sub-national government's tax revenues in total tax revenues and on the horizontal axis the share of sub-national governments spending in total spending. The degree of decentralisation varies greatly across OECD countries, ranging from 6% of expenditures in Greece to more than 60% in Canada and Denmark, and 3 to 50% of revenues accruing to sub-national governments. The unitary or federal nature of countries' constitutions does not influence the importance of sub-national governments' participation in revenues and spending. As for the evolution of sub-national governments' role in time, their share of expenditures has risen between 1995 and 2004, while their taxing power has generally remained stable (figure 2). In most countries, sub-national government expenditures by far exceed tax revenues, and this "fiscal gap" has widened during the last decade. This difference between responsibilities and resources implies large intergovernmental transfer schemes (OECD, WP 2006/2).

Figure 1. Indicator of fiscal decentralisation in OECD countries



Source:

Figure 2. Decentralisation ratios, evolution 1995-2006²³



Source: National Accounts Database; US Bureau of Economic Analysis

²² Note: Decentralisation is measured by the changes in the share of sub-national governments in total public revenues and spending; *2006 or latest year available: 2005 for Korea, New Zealand and Poland; **excludes transfers received from other levels of government; ***excludes transfers paid to other levels of government; the share of sub-national revenues is expressed in percent of total government mainland revenues.

²³ Or earliest year available: 1996 for Japan, Netherlands and Norway, 1997 for the Czech Republic, 1998 for Iceland; 2000 for Greece, Korea and Hungary; Or latest year available: 2005 for New Zealand; revenues excludes transfers received from other levels of government; spending excludes transfers paid to other levels of government; the share of sub-national revenues is expressed in percent of total government mainland revenues.

KEY ISSUES IN INTER-GOVERNMENTAL FISCAL RELATIONS

133. The main issues in inter-governmental fiscal relations relate to four broad concerns: assigning expenditures to each level of government (who is responsible for which public goods and services?), assuring the funding for these expenditures (who pays?), managing macroeconomic stability (how do we assure macroeconomic stability?) and searching for efficiency improvements (how do we increase efficiency?). This section looks at each of these areas in turn.

1. Allocating expenditures between levels of government

a) Assigning responsibilities for expenditure functions

134. The theory of assignment of functions to levels of government often begins from Musgrave's (1959) classification of government functions: redistribution, allocation, and stabilization. Musgrave and Oates (1972) suggest that the stabilization and redistribution functions should be assigned to the central level of government, while there is some role for sub-national governments in fulfilling the allocation function for certain types of public goods.

135. The reasoning behind the above allocation of responsibilities is three-fold. First, macroeconomic stabilization depends on monetary and fiscal policies normally residing at the central level of government. Indeed, fiscal policy is thought to be more effective when used by national governments, and national spending and tax policies may also provide automatic stabilizers that cannot be implemented at the sub-national level (because of a higher cost of borrowing, or spillover effects of local spending on other sub national governments, which will deter local spending).

136. Second, with respect to redistribution, it is very difficult for sub-national governments to redistribute in a world of mobile resources. Indeed, an attempt by a sub-national government to tax a mobile resource in order to redistribute to poorer mobile factors would result in the flight of the wealthy to avoid paying for the redistribution and an influx of the poor in order to benefit from it. This dynamic would tend to defeat the redistributive goal if pursued by sub-national governments. But as resources are less mobile internationally than within a country, central governments are in a better position to attain redistributive goals.

137. Finally, with respect to allocation, pure national public goods with economies of scale will benefit the most from cost-sharing and hence are clear candidates for central government provision. This is the case for example for defence, foreign affairs, interstate transport and telecommunications infrastructure, etc. Public goods that are subject to congestion and whose benefits are limited geographically will not benefit from cost-sharing and are therefore best provided by sub-national governments in order to take advantage of the ability of sub-national governments to more closely match regional public service delivery with local preferences. But sub-national governments will not take into account the possible externalities of their decisions on other regions (for instance, contagious diseases might have an impact outside the boundaries of a given sub-national government, but only the impact on its own residents will be taken into account, therefore leading to a lower level of spending on prevention if decided at sub-national level than the one that would be considered optimal on a nationwide scale).

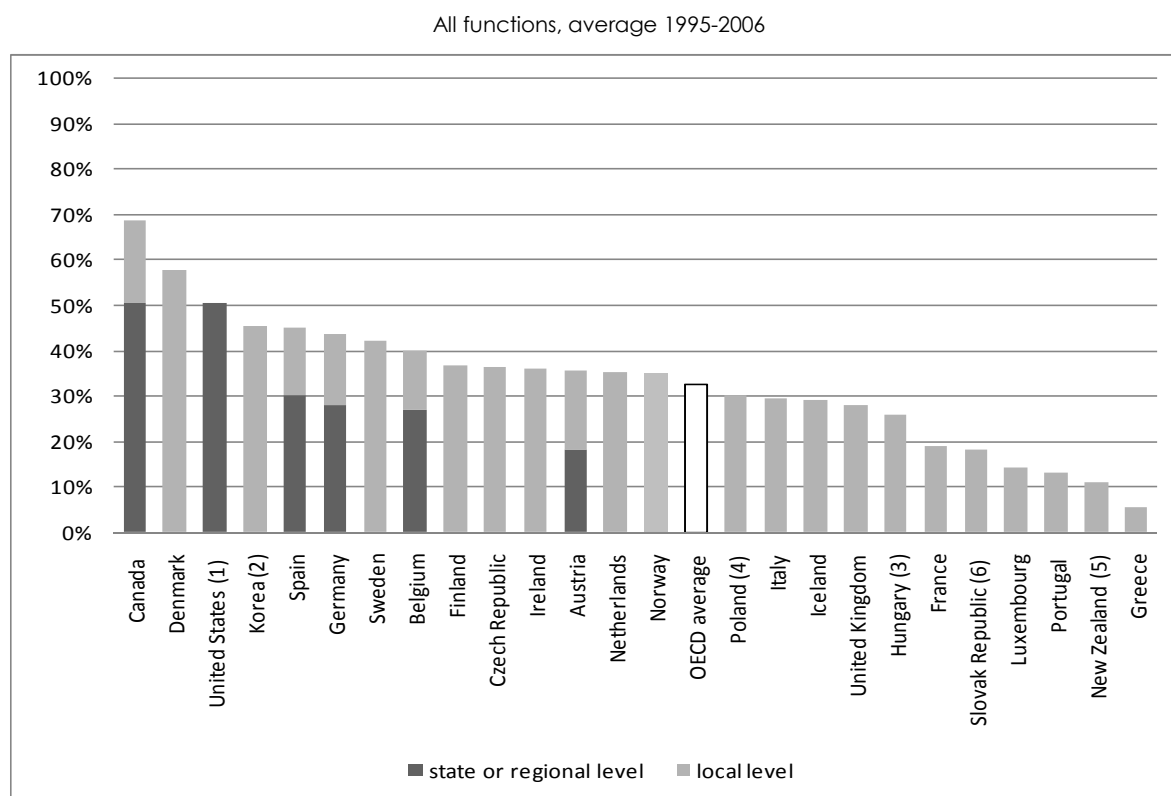
138. Although there is general agreement on the normative principles outlined here, actual expenditure assignment usually leads to some overlapping in the assignment of responsibilities. Some areas, such as defence, foreign affairs, foreign trade, etc., must clearly be assigned to central governments, while in others such as local police, fire prevention, sanitation, etc., sub-national governments have much more information about local needs and preferences, and are therefore best suited to provide the goods. But

many other expenses do not have such clear cuts, often leading to overlapping and ambiguities about which level of government is responsible for their provision. As there is no unique answer, this leads to a great variety of situations across countries. This situation was predicted by Mancur Olson’s (1969) theory of “fiscal equivalence” in which he argues that it might be possible to define an “optimal” geographic size of government for each public service that corresponds to the boundaries that internalize all externalities. But as the boundaries of governments and the relative power of central government pre-exist (they are given by historical factors that do not take these issues into account), it seems almost inevitable that there will be over-lapping assignments of responsibilities as countries deal with the most efficient way to structure government.

b) Share of sub-national expenditure in total government expenditure

139. The relative share of sub-national governments spending in total government spending varies greatly across countries, ranging from 6% in Greece, to almost 70% in Canada, with an average of 33% (figure 3).

Figure 3. Share of sub-national government expenditure in total government expenditure



Note: Unconsolidated data. For the following countries data are not available for the period 1995-2005: Korea (2000 – 2005), Hungary (2001 – 2005), Poland (2002 – 2005), New Zealand (2003 – 2005), Slovak Republic (2003 – 2004). For the United States, National Accounts do not provide a breakdown between state and local governments.
Source: OECD National Accounts

c) Spending power of sub-national governments

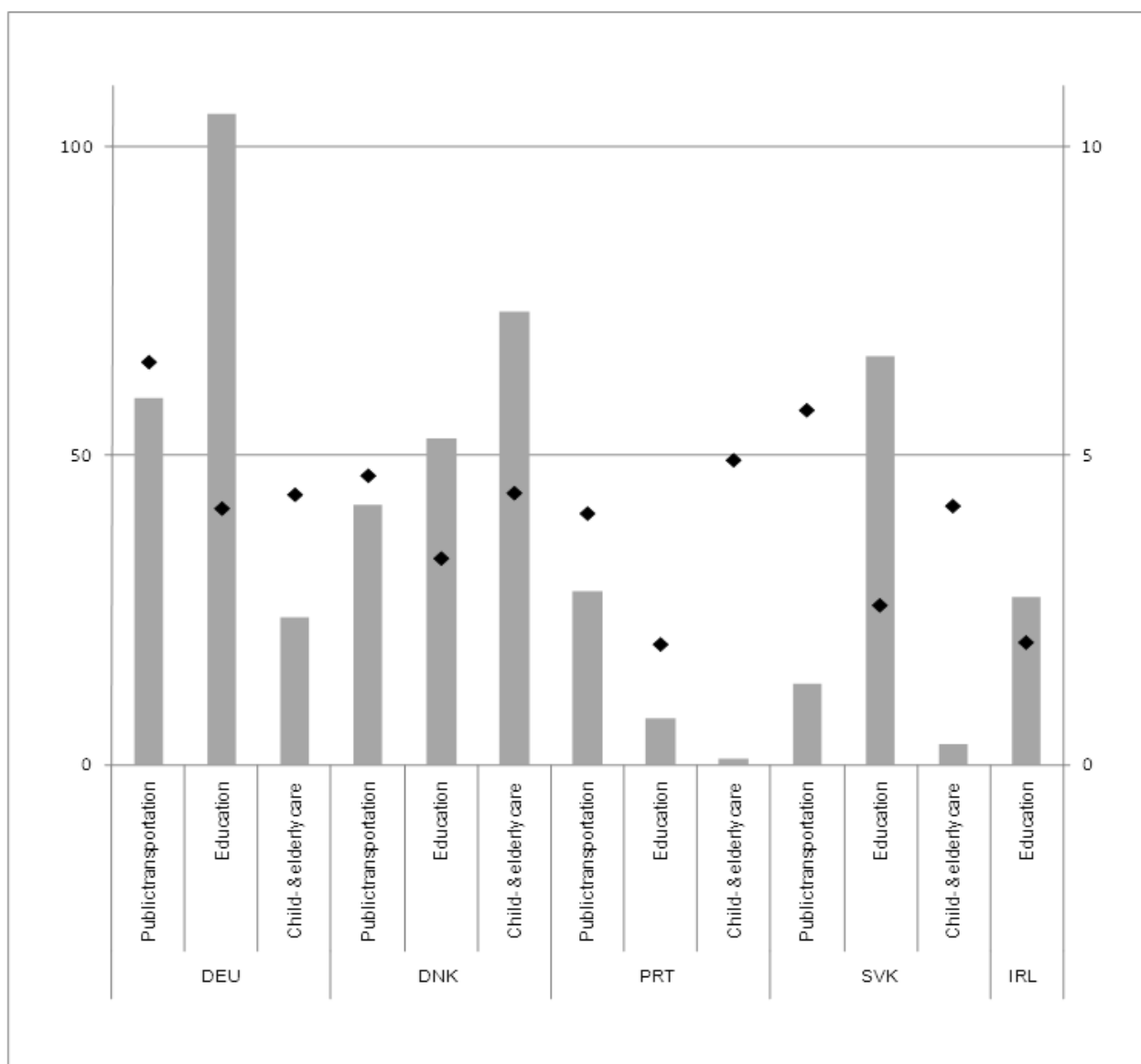
140. Assigning spending responsibilities to sub-national governments is not enough to assure effective allocation efficiency. Indeed, sub-national spending might be strongly influenced by upper levels of government, thereby reducing their discretion over their spending, thus reducing their ability to allocate

resources where they are most efficient at the local level. The commonly used measure of the relative share of sub-national spending to total government spending (figure 3) does not take this factor into account. It would therefore be useful to have a set of indicators of sub-national spending power autonomy, in order to assess how decentralisation affects policy outcomes like public sector efficiency or the long-term fiscal stability.

141. There is no set of internationally comparable indicators of spending power (defined as the extent of control sub-national governments exert over their budget), except for very recent studies by the OECD. In particular, the OECD Network on Fiscal Relations across Levels of Government has recently done a pilot study on sub-national spending power indicators, by sending questionnaires to a sample of countries in the summer 2007 and spring 2008, focusing on four specific policy areas: education, public transport, childcare and elderly care (OECD 2008/8).

142. The term “spending power” was defined for this study as the “ability of sub-national governments to shape, determine and change their spending policy”, which means: to what extent do they set the rules and regulations that govern the services they provide? These rules and regulations were grouped into five categories: policy autonomy (are sub-national governments obliged to provide certain services?), budget autonomy (is expenditure autonomy limited by earmarked grants or expenditure limits?), input autonomy (staff management, salaries, right to tender or contract out services), output autonomy (standards setting for quality and quantity of goods provided) and monitoring and evaluation (to what extent do sub-national governments exert control over evaluation, monitoring and benchmarking?).

Figure 4. Comparing sub-national government expenditure ratios and sub-national government spending power indicators



Note: Bars and the left hand scale represent SCG expenditure shares in percent, dots and the right hand scale represent spending power indicators. The spending power indicator for "public transportation" is compared to the expenditure ratio for "economic affairs". The spending power indicator for (primary and secondary) "education" is compared to the expenditure ratio for "education". The mean of the spending power indicators for "child- and elderly care" is compared to the expenditure ratio for "social protection". Switzerland is not represented due to lack of COFOG I data. National Accounts data are unconsolidated.

Source: OECD (WP 2008/8).

143. Figure 4 compares the spending power indicators with the expenditure shares in the corresponding policy areas. It supports the thesis that simple expenditure ratios often poorly reflect effective sub-national spending power: whereas expenditure ratios frequently exceed 50%, the corresponding spending power indicator is rarely above the value of 5 (on a scale of 10), indicating that sub-national spending power is more limited than expenditure share suggest.

144. The conclusions of this preliminary study are the following:

- *Spending power indicators show relatively low sub-national government spending autonomy:* much sub-national spending is regulated or otherwise influenced by central government, and simple expenditure shares tend to overestimate actual sub-central spending autonomy;
- *Spending power is particularly low in education,* even though sub-national government spending share in this area is very large (above 50%);
- *Federal countries grant more power than unitary countries,* but the potential efficiency gains from this larger autonomy might be mitigated by the fact that they also have more overlapping responsibilities.

2. Determining the size and type of revenues for sub-national governments

145. Financing public service delivery is also a shared responsibility between levels of government. Sub-national governments have two main sources of funds: own taxes and transfers. Each of these types of revenues has different implications on the efficiency, equity and stability objectives, and therefore, the sub-national revenue mix will affect the final outcomes. In this section, we analyse the theoretical views of which taxes should be attributed to sub-national governments and which should be collected by central governments, and finally, what is the optimal level of discretion of sub-national governments over these resources (control over the tax rates and the tax base). Each time, we will confront these general principles with the actual practice in OECD countries.

a) Revenue structure of sub-national governments: taxes vs. grants

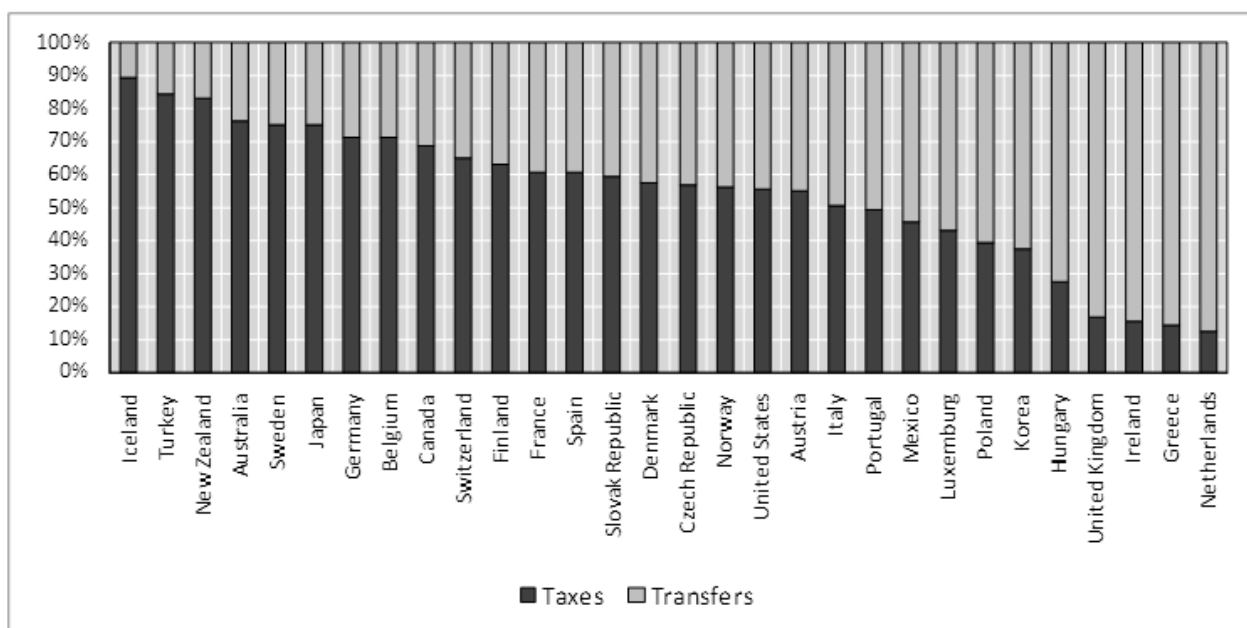
146. The “Fiscal gap” (the difference between sub-national governments expenditures and revenues) can be quite large in some countries, and several OECD reports show that this vertical imbalance has widened during the last decade (OECD 2008/5). As this vertical imbalance is mostly covered by grants, the reliance of sub-national governments towards grants has increased. What implications does this have on the efficiency, equity and stability objectives?

147. The mainstream view is that sub-national governments spending should essentially be covered by own tax revenues. Indeed, own taxes improve resource allocation and management efficiency, as citizens will put more pressure on sub-national governments to be more efficiency oriented and more responsive to their tastes and preferences when they actually pay for the goods and services provided. For efficiency considerations, the last dollar of spending should be financed by own-tax, so that citizens only demand an extra service if they value it at more than the cost of providing it. Own taxes are also considered to promote democratic accountability, since those that benefit from public services decide on taxation levels and finally pay the bill. Finally, a high reliance on own-resource revenues provides sub-national governments with incentives to growth-oriented economic and fiscal policies, since they may fully reap their financial benefits.

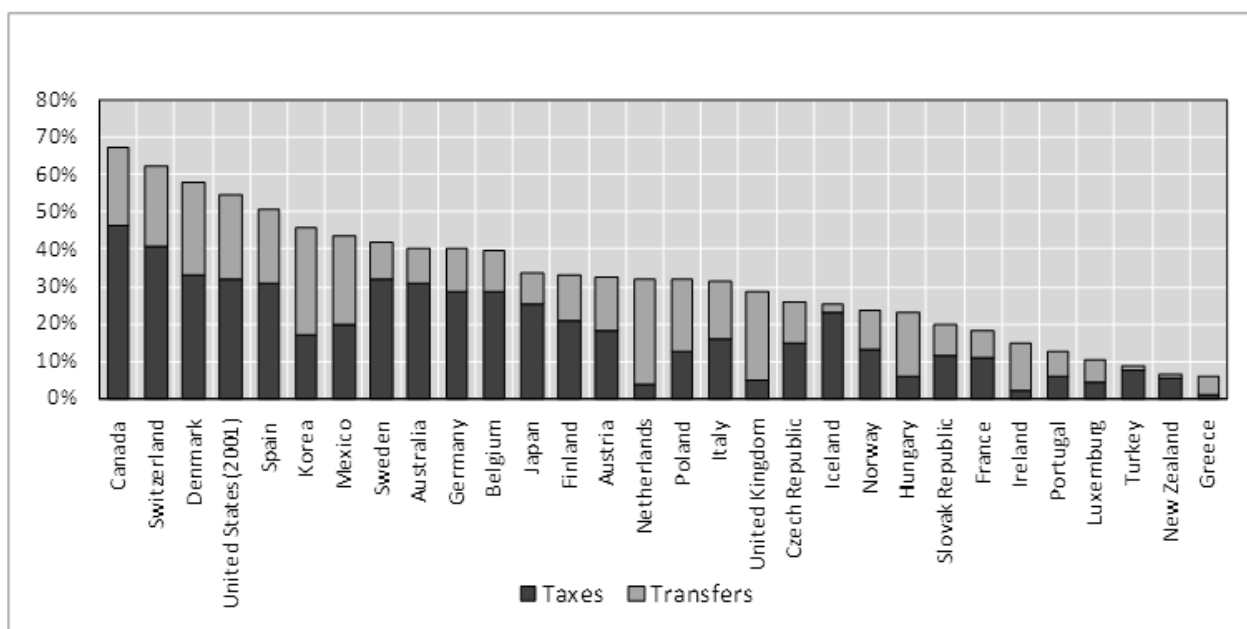
148. But figure 5 below shows that on average, only about half of sub-national government revenue is covered by own taxes, the other half being covered by intergovernmental grants. Of course, this average hides a large variation, with own tax revenues representing up to 90% of sub-national governments revenues in Iceland, and as little as 13% in the Netherlands. In general terms, federal countries tend to allocate a slightly higher own tax share to their sub-national governments than unitary countries.

Figure 5. Revenue composition of sub-national government, 2005

In percentage of total sub-national government revenue



In percentage of general government revenue



Source: OECD (2008/5).

b) Which taxes for sub-national governments?

149. It is generally agreed that sub-national governments should rely on taxes levied on relatively immobile assets (such as property), in order to avoid tax-induced migrations of factors of production, and on relatively stable assets, to avoid large sub-national government's budget fluctuation. Therefore, central governments are usually assigned the taxes levied on the most mobile factors, taxes with the higher income elasticity, and taxes levied on tax bases that are distributed unevenly across countries (Ter-Minassian, 1997). According to these criteria, income taxes on enterprises should be assigned to central government, while taxes on individuals and households (such as income taxes or property taxes) are more suited for sub-national governments, as these are seen as less mobile than enterprises. Taxes on natural resources and on foreign trade are usually assigned to central governments, as well as multi-stage sales taxes (such as VAT), as coordination problems between regions would make their management very difficult for sub-national governments.

150. Table 1 below shows that indeed, income taxes on individuals represent the largest share of sub-national governments' tax revenues, with more than 35% on average. The second largest taxes are taxes on property, with 27%, and third come taxes on goods and services, which represent 21% of total sub-national governments' tax revenues.

Table 1. Composition of sub-national governments' own taxes

Type of tax	As % of total SNG taxes
1000 Taxes on income, profits and capital gains	41.7
1100 Of individual	35.5
1200 Corporate	5.9
1300 Unallocable between 1100 and 1200	0.3
2000 Social security contributions	0.3
3000 Taxes on payroll and workforce	3.3
4000 Taxes on property	27.3
5000 Taxes on goods and services	21.4
6000 Other taxes	5.9

Note: Unweighted average. Countries included are: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Iceland, Italy, Japan, Korea, Mexico, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and Turkey.
Source: OECD (2006).

c) Tax autonomy

151. For most countries, taxes represent the largest share of sub-national government revenues, but what is the actual discretion of sub-national governments over this source of revenues? What is sub-national governments' right to introduce or abolish a new tax, to set tax rates, to define the tax base, or to grant tax allowances or reliefs to individuals and firms? The OECD has developed a series of indicators to measure the level of sub-national governments' tax autonomy (OECD, WP 2006,2; 2008/7).

152. Taxing power indicators developed by the OECD measure the degree of own-taxing power of sub-national governments by capturing the degree to which sub-national governments can set their own tax rates and bases. In a number of countries, taxes are not assigned to one specific government level, but shared between the central and sub-national governments. Such tax-sharing agreements deny a single sub-national government any control on tax rates and bases, but collectively, sub-national governments may negotiate the sharing formula with central government. The OECD Network on Fiscal Relations across Levels of Government has developed a set of institutional indicators to estimate tax autonomy. The framework consists of five main categories of autonomy, ranked in decreasing order from highest to lowest taxing power (from left to right in table 2). The category “a” represents full power over tax rates and bases, “b” represents power over tax rates, “c” power over the tax base, “d” tax-sharing agreements, and “e” no power on rates and bases at all. Each of these categories is again divided into sub-categories up to a total of 13 different categories.

153. The average results are presented in table 2, for the year 2005 (country data is available in Annex 1). They show that although tax autonomy varies widely across countries, most sub-national governments have considerable discretion over their own taxes: on average, the tax revenue share with full or partial discretion (categories a, b and c) amount to more than 50% for state and almost 70% for local governments.

Table 2. Summary of taxing power of sub-national governments, 2005

Unweighted average	SNG tax revenue		As share of SNG tax revenues										
	as % of GDP	as % of total tax revenue	Discretion on rates and reliefs	Discretion on rates		Discretion on reliefs	Tax-sharing arrangements Revenue split set:				Rates and reliefs set by CG	Other	Total
				Full	Restric ted		by SNG	with SNG consent	by CG, pluriannual	by CG, annual			
			(a)	(b1)	(b2)	(c)	(d1)	(d2)	(d3)	(d4)	(e)	(f)	
State	6.9	19.8	45.3	0.3	8.2	-	-	19.9	18.4	4.7	1.8	1.4	100
Local governments	4.5	11.8	14.6	22.5	31.5	0.3	-	2.9	16.4	0.8	6.0	5.0	100

Source: OECD (2008/7).

154. The data of tax autonomy by tax type reveals that autonomy varies according to the tax type, in both levels of sub-national government (state and local). Property taxes are usually assigned more discretion than other taxes, with almost all tax revenue in category a and b. Around a quarter of income tax revenue is embedded in tax-sharing systems, which restrict a single sub-national government’s control over this tax. Taxes on goods and services are even more embedded in tax-sharing arrangements than income taxes, and so provide a relatively small part of the tax revenues under the full control of sub-national governments (OECD 2008/7).

155. Tax-sharing arrangements are something of a hybrid between decentralized and centralized revenue sources for sub-national governments and in practice, are difficult to distinguish from grants.²⁴ Tax-sharing formulas are not simply a division of revenues, but can involve complex formulas that are similar to grant formulas. Equally, intergovernmental grants are sometimes little more than a share of national taxes. The National Accounts and Revenue Statistics provide some guidelines, but it is entirely possible that reported tax-sharing in one country would be reported grants in another. In terms of their

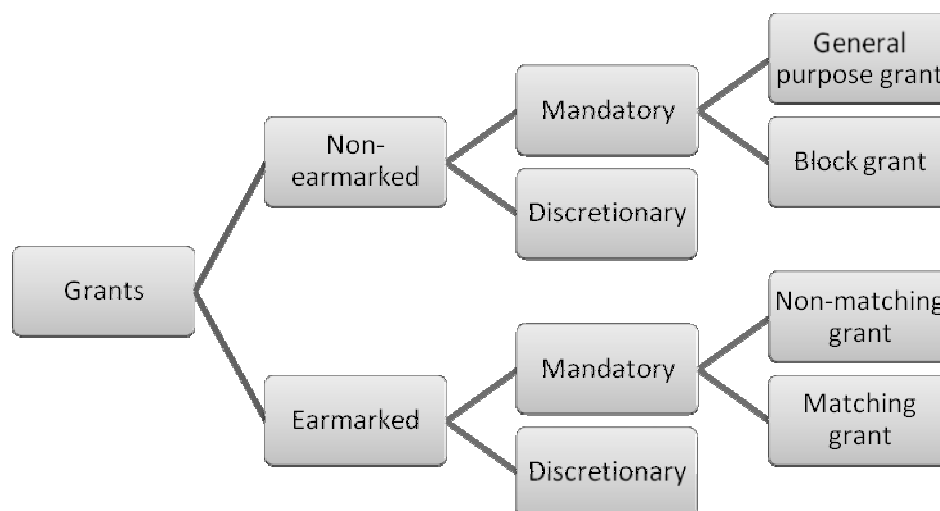
²⁴ See OECD (WP 2006/2) and OECD (2008/7) for some attempts to draw a line between grants and tax-sharing agreements.

economic effects, tax-sharing arrangements are almost indistinguishable from grants. Since sub-national governments do not set the rate or base, countries with tax-sharing arrangements cannot take full advantage of one of the main benefit of decentralisation, the offering different public service-tax packages to satisfy diverse tastes. But on the other hand, the pooling of taxes tackles potential drawbacks of local taxation, such as mobility of the tax base. Fiscal equalisation elements, which are often built into tax-sharing arrangements, suffer from the same incentive difficulties as equalizing and formula-based grants, which are discussed below.

d) Intergovernmental Grants

156. Intergovernmental grants respond to three types of objectives:

- **Financing sub-national services and investments:** As we have seen in figure 1, in most countries, spending by sub-national governments is larger than their revenues. Grants are therefore used to fill the gap between sub-national governments' revenues and spending responsibilities.
- **Equalisation:** While taxes are preferable to grants in terms of efficiency and accountability, a high reliance on own tax revenues for sub-national governments might raise equity concerns. Indeed, tax raising capacity is usually unevenly distributed across sub national governments, which could lead to different levels of public service delivery across regions or to different levels of tax burdens on citizens. Equity concerns might then arise, and the central government might prefer sub-national governments to provide the same basic bundle of services with roughly the same tax effort. Intergovernmental "equalisation" grants are then used to redistribute wealth from richer to poorer regions.
- **Correcting externalities (subsidisation):** Grants can also be used to correct potential fiscal externalities or "spillovers". Such externalities arise when the fiscal policy of one sub national government affects outcomes in other sub national governments. Grants (mainly matching grants) are then used to change the price of providing public goods, in order to internalize the externality.

Box 1. A typology of grants**Earmarked and non-earmarked grants**

Grants can be either earmarked or non-earmarked. An earmarked grant is a grant that is given under the condition that it can only be used for a specific purpose. Non-earmarked grants can be spent as if they were receiving sub-national government's own (non-earmarked) tax revenues.

Mandatory and discretionary grants

Both earmarked and non-earmarked grants can be either mandatory or discretionary. Mandatory grants (entitlements) are legal, rules-based obligations for the government that issues the grant. This requires that both the size of the grant and the conditions under which it is given be laid down in a statute or executive decree and that these conditions be both necessary and sufficient. Typically, sub-national governments can also appeal to a court or administrative judicial authority in order to obtain the grant. Most grants that are given to sub-national governments on a regular basis are mandatory. The size of discretionary grants, and the conditions under which they are given, are on the other hand not determined by rules but decided on an *ad hoc*, discretionary basis. Discretionary grants are often temporary in nature and include, for example, grants for specific infrastructural projects of emergency aid to a disaster area.

Matching and non-matching grants

Earmarked mandatory grants can be either matching or non-matching. Matching grants complement sub-national contributions. Matching grants are dependent on normative or actual spending for services for which the grants are earmarked, or on local revenue collection related to these services. All mandatory earmarked grants that are not given complementary to sub-national contributions are non-matching. The decisive question to determine whether a grant is matching or non-matching is whether the decrease in sub-national spending would automatically lead to a decrease in the grant.

General purpose and block grants

Non-earmarked mandatory transfers can be general purpose or block grants. Both types are similar in that they increase the sub-national governments' revenues without changing relative prices in the provision of services. The difference is that a block grant is given by the grantor for a specific purpose (or purposes). However, since the grant is not earmarked, the grantee's actual use of the grant is not controlled. Instead, the output could be regulated through, for example, a set minimum standard that the sub-national government would have to provide. In this case, resources are transferred in the form of a grant to the sub-national government to cover all or part of the cost for certain sub-national services. The criteria used to calculate the level and distribution of the grant are usually connected to the normative cost of providing the goods or services for the sector as a whole, using variables that a specific sub-national government cannot directly control. The rationale for this type of grant is to improve efficiency in the use of resources at sub-national level, whereas

the activity is financed, in part or fully, by the central government. If a sub-national unit is able to perform the activity at lower than normative costs, the grant will not be reduced for that unit as a consequence, thereby giving the sub-national government an incentive to fully explore the advantages of decentralised service provision. This kind of grant can be a means of moving away from earmarked grants.

Source: Bergvall et alii (2006)

i. Financing sub-national services

157. On average, earmarked transfers constitute about half of grants for both the state and the local level of government (table 3; country information is presented in Annex 2). These average numbers hide a very large variation across countries, with earmarked grants representing as much as 94% in Australia, and as low as 17.6% in Spain (OECD, 2008/5). Table 3 also shows that most earmarked grants are matching, both at state and local government levels.

Table 3. Average grant revenue by type of grant, 2006

As a percentage of total grant revenue

Unweighted average	Earmarked				Non-earmarked		
	Mandatory		Discretionary		Mandatory		Discretionary
	Matching	Non-matching	Matching	Non-matching	General purpose	Block grants	
State	18.8	13.7	8.5	9.3	48.2	0.2	1.1
Local	27.7	5.6	3.0	16.3	39.3	3.0	3.0

Source: OECD (2008/5)

158. Functions financed by grants vary significantly between countries (Table 4). On average, the most important functions are education (21%), general public services (17.4%) and social protection (16.7%), but these averages hide a large variation between countries, with education representing only 7.5% of grants in Hungary for instance, and more than 60% in Mexico.

Table 4. Grants by government function, 2006

In percent of total earmarked grants

	Defence	Economic affairs	Education	Environment protection	General public services	Health	Housing and community amenities	Public order and safety	Recreation, culture, religion	Social protection	Total
Australia	-	14.9	36.5	-	-	37.1	3.6	0.2	0.0	7.8	100.0
Austria	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Belgium	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Canada	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Czech Republic	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Denmark	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
France	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Germany	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Greece	-	22.4	-	6.3	43.1	-	6.1	-	7.9	14.2	100.0
Hungary	0.1	3.8	7.5	7.3	18.8	4.4	32.6	-	5.7	19.7	100.0
Iceland	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Ireland	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Italy	-	46.9	8.1	2.8	12.4	27.0	2.9	-	-	-	100.0
Japan	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Korea	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Luxembourg	-	2.2	7.0	0.5	72.8	-	6.0	0.5	6.3	4.8	100.0
Mexico	-	-	63.8	1.8	5.7	10.3	-	8.7	-	9.6	100.0
Netherlands	-	0.6	12.7	10.1	3.4	-	6.0	0.1	9.3	57.7	100.0
New Zealand	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Norway	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Poland	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Portugal	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Slovak Republic	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Spain	-	28.9	16.3	-	23.9	5.2	3.9	7.9	0.5	13.2	100.0
Sweden	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
Switzerland	0.4	51.3	13.1	2.7	-	0.0	-	1.0	0.2	31.3	100.0
Turkey	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
United Kingdom	-	-	55.6	-	-	3.9	22.2	-	-	18.3	100.0
United States ¹	0.8	3.6	10.4	1.1	11.0	48.9	11.7	1.1	-	6.5	95.1
<i>Unweighted average</i>	0.1	15.9	21.0	3.0	17.4	12.4	8.6	1.8	2.7	16.7	99.5

1) Not including the heading "Other grants" that could be classified in one of the above categories.

Source: OECD (2008/7)

ii. Fiscal equalization

159. One of the most important roles of intergovernmental grants is to reduce differences in tax raising capacity and public service needs across sub national governments. Most countries have introduced explicit or implicit equalization systems using either vertical transfers to financially weak sub-national governments, or horizontal transfers from financially strong to financially weak sub-national governments (Blochliger and Charbit, 2008). Fiscal equalization is defined as “a transfer of fiscal resources across sub national governments with the aim of offsetting differences in revenue raising capacity or public service cost. Its principal objective is to allow sub-central governments to provide their citizens with similar sets of public services at a similar tax burden” (OECD, 2007/4). Box 2 below describes the main reasons for equalization.

Box 2. Main reasons for equalisation**EQUITY**

To equalise per capita tax revenue raising capacity and the per-beneficiary cost of providing public goods and services across regions. Tax raising capacity per capita and cost of providing public services can differ across regions for geographic or socio-economic reasons. The objective of equalisation is to provide every citizen with an average level of public services at comparable tax rates.

To equalise the marginal benefit of public spending across regions. OECD countries that have central government programs for important public services (such as health and education) administered by sub-central governments, may use equalising transfers to equalise the marginal social benefit of public spending across regions.

EXTERNALITIES

To avoid fiscal externalities resulting in a misallocation of labour and/or capital across regions. A decentralised fiscal system could distort the location decision of mobile factors. Unequal tax bases result in pecuniary incentives to locate in high tax base regions, thereby distorting location decisions of mobile factors of production. Grants that equalize tax bases across regions will eliminate this source of inefficiency.

INSURANCE

To provide insurance against asymmetric income or employment shocks. If the regions of a country are subject to asymmetric shocks, redistributive grants may provide regions with insurance against the adverse effects of such shocks on income or employment.

In all countries, the driving force for equalisation is equity, i.e. having similar tax raising capacity and equal access to public services across sub national governments.

Source: OECD (WP 2007/4)

160. On average, equalisation represents 2.3% of GDP (table 5), but ranges from 0.5% in Australia and Norway, to 4% in Japan. It represents on average 4.8% of total government expenditures, and about 55% of intergovernmental grants. All grants do not have an equalisation objective. Are considered equalisation grant only those fiscal arrangements that provide greater transfers per resident to sub-national governments with below-average tax revenue-raising capacity, or greater transfers per resident to sub-national governments with above-average public service cost, even though this last distinction proved difficult for some countries (OECD, WP 2007/4). The coefficient of variation gives a picture of regional disparities. It measures the variability of GDP per capita per region in a given country. Table X shows that fiscal equalisation considerably reduces disparities, from an average of 30% to less than 10%. In some countries, such as Australia and Sweden, disparities are actually reduced to zero. After equalisation, fiscal disparities are clearly below economic disparities as measured by regional GDP, meaning that the potential to provide public services is more evenly distributed than economic wealth (OECD, 2007).

Table 5. A snapshot of fiscal equalisation

Equalising grants and their fiscal disparity-reducing effect

	Size of the equalisation system (in percent)			Effect on fiscal disparities (variation coefficient)		
	Percent of GDP	Percent of government expenditure	Percent of intergovernmental grants	Disparities before equalisation	Disparities after equalisation	Difference
Federal/regional countries						
Australia	0.5	1.4	19	16.8	0.0	16
Austria	3.8	7.6	69	-	4.2	
Canada	1.0	2.5	24	29.8	20.1	9
Germany	2.0	4.2	45	13.0	2.7	10
Italy	3.0	6.3	48	39.0	6.0	33
Mexico	3.7	-	78	-	-	
Spain	3.0	7.6	67	26.5	10.1	16
Switzerland	3.0	8.2	80	31.8	23.2	8
Unitary countries						
Denmark	2.8	5.1	23	16.0	6.0	10
Finland	3.8	7.4	71	17.7	4.2	13
Greece	1.2	2.4	75	-	-	
Japan	4.0	11.0	-	36.0	-	
Norway	0.5	1.2	11	23.0	8.0	15
Portugal	1.8	4.0	81	90.0	28.0	62
Sweden	2.6	4.6	50	10.0	0.0	10
Turkey	1.1	-	82	39.0	14.0	25
Unweighted average	2.3	4.8	55	29.9	9.7	19

Source: OECD (2006)

161. Equalisation thus seems to improve equity. Nevertheless, equalisation also has some drawbacks.

- On the revenue equalisation side, equalisation can have negative incentives on a sub national government's tax efforts. Indeed, for richer sub national governments, an increased tax effort will be equalised away, as a share of the extra revenues will be transferred to poorer sub national governments. The higher the equalisation tax rate²⁵, the bigger the incentives for strategic tax rate setting (such as avoiding taxes that enter the equalisation formula, etc.). Besides, by guaranteeing a minimum fiscal capacity to all sub-national governments, equalisation might deter poorer regions from developing their economic and fiscal base. Possible solutions are to include only part of sub-national governments' tax revenues in the equalisation formula, or to base equalisation on other criteria than fiscal revenues, such as the regional development programmes in Italy, where a part of investment support is linked to a region's performance in selected policy areas (OECD, WP 2007/4).
- Cost equalisation tends to be rather complex and difficult to manage. Indeed, the cost of services varies across regions due to a number of different factors: geographic location, population size and concentration, demographic characteristics, etc. Objective criteria must be selected to explain cost differences, and cost equalisation schemes easily open the door to rent seeking and potential over estimation of expenditure needs, and therefore, of equalisation payments (see boxes 3 and 4 for the Austrian and Japanese experiences). Indeed, if there can be objective reasons for production costs to be higher in certain regions than in others, these differences might also be due to inefficient structures and institutions. In the long run, a compensation for higher costs might therefore reduce service providers' interest in developing cost-saving technologies.

Box 3. Equalisation tax rates in Austria

Some Austrian municipalities with weak fiscal capacity face equalisation tax rates exceeding 100 percent. The comprehensive and complex Austrian fiscal equalisation is embedded in a tax-sharing system that covers both the state and the municipal level. Shared taxes are distributed across the *Länder* according to population mainly and a factor representing tax shares of the past, and to the municipalities according to various criteria such as fiscal capacity, expenditure needs and a scale factor favouring larger municipalities. Altogether five distinct equalisation schemes govern the allocation of the equalisation grant to the individual municipality, each with different tax and expenditure bases. As the equalisation formulas interact, a municipality's overall loss in equalisation grants may in some cases be greater than its gain in additional tax revenue resulting from development efforts. Since the disincentive is larger for poorer than for wealthier municipalities, and since policy makers at the *Länder* level tend to favour development in municipalities with a low equalisation tax rate (Schneider, 2002), Austrian municipal equalisation may in the long run exacerbate.

Source: OECD (WP, 2007/4)

Box 4. Service capacity equalisation in Japan

Sub-national authorities should not be able to influence the criteria for service cost equalisation. This requirement is not entirely met in Japan, where at least part of the borrowing by sub-national governments (and consequently the worsening of Japanese public finances) can be ascribed to the fact that road construction volumes and interest payments are important distribution criteria for the non-earmarked grant (the LAT, local allocation tax). Each of these criteria creates an incentive for Japanese prefectures to borrow and overspend on roads. Other OECD member countries where road construction volumes constitute an important distribution criterion for the equalisation grant are Portugal, the Slovak Republic and Denmark. In the latter country, the number of local road kilometres was a criterion for the need for road spending during the 1980s. Local authorities then began to turn small, private dirt roads into public roads. This led to much more equalisation compensation than the costs of maintaining the dirt roads (which only involved a truck and some gravel every second or third year). The criterion was later abandoned. The reason for the wrong incentives is that the

²⁵ The concept of "marginal equalisation rate" (or "equalisation tax", "tax back" or "compensation rate") is defined as the amount of money a sub-national government loses (wins) if it increases (decreases) its own tax revenue by 100 monetary units).

grants do not equalise service capacity (the need for roads or borrowing) but the actual level of road construction or borrowing.

Source: OECD (WP, 2007/4)

iii. Correcting externalities

162. Fiscal externalities arise when the fiscal policy of one sub national government affects outcomes in other sub national governments. In these cases, sub-national governments do not take into consideration the full social effect of their decisions, as they only consider the impact on their own constituents²⁶. Externalities may arise on the spending side, for example, when one sub national government finances public infrastructure that will also benefit the residents of neighboring sub national governments. Or they can arise on the revenue side (tax externalities), when a sub-national government's tax policy affects the residents of other regions, for example, by tax exporting (trying to have non-residents paying local and regional taxes) or by tax competition (lowering the tax rate to attract firms). Grants can be used to correct for these externalities. Matching grants are often used to compensate local authorities for the extent of benefit spillovers across administrative boundaries. By lowering the cost of the public good (as they complement sub-national governments spending, sub-national governments only face part of the cost of providing the good or service), they give incentives to the sub-national government to provide higher levels of public services to non-residents. Still, an OECD study (OECD, 2008/5) has shown that the real scope for externality correction is rather limited, and probably much smaller than the size of the matching grants created to correct them. Thus, it seems that the size and structure of grants, and particularly matching grants, depend more on political economy factors rather than purely fiscal considerations.

163. But regional spillovers are not necessarily handled through grants: other possible ways to solve regional spillover problems are to increase the size of sub-national governments, or to charge non-residents a differentiated rate for the use of services²⁷. Some OECD countries have also used inter-municipal fiscal contracts. Voluntary contracts are preferable, but often difficult to put in place, because sub national governments that benefit from positive spillover effects might be tempted to free-ride, and avoid paying the costs. Grants can then be designed to encourage cooperation between sub-national units of government, as the EU LEADER Programme (*Liaison Entre Activités du Développement de l'Economie Rurale*), which aims at bringing an integrative approach to rural development. It attempts to use subsidies to encourage public-private and intergovernmental cooperation through innovative multi-sector projects. France has also an interesting program of inter-municipal cooperation (Box 5).

Box 5. French support for co-operation

Inter-municipal co-operation has been and remains an important element of most national programmes. This is especially true in France where there are more than 36 000 municipalities and where mergers are resisted by local politicians and citizens and are not promoted by the central government. In order to increase the scale of local service provision, the French authorities have favoured the use of incentives to encourage co-operation. These incentives were systematised in 1999 with central support for "structures à fiscalité propre" (inter-municipal structures with their own tax), even if other types of inter-municipal structures remain. The principle is the following: the inter-municipal bodies continue to be voluntary structures; the parent communes have 10 years to progressively converge towards the same business tax rate (the most important local tax) and the "losers" in this converging process receive compensatory payments; the tax rate is decided by the inter-municipal body which will also directly receive the tax revenue. In order to stimulate local authorities to

²⁶ Sub-national governments do not fully perceive the social marginal costs and benefits of their taxing and spending decisions.

²⁷ This of course requires excludability, i.e. that it be possible to prevent people from using the service if they do not pay for it (some public goods such as public lightning are not excludable: once they are provided, everybody can enjoy them).

participate in these structures, the French government pays a supplementary grant to the EPCI (*établissements publics de coopération intercommunale*) in addition to the general purpose grant to all sub-national levels, the DGF (*dotation globale de fonctionnement*). This supplement is called the "*dotation d'intercommunalité*" (intermunicipal grant), and its size depends upon the type of EPCI. Six years after the launch of this new programme, 84% of the French population lives in an area covered by an EPCI with its own tax revenue (88% of French municipalities are located in these areas).

Source: OECD (WP 2006/3)

3. Managing macroeconomic stability: fiscal rules

164. Decentralising expenditure capacity to lower levels of government can have positive effects on efficiency, as local governments are more aware of local needs and tastes than central governments. But this can also undermine global macroeconomic stability, as sub-national governments do not always take into account the effect of their fiscal decisions on the rest of the country on the one hand, and might even have incentives to overspend on the other hand. Fiscal rules are therefore needed, in order to reduce this possible risk. Fiscal rules are defined as a set of institutional constraints on policymakers' decision-making discretion. Such rules may be imposed on sub-national governments by a higher level of government, or sub-national governments may adopt them themselves, where constitutional arrangements grant them the autonomy to do so (OECD, WP 2006/1).

165. We have shown that the increase in sub-national governments spending responsibilities has been larger than the increases in their tax autonomy. Sub-national governments do not bear the whole costs of the public goods and services they are responsible for, thus creating incentives for overspending. If sub-national governments are allowed to borrow on capital markets, they might face interest rates that do not fully reflect their credit risk (as lenders perceive that their borrowing is implicitly guaranteed by central government), thus leading to possible over-borrowing. If investors anticipate a bailout in case of default by a sub-national government, fiscal decisions of one sub-national government will impact on the borrowing costs of the other sub-national governments and of the central government, reflecting a higher overall risk of default. Sound sub-national governments fiscal policies are therefore crucial for the macroeconomic stability of the whole country. Four types of rules can be used to support fiscal sustainability and short-term stability: balanced budget requirements, borrowing constraints, tax and expenditure limits (TEL) and process and implementation regulations.

- *Balanced budget requirements* in OECD countries vary according to whether they are applied to the current budget and/or the capital account (balanced budget requirement applied only to the current budget, thus allowing borrowing to finance net investments is usually referred to as the "golden rule" of public finance); whether they are set annually or multi-annually; and whether they are imposed from above or self-imposed. Most commonly, balanced budget requirements are applied to current and capital budgets, are set annually, and are imposed from above.
- *Borrowing constraints* are widely used in OECD countries, but with a substantial variation in terms of restrictiveness. They range from total prohibition (Denmark and Korea) to no restriction at all. In most cases, sub-national government borrowing requires prior approval by higher levels of government, and is often restricted to certain purposes (such as investment). Box 6 gives some examples of borrowing constraints in OECD countries.
- *Tax and expenditure limits*. Overall limits on tax rates or reliefs are widely used in OECD countries, and usually take the form of an explicit limit on tax autonomy set by central government (see table 2). Expenditure increase limits are usually linked to income, inflation or population growth. But explicit, binding, expenditure limits are rather rare (they exist only in Germany, Korea, Portugal and Turkey). In some countries such as Japan, the Netherlands, Poland and Spain, expenditure limits are not imposed by central government, but self imposed.

- *Process rules* that govern implementation will determine the degree of commitment of sub-national governments to the set of rules described above (indeed, without a proper commitment mechanism, sub-national governments could either ignore, or change the rules binding their autonomy). Process rules include the obligation to produce financial accounts (transparency), monitoring and reporting, and eventual sanctions in case of non compliance. But process rules should also allow for flexibility of response, as breaking the fiscal rules might be the appropriate response to an unanticipated shock such as large revenue shocks, downturns in the local economy, the impact of natural or other disaster, etc. This is why many countries incorporate escape clauses that allow sub-national governments to breach the rule in case of certain predetermined events.

Box 6. Examples of borrowing constraints in OECD countries

Borrowing constraints cover a range of restrictions on sub-central government recourse to debt financing. With the exceptions of Australia, Canada, Spain (states) and Switzerland, a higher level of government typically imposes these constraints (Table 2, Panel A).²⁸ In the most restrictive cases, borrowing may not be allowed at all (as in Denmark, or in Korea and Spain for current expenditure). In Poland, no borrowing is allowed if general government debt levels exceed 60% of GDP. The requirement of prior approval from higher levels of government is also quite widespread, including permission to borrow in foreign currency as in Mexico and Turkey. The need for prior approval on a project-by-project basis is gradually being relaxed in OECD countries, such as Mexico which abandoned such a system in 2000. In Japan and Korea the formal requirement to obtain permission from a higher level of government is being relaxed. In Norway and Spain, prior authorisation can be imposed when sub-central governments breach agreed deficits or the proposed borrowing is substantial. In Belgium, in large part due to complicated inter-governmental relations, there are no explicit sanctions for breaching consensual targets set by the *Conseil Supérieur des Finances* (CSF) for each local government and local government as a whole. However, legislation permits the federal government to limit borrowing by non-compliant regions for two years.²⁹ A few countries apply limits on borrowing for specific purposes. For example, in Spain, local authorities can borrow up to 30 per cent of current revenues to cover short-term liquidity needs, while long-term borrowing is restricted to capital investment. No constraints on access to borrowing are applied in the Czech Republic, Finland, the Netherlands, and Japan. In interpreting this information, it should be kept in mind that strict budget balance requirements (see Table 1) may also have the effect of outlawing in practice the need for borrowing constraints.

Source: OECD WP 2006/1

166. The need for fiscal rules is influenced by three factors: expenditure assignments, revenue assignments and financial market oversight.

- *Expenditure assignment.* Fiscal rules are particularly important when sub-national governments are responsible for large and politically sensitive areas such as health, education or social welfare, as it may then be difficult for central governments to resist bailing out deficit-prone sub-national governments. However, fiscal rules limiting sub-national governments' spending autonomy must not reintroduce central direction, which would then undermine the benefits from decentralising spending decisions.
- *Revenue assignment* (the extent and sources of sub-national governments' income) also affect the need for fiscal rules: the more sub-national governments depend on transfers, the more fiscal rules (such as borrowing constraints) are needed to compensate for the lack of matching between the benefits from spending, and the weight from financing these expenditures. For those sub-national governments with higher tax autonomy, tax competition can be a positive factor in keeping deficits small without the need for fiscal rules.

28. In Germany, the *Länders'* access to borrowing is almost totally unconstrained. Technically, there is a provision to limit borrowing to prevent major macroeconomic disturbances, but this has never been invoked.

29. Maintaining limits on deficits was important due to the vertical fiscal gap that opened during the process of decentralisation. More recently, as greater revenue sources have been assigned to sub-central governments, macroeconomic considerations would suggest they target minimum surpluses.

- Finally, *financial market oversight* might substitute for other monitoring mechanisms by imposing higher borrowing costs to profligate sub-national governments. However, this market discipline requires that central governments credibly commit not to bailout defaulting sub-national governments. Besides, the adoption of fiscal rules limiting their deficit and debt levels may still be used by sub-national governments as signals of fiscal discipline in order to obtain lower interest rates.

167. Depending on their expenditure assignment, revenue assignments, and the importance of financial market oversight, each country has developed its own set of fiscal rules. Box 7 below describes the particular case of Switzerland.

Box 7. Fiscal rules in Switzerland

Switzerland is a highly decentralised federal country, where the cantons are autonomous in all the spheres of competences where the confederation is not authorised by the constitution. This constrains the ability of central government to impose fiscal rules on sub-central governments (and as a result the confederation can face difficulties in conducting counter-cyclical fiscal policy). The confederation changed the constitution in 2001 to the effect that the budget is balanced over the cycle, but this "debt brake" does not apply to the cantons.

There is considerable variety in the cantons' own fiscal rules and the rules they impose on their communes. For example, 13 cantons have their own "debt brakes" of various degrees of restrictiveness and requirements to hold referenda on expenditure vary across the cantons. The cantons determine budget balance objectives and debt service limits for the communes. In some cases, the cantons are responsible for deficits experienced at the communal level.

A number of studies have identified features that have helped restrain the growth in the size of government. These include most notably the institution of direct democracy (the requirement to hold referenda on expenditures that exceed certain thresholds). Tax competition between the cantons has helped maintain pressure on policymakers to keep rates low, particularly on the more mobile tax bases. As a result, the argument that sub-central government have a tendency, from political myopia, to tax inefficiently or excessively has not been an important motivation for fiscal rules in Switzerland. Other factors that lead to smaller government include the small size of the cabinet, bodies that oversee the finance commissions and, in some cantons, rules that debar bailouts of communes (Schaltegger and Feld, 2004; Schelker and Eichenberger, 2005; and Blankart and Klaiber, 2005). And a recent federal court ruling that a canton (Valais) did not have the obligation to bail out a delinquent commune (Leukerbad) has further strengthened the position of the cantons vis-à-vis the communes and enhanced the potential monitoring and sanctioning role financial markets can play.

Notwithstanding these aspects of the fiscal policymaking landscape, during the 1990s, the growth of sub-central government as a share of GDP increased and liabilities almost doubled in real terms. This occurred despite most cantons having adopted recommendations contained in the Conference of Cantonal Ministers of Finance's *Handbook of Public Budgeting* to balance their budgets over the business cycle and to reduce debt over a 10-year period. The growing debt levels provoked over a third of cantons to introduce new limitations on the accumulation of debt. These "debt brakes" have proven to be successful at preventing deficits (Feld and Kirchgässner, 2004, 2005). Another source of pressure has been exposure to guarantees given to canton owned banks. The recent experience of a few cantons having to bail out publicly owned banks has led to a reassessment of these types of guarantees.

The problems of the 1990s emerged because the existing fiscal rules were ill adapted to cope either with cyclical variations in revenue or the secular upward pressures on spending (Bodmer, 2004). Direct democracy -- by voting on new spending -- is weak in addressing growing programme spending. Thus, as programme spending rose during the 1990s, both as a result of the economic downturn leading to larger social security spending and the consequences of population ageing, this has led to a severe squeeze on spending, which may be leading to allocative inefficiencies. Furthermore, the constraints of the rules have led some canton to shift expenditure off-budget and increasingly resort to non-tax revenue. This serves to reduce the transparency of budgetary reporting, which is already murky with respect to social security and health spending and only weakly constrained by a recommendation to use a common reporting standard. On the other hand, no investment insufficiency has arisen because debt brakes have usually differentiated between current expenses and investment.

The experience of Switzerland highlights the fact that certain institutional features, such as direct democracy and tax competition can help constrain the size of the public sector and obviate the need for tax rules. It also shows that appropriate borrowing and debt rules can enhance fiscal policy even where there is financial market oversight: cantons with stronger debt brakes have experienced a slower growth of expenditure than those with weaker brakes. Nevertheless, such rules need to be flexible with respect to cyclical shocks -- a significant minority of cantons now allow a correction

with respect to the business cycle -- and forward looking if they are to deal effectively with spending pressures stemming from ageing and demand driven growth of entitlement spending.

Source : OECD (WP 2006/1)

168. Fiscal rules can help central and sub-national governments address stability concerns, but they can also suffer from side-effects and trade-offs such as pro-cyclicality, inefficiency or fiscal gimmickry. Balanced budget and borrowing rules can lead to pro-cyclicality in revenues for sub-national governments. Efficiency may also be impaired as sub-national governments lose the ability to smooth consumption over time, and may reduce their level of investment, as capital spending is easier to reduce than current expenditures in the short run. Golden rules have the opposite effect, by leaving capital expenditures outside the rules' frame. Sub-national governments may also appeal to fiscal gimmickry to try to circumvent the rules. Tax and expenditures limits seem to be frequently overcome by the creation of "special districts" that are not covered by the rule, and tax limitations might be circumvented by rising user charges and service fees.

169. These problems are dealt with in different ways, but dealing with different trade-offs and side-effects usually implies the adoption of a multiple set of rules, with some rules created to reduce the side-effects of others. For instance, multi-annual budgets are sometimes used to smooth out cyclical effects, upper limits on tax rates are used to prevent a ratchet effect on spending from a borrowing constraint, and increased information requirement and monitoring may help reducing fiscal gimmickry.

4. Promoting efficiency and effectiveness

170. The growing spending power of sub-national governments increases the importance of the issue of efficiency and effectiveness for policy makers. Countries have adopted various approaches to generating the competitive pressures and the synergistic opportunities that might enhance efficiency of local public spending. These include in particular, inter-municipal mergers and collaboration, the use of market mechanisms, and the implementation of performance indicators systems.

a) Inter-municipal mergers and collaboration

171. In theory, inter-municipal mergers and collaboration are warranted under several circumstances including economies of scale, standardization of services, strategic alliances, and financial constraints. However, several empirical studies have shown that the scope for economies of scale from mergers is not so important, and these imply high transition costs (in particular, it is very difficult to actually reduce personnel after a merger). Cooperation might therefore be a more viable alternative, and is very widely developed. In Finland for example, cooperation has been used by municipalities that have resisted mergers for many years (OECD, 2006).

172. Denmark has a large experience in cooperative arrangements, with the average municipality participating in approximately 30 such arrangements. Often, larger municipalities act as a supplier and smaller ones act as a purchaser of services. The Danish Commission on Structural Reform found that cooperation can help municipalities gain economies of scale and access a greater number of services, but they also found that cooperation can diminish the tailoring of services to local needs, reduce citizen influence, and make responsibility less clear. Interestingly, mergers rather than cooperative arrangements seem to be preferred by the central government in Denmark, who has recently imposed a merging policy, where each municipality was allowed to choose with whom to merge, as long as they reached a threshold size of 20,000 inhabitants. This reduced the number of municipalities from 270 to 98. At the same time, Denmark eliminated 14 counties which were replaced by 5 regions.

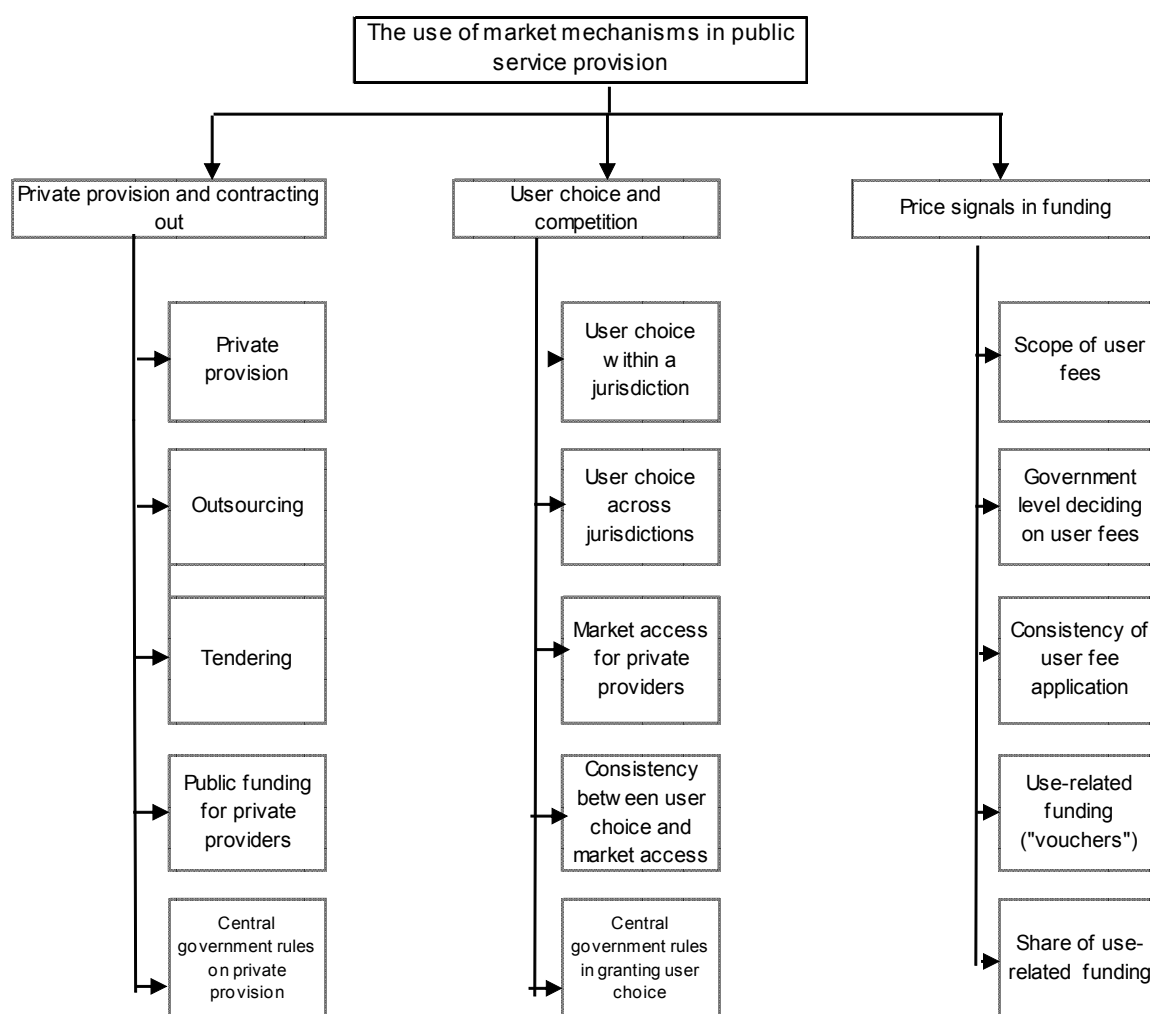
173. But this type of obligation to merge is very exceptional within OECD countries, where most of the countries do not have an explicit merger policy. Some countries, such as France or Austria even have some disincentive to merge (France encourages cooperation, and Austria just eliminated an equalisation benefit that used to benefit municipalities which reached a threshold of 5,000 inhabitants). The majority of other countries have a voluntary policy and neither encourages nor discourages mergers.

b) Market mechanisms

174. Another strategy for sub-central governments to improve efficiency and effectiveness is to incorporate the use of market mechanisms. Market mechanisms refer to the set of rules and institutions of a market economy as applied to the public sector (OECD, WP 2008/6). These can be supply-side measures, such as outsourcing, private provision, and competition, or demand-side measures, such as “user choice”, vouchers or other forms of performance related funding. The purpose of market mechanisms is to take advantage of the resource allocation efficiencies of the private market in providing public services. Indeed, market mechanisms can increase the efficiency of public service delivery in three ways: improving productive efficiency by lowering costs without compromising quality; increasing resource allocation and welfare by increasing service providers’ responsiveness to consumers’ tastes and preferences; and improving budget management efficiency by making the costs of providing the services clearer. Market mechanisms are widely used in education, hospitals, public transport, nursing homes, childcare, and waste collection, which are to a large extent under the responsibility sub-national governments in most OECD countries.

175. Market mechanisms can be divided into three broad categories, each reflecting the properties of a market economy (see Figure 6): private provision and contracting out (public and private ownership, outsourcing, tendering, etc.), user choice and competition (letting users choose increases pressure on providers to deliver the desired good), and price signals in funding (extent to which public funding reflects actual service utilisation and/or performance).

Figure 6. Market mechanisms in public service provision: indicator tree



Source: OECD (WP 2008/6).

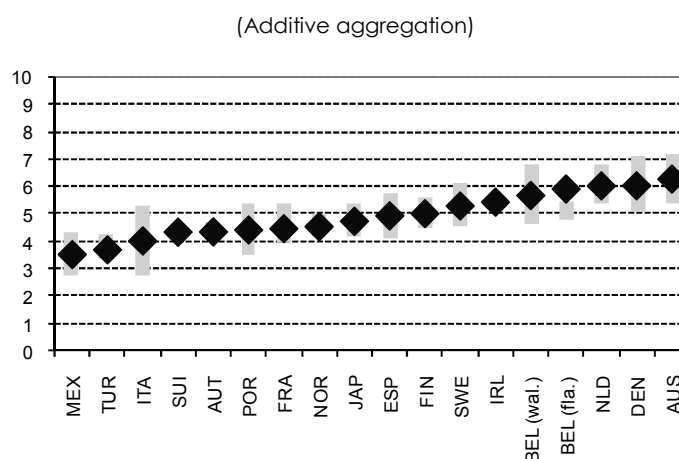
176. An OECD index measuring the reliance on market mechanisms can be used for international comparisons. This index is divided in sub-indexes, following the classification in figure 6 above. An examination of sub-indices reveals that there is substantial diversity in the use of market mechanisms both across countries and across types of public services³⁰. For example, private ownership and contracting seems very efficient in Sweden, Australia and Belgium (Flemish part) and less so in Italy, Switzerland and Mexico. User choice is also subject to great variations across countries. It is quite common in childcare and the hospital sector, while it is generally more restricted in primary and secondary education, reflecting the traditional system where parents are assigned a school where they reside. The third sub-index, price signals in funding shows the least variation across countries, and the smallest values, pointing at relatively weak use of this mechanism (within this sub-category, we can distinguish between user fees, which are widely

³⁰ See OECD (WP 2008/6) for the precise values of each sub-index in each country.

used, and constitute an important revenue source for sub-national governments, and vouchers and other use-related funding³¹, which are still very seldom used).

177. A composite index (summary indicator) measuring the use of market mechanisms can be used to evaluate the scope of each of these arrangements in OECD countries. Figure 7 indicates that the composite indicator shows little variation across countries. Indeed, it appears that countries often compensate low values for one service with higher values for another. The index shows high values (i.e. more efficient market arrangements in public service provision) for Australia, Denmark and the Netherlands, and low values for Mexico, Turkey and Italy.

Figure 7. Summary indicator: use of market mechanisms in public service provision



Note: Values scaled between 0 and 10, with a higher value representing more efficient market arrangements in public service provision. For technical details on indicator construction, see the annex of OECD (WP 2008/6).

Source: OECD (WP 2008/6)

178. If market mechanisms can improve public service efficiency, by introducing competition, by increase user choice or by relying on price signals in funding arrangements, they can also have some drawbacks. Indeed, a wide use of market mechanisms can run against universal policy access objective, with undesirable social and geographical effects. User fees, for instance, might exclude poorer users from public services (hospitals, schools, universities, transportation, etc.). User choice can be a problem if it leads to screening of users by service providers, and contracting out could have negative effect on service coverage.

179. These drawbacks can be addressed with a set of policy tools, such as setting minimum standards, obliging providers to accept all users, lowering fees for users in need, or giving specific population groups a direct income support to compensate for higher user cost. This can lead to the intervention of central governments, which might wish to make sure that sub-national governments make good use of economies of scale and scope, while complying with nationally set objectives. Central governments can for instance use earmarked grants or other equalisation systems to allow all sub-national governments to reach given standard, but without compelling them, or they can set national standards and requirements for service

³¹ Pure “voucher” systems where consumers would receive a lump sum from government do not exist, but “use-related funding”, where the government pays the service provider according to a use indicator is becoming more common. Examples include schools funded according to the number of pupils, or nursing homes funded by the number of residents (OECD, WP 2008/6).

delivery. Finally, central governments can just provide information and benchmarking about the performance of service delivery in other sub-national governments. This is the subject of the next section.

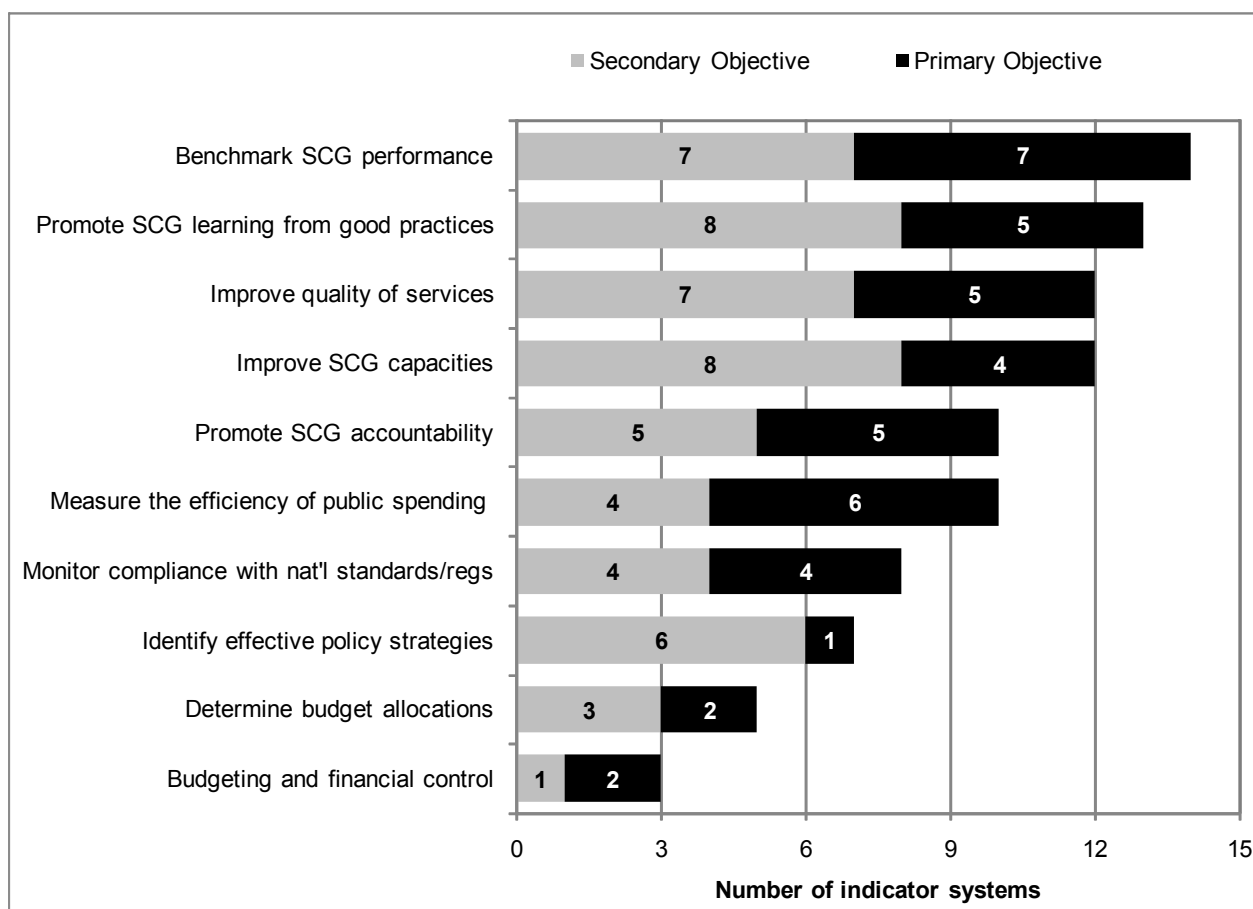
c) Performance indicators

180. The third tool we have mentioned to promote efficiency is the use of performance indicators or “indicator systems”. Indicator systems refer to the systematic collection of information to measure and monitor the activities of government (OECD, WP 2008/5). The use of this type of system has greatly increased during the 1980’s and 1990’s, but analysis usually focuses on horizontal use of performance indicators by central or sub-national governments, to monitor their own performance. In this section, we examine how performance indicators can also be used by central governments to monitor public service delivery by lower levels of government, and to put pressure towards increased efficiency and effectiveness at sub-national level.

181. Indeed, performance indicators can increase efficiency and effectiveness at sub-national level, first, by increasing available knowledge and reducing information asymmetries between levels of government. This on the one hand, allows the central government to monitor sub-national activities, making sure that national objectives are achieved, and on the other hand, central government can act as a node in a network of sub-national governments, retransmitting the relevant information to other local governments, in order to disseminate best practices, or provide national benchmarks. Second, the use of performance indicators encourages performance improvements, by altering incentives faced by sub-national governments. Indeed, indicators can be associated with targets, or provide information to citizens which will then hold their local policy makers accountable for performance.

182. Performance indicators can serve several specific objectives: allocation of resources, control of resources, evaluation of quality, cost, and coverage, transparency and communication with citizen stakeholders, promoting efficiency, etc. In most countries, benchmarking and learning from good practice are the main goals of the indicators system. Figure 8 below classifies the different types of objectives according to the number of countries that consider them as the primary or secondary objective of their performance indicators system.

Figure 8. Objectives of performance indicator systems



Note: "Secondary objective" refers to objectives marked as "secondary" on the questionnaire, as well as those marked "an objective, but I don't know how to rank it". This may understate the primacy of some objectives. Objectives that were marked "not an objective" or were not marked at all were considered "not an objective" of the system.
 Source: OECD (WP 2008/5).

183. Indicators are a key instrument in relations across levels of government. Indeed, on the one hand, they reduce asymmetries of information, both vertically, between sub-national governments and central governments, and horizontally, among different sub-national governments. And on the other hand, they can be used by central governments to set targets to sub-national governments, and monitor their performance. But this last point is delicate, as using indicators should not be perceived as an extension of central control. It is therefore very important to involve sub-national governments in the construction of indicators systems, or else sub-national governments might comply with the reporting constraint, but not use the information produced by the indicators to actually improve their performance. Building indicator systems should therefore reinforce intergovernmental collaboration. Both levels of government may be motivated to collaborate if they perceive it will lead to new or better information for enhancing service delivery and/or if they can share the additional resources which result from efficiency gains (OECD, WP 2008/5).

184. A good example of multi-level government collaboration in the building of an indicators system is the creation of KOSTRA in Norway. This system is described in Box 8 below. In practice, responses to an OECD questionnaire suggest that the link between performance indicators and national decision making

is relatively weak, and the use of explicit targets very rare (only used in Finland and Berlin, Germany). The impact of indicators use is rather indirect, through the higher quality of information available for policy decisions, both at central and local levels (OECD, WP 2008/5).

Box 8. KOSTRA - Data reporting and information system in Norway

KOSTRA is Norway's information system for conveying data from the municipalities to the central government, between municipalities, and to the public. Launched for all municipalities in 2002, the system transformed the collection, processing, and dissemination of statistical information from local governments. Emphasis is placed on electronic transmission of data by municipalities to the central government. The latter adds value by combining municipal data and producing key indicators on financial figures, productivity, coverage rates, and priorities. At the municipal level there are about 40 key indicators and an additional 1 000 indicators covering 16 service areas.

The introduction of KOSTRA benefited both the central and sub-central governments. At the central level, the system rationalised data collection and processing, contributed to uniform standards thereby enhancing the comparability of municipalities and service sectors, helped the central government to determine if municipalities are complying with national standards and regulations, and facilitated a common assessment of the local economic situation which is used as the basis of a parliamentary discussion on the transfer of resources to municipalities. For the municipalities, KOSTRA lessened the administrative burden of reporting. It also provided a tool for internal planning, budgeting, and communication at the local level. In addition, it facilitated the sharing of knowledge between municipalities which are able to use indicators for the purpose of benchmarking performance.

While KOSTRA has brought benefits, there are limitations in the current system. First, the large amount of data collected makes ensuring quality challenging. Second, there is a tendency for the central government to request more and more data, causing both the administrative burden and the costs of data collection to rise in municipalities. Municipalities also receive much more data than in the past.

Overall, KOSTRA has been perceived as a very successful information system with potential for further refinement. Looking forward, focus is being placed on collecting data regarding quality of public services and developing indicators of quality. "Soft data" collected outside of KOSTRA (test scores, reading proficiency and user satisfaction for various service, etc.) are gradually being used in combination with data from the KOSTRA system. This will permit policy makers and citizens to assess outcomes as well as outputs.

Sources: OECD (2006), Statistics Norway (2002), "KOSTRA" online at http://www.ssb.no/english/subjects/00/00/20/kostra_en

185. If using a system of performance indicators can have positive effects on efficiency, its implementation poses some challenges. The first challenge to overcome is capacity building. Indeed, constructing and operating a system of indicators requires experience in defining good indicators, in assessing the quality of the data, the needs that should be covered, etc. Second, using indicator systems is costly. Costs occur in a direct form, by the necessary investments in information systems, training, communication, etc., but also in a more indirect way, through an increased administrative burden, which might be disproportionately high for small municipalities. This point can be tempered by coordinating information needs and reducing redundant requests, as well as carefully selecting the indicators, in order to reduce their number. Another type of possible cost is due to the risks of strategic behaviour (short-termism) or prioritization of resources to influence the measures of the indicators. The last challenge is measurement and data quality concerns. Indeed, public sector's outputs and performance are very difficult to measure. Besides, there is a trade-off between timeliness and quality of data, as using timely data can enhance the relevance of indicators for decision making, but it may be harder to review and validate recent data. Auditing can improve data quality, but may delay its availability.

ONGOING CHALLENGES FOR FISCAL RELATIONS

186. Countries encounter several challenges as they manage fiscal relations across levels of government. Although they are often inter-related, the challenges can be thought of in three main groups: matching responsibilities and resources, balancing of accountability and sub-national autonomy, and ensuring sufficient capacity.

1. Matching responsibilities and resources

187. Increasing sub-national governments' responsibility in providing public goods increases efficiency, but these new responsibilities must be matched by higher resources. This need to provide sub-national governments with more resources poses either equity concerns, if the extra resources come from own taxes (as richer regions will provide more public goods), or stability concerns, if sub-national revenues mainly come from intergovernmental transfers (as these create incentives for overspending). The efficiency benefits from decentralising spending must therefore be contrasted with the equity or stability costs of increasing local revenues.

188. The design of the intergovernmental financial system, i.e. the choice of what to decentralise, and how to fund it is therefore crucial. Fiscal equalisation grants can be used to match resources with responsibilities, and particularly matching grants might reduce the risk of over-spending by sub-national governments, as these still bear part of the cost of increasing the quantity of public goods provided. Fiscal rules can also be a useful tool to meet the stability objective, while giving more responsibilities to sub-national governments.

2. Balancing accountability and autonomy

189. Countries may encounter a trade-off in granting autonomy to sub-national governments and holding them accountable to the central government. This can be related to the first challenge because it is often the case that a mismatch of responsibilities and resources is rectified through the use of grants, but this may also lead to a desire on the part of the central government funder to control sub-national government expenditure types and otherwise interfere in sub-national decisions. The result is a trade-off between sub-national autonomy and accountability. This trade-off is of course central to the design of a multi-level government system and the optimal degree of sub-national autonomy and central control. This optimal division depends on a number of factors including the basic constitutional division of powers in a country, the responsibilities assigned to each level of government, the taxing power of each level of government, and the relative preferences of the central and sub-national level of government. The resulting balance between sub-national autonomy and central control will impact a myriad of multi-level governmental policies, including choices between taxes and grants, types of grants, and monitoring systems such as performance indicators.

190. The use of fiscal rules is one method that central governments can use to enhance accountability and macroeconomic stability while allowing a certain amount of sub-national government autonomy. Fiscal rules are particularly useful to enhance accountability and oversight when significant grant funds are received by sub-national governments. Grants can also be designed to help meet this challenge. For instance, matching grants encourage sub-national governments to provide some of their own funds and by doing so the sub-national government both retains autonomy and becomes more accountable since it has a monetary stake in the project. Performance indicators can also be used to increase accountability incentives, but should not be used to replace central government's control on inputs by a control on outputs.

3. Ensuring sufficient capacity

191. A third challenge is ensuring sufficient capacity at all levels of government. To perform effectively and efficiently, governments at all levels need to have institutions (such as a tax collection agency), trained personnel, and revenue capacity. If sub-national governments lack any of these, they can impair the ability of national governments to meet policy objectives. Moreover, capacity challenges sometimes interact with the trade-off between sub-national autonomy and central control as central governments are sometimes fearful of a lack capacity at the sub-national level if given autonomy. Some capacity challenges, such as experience defining good performance indicators, negotiating appropriate targets, or accessing good quality data, can occur at both the central and sub-central levels of government (ODPM, 2005).

192. Countries appear to meet this challenge in different ways. Revenue capacity can be enhanced through fiscal equalization and other sorts of grants, as well as by allowing sub-national government access to new revenue sources. Market mechanisms can be used to enhance efficiency and substitute private for public skills, but countries use different combinations of private contracting, user choice and competition, and price signals. Performance indicators can also be helpful in certain circumstances in building capacity, for example by providing an incentive for training.

CONCLUSIONS

193. One observes a wide array of multi-government systems in the OECD because of differences across countries in institutions, the size of government, the tasks assigned the sub-national governments, and financing possibilities. Multi-level governance in the OECD thus involves a somewhat more complex assignment of tasks, and one with more constraints, than the classic assignment of expenditure and revenue functions of Musgrave and Oates. The OECD assignment is perhaps closer in nature to Olson's theory of "fiscal equivalence," albeit a fiscal equivalence with constraints that lead in many instances to an overlapping of functions. Some of the deviations of countries from the classic assignment can also be explained by the use of more than one policy instrument (e.g. local income taxes in combination with equalizing grants) that effectively turn an inefficient policy into an efficient one (Goodspeed, 1995).

194. Own-tax revenues are recommended on the margin for financing sub-national governments. Other than own-tax revenues, sub-national governments are financed primarily by grants from higher level governments. Such grants can be used for many purposes, including stimulating spending in a particular area (possibly correcting for an externality), equalizing funding opportunities and possibly public service levels (particularly when there is a national public policy such as a national health or education system that is implemented at the sub-national level), supporting local investment in public infrastructure, among others. Tax-sharing arrangements are another form of finance for some countries of the OECD that is something of a hybrid; while legally considered tax revenues, the economic effect of tax-sharing is closest to a grant. This is because tax-sharing is often by formula and does not allow for sub-national choice of tax rates or bases and consequently removes the primary economic reason for financing by own-tax revenues on the margin.

195. Grant finance (and because of its similarity tax-sharing) can suffer from several problems that can potentially lead to severe inefficiencies and budgetary problems. These include the difficulty of ascertaining accurate information on costs or other aspects of sub-national provision of goods and services, the possibility of using grant funds as a political favouritism device, the problem of time consistency of grant policies (possibly due to political motivations) which could lead to soft budget constraints, and, for the sub-national government, the problem of unpredictability and volatility of revenue.

196. OECD countries have dealt with some of these and other problems in multi-governmental finance in a variety of ways. Some have used fiscal rules which can help in alleviated short-term economic instability and long-term fiscal unsustainability as well as potentially increasing aggregate and allocative efficiency. Efficiency and effectiveness have also been enhanced through inter-municipal mergers and collaboration (especially in cases of with economies of scale or externalities). OECD countries also make use of market mechanisms such as outsourcing, competition, and the offering of additional public service choices. Finally, performance indicators are used in some countries to improve sub-national government incentives, inject competitiveness, and improve information exchange.

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ANNEXES

Taxing power of sub-national governments, 2005

	Sub-central tax revenue		As share of sub-central tax revenues										
	As % of GDP	As % of total tax revenue	Discretion on rates and reliefs	Discretion on rates		Discretion on reliefs	Tax sharing arrangements				Rates and reliefs set by CG	Other	
				Full	Restricted		Revenue split set by SCG	Revenue split set with SCG consent	Revenue split set by CG, pluriannual	Revenue split set by CG, annual			
			(a)	(b1)	(b2)	(c)					(d1)	(d2)	(d3)
Australia¹	-0.1	-0.6											
States	-0.1	-0.5	-0.6	-	-	-	-	-46.2	-	46.8	-	-	-
Local	0.0	-0.1	-	-	-	-	-	-	-	-	-	-	-
Austria	-0.1	-1.4											
States	-0.1	-0.7	5.2	-	-	-	-	-98.0	81.4	-	8.4	3.0	-
Local	-0.1	-0.7	-6.0	-	-5.4	-	-	-80.5	65.3	-	20.7	5.9	-
Belgium	1.0	1.5											
States	0.9	1.4	16.7	-47.5	23.5	-	-	4.3	-	-	0.1	2.9	-
Local	0.1	0.1	-4.1	-84.0	85.7	-	-	-	-2.5	-1.0	5.8	-	-
Canada	-1.5	-2.8											
Provinces	-0.8	-1.5	-	-	-	-	-	-	-	-	-	-	-
Local	-0.6	-1.3	-	-	-	-	-	-	-	-	-	-	-
Czech Republic	1.1	0.4											
Local	1.1	0.4	2.4	-5.0	3.0	-3.0	-	-	0.4	-	2.3	-	-
Denmark	1.5	3.8											
Local	1.5	3.8	-	-8.7	4.8	-	-	-	1.3	-	2.6	0.0	-
Finland	-1.1	-1.5											
Local	-1.1	-1.5	-	-2.3	5.1	-	-	-	-11.0	8.1	0.2	0.1	-
France²	0.7	1.5											
Local	0.7	1.5	-4.6	-	-0.3	1.1	-	-	-	7.7	0.8	-4.7	-
Germany	-0.6	0.2											
States	-0.6	-0.2	-	2.9	-	-	-	-18.6	-	-	9.4	6.3	-
Local	0.0	0.4	-1.0	-35.1	42.8	-	-	-7.6	-	-	-	0.9	-
Greece¹	0.0	0.1											
Local	0.0	0.1	-	-	-10.0	-	-	-36.1	-	-	46.1	-	-
Hungary	1.3	3.7											
Local	1.3	3.7	-	-30.0	87.0	-	-	-	-	-57.3	-	0.3	-
Iceland	2.2	3.9											
Local	2.2	3.9	-8.0	-92.0	95.9	-	-	-	-	-	-	4.1	-
Ireland	-0.1	-0.2											
Local	-0.1	-0.2	-	-	-	-	-	-	-	-	-	-	-
Italy¹	0.0	-3.0											
Regions	0.0	0.0	-	-	-0.1	-	-	1.5	-1.4	-	-	-	-
Local	0.0	-3.0	-6.7	-	2.8	-	-	-	6.8	-	-2.9	-	-
Japan	6.9	0.0											
Local	6.9	0.0	0.2	-37.7	33.2	-	-	-	-	-	4.3	-	-
Korea	4.6	-0.9											
Local	4.6	-0.9	-	-	-	-	-	-	-	-	-	-	-
Luxembourg	-0.7	-1.9											
Local	-0.7	-1.9	-	-	-	-	-	-	-	-	-	-	-
Mexico	0.1	-2.7											
States	0.6	0.6	-0.6	-	-	-	-	-	0.6	-	-	-	-
Local	-0.5	-3.3	-3.3	-	-	-	-	-	3.3	-	-	-	-
Netherlands	0.4	1.2											
Local	0.4	1.2	-	-26.4	26.4	-	-	-	-	-	-	-	-
New Zealand	0.0	0.0											
Local	0.0	0.0	-	-	-	-	-	-	-	-	-	-	-
Norway	-2.2	-6.3											
Local	-2.2	-6.3	-	95.5	-	-	-	-	-0.5	-	-97.0	2.0	-
Poland	3.8	10.6											
Local	3.8	10.6	-	-	-	-	-	-	-	-	-	-	-
Portugal	0.4	0.8											
Local	0.4	0.8	-	-43.8	47.6	-	-	-	7.3	-	-11.1	-	-
Slovak Republic													
Local													
Spain	6.8	17.2											
Regions	6.3	17.0	45.8	-0.6	-	-	-	28.2	-	-	-	-73.5	-
Local	0.4	0.2	-6.0	-54.2	49.5	-	-	2.1	-	-	5.3	3.3	-
Sweden	1.2	1.2											
Local	1.2	1.2	-2.0	2	-	-	-	-	-	-	-	-	-
Switzerland	0.4	-0.9											
States	0.6	0.9	11.0	-	-	-	-	-6.0	-5.0	-	-	-	-
Local	-0.3	-1.8	3.0	-97.0	97.0	-	-	-	-3.0	-	-	-	-
Turkey	1.8	-5.2											
Local	1.8	-5.2	-	-	-	-	-	-	-	-	-	-	-
United Kingdom	0.4	1.0											
Local	0.4	1.0	-	-100.0	100.0	-	-	-	-	-	-	-	-
United States	9.4	1.3											
States	5.5	0.4	-	-	-	-	-	-	-	-	-	-	-
Local	3.9	0.9	-	-	-	-	-	-	-	-	-	-	-
<i>Unweighted average</i>													
States	1.2	1.7	9.7	-5.7	2.9	0.0	0.0	-16.8	9.4	5.8	2.2	-7.7	-
Local	0.9	0.1	-1.7	-24.7	30.2	-0.1	-1.6	-4.1	3.2	-2.0	-1.0	0.6	-

1. 2005-2002
 2. 2004-1995
 Source : OECD (2008/7)

Grant revenue by type of grant (2006)

as a percentage of total grant revenue

	Earmarked								Non earmarked			Total
	Mandatory				Discretionary				Mandatory		Discretionary	
	Matching		Non-Matching		Matching		Non-Matching		General purpose	Block grants		
	Current	Capital	Current	Capital	Current	Capital	Current	Capital				
Australia*												
State	-	-	-	-	47.5	9.2	32.4	4.9	5.9	-	-	100.0
Local	-	-	-	-	15.6	-	2.8	0.0	81.6	-	-	100.0
Austria												
State	48.4	2.4	12.1	17.3	0.9	-	0.3	-	10.9	0.2	7.5	100.0
Local	36.5	3.3	11.5	28.7	1.8	-	0.2	-	18.0	0.1	0.0	100.0
Belgium												
State	1.0	0.3	-	-	-	0.0	-	-	97.1	1.6	-	100.0
Local	45.0	5.0	-	-	-	-	-	-	49.9	-	-	100.0
Canada												
State												
Local												
Czech Republic												
Local	12.4	-	-	-	-	-	72.3	15.3	-	-	-	100.0
Denmark												
Local												
Finland												
Local	5.8	-	-	-	-	-	1.9	1.7	14.2	75.8	0.6	100.0
France												
Local	6.8	-	0.1	-	-	2.0	1.7	1.8	80.9	6.7	-	100.0
Germany												
State												
Local												
Greece												
Local	40.9	36.1	-	-	-	-	-	-	23.0	-	-	100.0
Hungary												
Local	36.2	10.5	-	-	-	-	5.3	10.6	36.2	-	1.1	100.0
Iceland												
Local												
Ireland												
Local	-	-	-	-	-	-	14.8	73.5	11.7	-	-	100.0
Italy												
State	-	4.5	-	5.1	-	-	14.7	5.6	70.2	-	-	100.0
Local	-	-	-	-	-	-	30.5	31.5	38.0	-	-	100.0
Japan												
Local												
Korea												
Local	-	-	-	-	12.7	14.7	-	-	72.6	-	-	100.0
Luxembourg												
Local	86.3	13.6	-	-	-	-	-	-	-	-	-	100.0
Mexico												
State	-	-	49.0	-	-	-	5.7	-	45.4	-	-	100.0
Local	-	-	42.3	-	-	-	-	-	57.7	-	-	100.0
Netherlands												
Local	48.4	-	-	-	-	-	-	-	51.6	-	-	100.0
New Zealand												
Local												
Norway												
Local	9.6	0.0	0.0	0.0	0.0	0.0	33.5	0.0	0.0	56.9	0.0	100.0
Poland												
Local												
Portugal												
Local	-	-	-	-	-	-	16.1	-	83.9	-	-	100.0
Slovak Republic												
Local												
Spain												
State	0.3	0.4	8.5	4.4	1.3	0.8	1.1	0.9	82.4	-	-	100.0
Local	17.1	17.8	2.1	-	-	-	-	-	62.9	-	-	100.0
Sweden												
Local												
Switzerland												
State	74.3	-	-	-	-	-	-	-	25.7	-	-	100.0
Local												
Turkey												
Local	-	-	-	-	-	-	-	57.0	-	-	43.0	100.0
United Kingdom												
Local												
United States												
State												
Local												
<i>Unweighted average</i>												
State ¹	17.7	1.1	9.9	3.8	7.1	1.4	7.7	1.6	48.2	0.2	1.1	100.0
Local	19.2	4.8	3.1	1.6	1.7	0.9	9.9	10.6	37.9	7.7	2.5	100.0

* Since 2006 there has been a significant restructuring of Australia's Federal financial relations

Source : OECD: (2008/5)

CHAPTER 2: CHALLENGES OF HUMAN RESOURCE MANAGEMENT FOR MULTI-LEVEL GOVERNMENT – MAIN CONCLUSIONS

This chapter presents the main conclusions from an OECD study on human resource management (HRM) in a multi-level context. It is based on seven country notes (covering Belgium, Chile, Denmark, France, Germany, Iceland, and Spain) and draws in information from other countries. It is meant to provide an illustration and analysis of the existing spectrum of multi-level governance HRM arrangements.

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I.1 EXECUTIVE INTRODCUTION

197. What does it mean for a national government that important decisions about public employment and public employees are taken by other decision makers? Which are the risks that the national government runs as a result of the decentralisation³² of responsibilities and competences, and which strategies and measure can a national government develop to manage these risks? These are the questions dealt with in this study.

198. The focus of this study is on the national governments' strategies and policies in respect to human resource management in sub-national administrations, and on the challenges that an extensive delegation or devolution of the responsibilities for public services may create for national governments. It also covers some financial management issues due to the interchangeability between financial controls and direct controls over establishment, employment systems and remuneration.

199. The study is based on seven country notes covering Belgium, Chile, Denmark, France, Germany, Iceland and Spain. The selection is neither planned, nor unbiased. The sample consists of countries that either have experiences of a system with extensive decentralisation to sub-national governments, or that have recently been decentralising responsibilities to sub-national governments. The study also uses information from other countries, but this is not based on any systematic information retrieval.

200. The national context for these strategies and policies varies substantially across OECD countries. Any type of classification of this context would by necessity be an over-simplification. A key element in the description of the national contexts is however two archetypes of employment arrangements; the civil service or career system, and the public employment or position system. No country has a pure system, and the picture is that of a range of mixed or intermediary systems.

201. The final chapter contains the conclusions that can be drawn from the study. These should be seen as provisional, due to the limited set of country notes. There are two issues that seem to have been more predominant in the deliberations of national governments than others.

202. The first is that the national governments needs to be able to influence the remuneration and employment conditions at sub-national level; either by formal means or by informal consultations. The main concern does not seem to have been the financial consequences but the need to prevent wage inflation through enhanced employer cooperation.

203. The second is that a prerequisite for the decentralisation of responsibilities is that the recipients have sufficient capacity for assuming these responsibilities and for delivering the expected results. This has been achieved through inter alia mergers of sub-national governments and promoting sub-national multi-government organisations.

³² The term "decentralisation" covers both delegation and devolution.

I.2. ABOUT THIS STUDY

204. The number of country notes made available for this study is limited, but they represent a spectrum of different administrative traditions and different stages in a political decentralisation process. It can be difficult to draw reliable conclusions from such a small sample, but the country notes can be used to underpin analyses and illustrate the existing spectrum of arrangements. The study has also made use of material from other sources, including other OECD material, a comparative European study and various documents available from reliable internet sources.

205. The reasons for this scarcity of background notes can only be the subject of speculation. Among the possible hypotheses is that the central human resource management units within the national administration (which are the contact points for OECD in this policy area) are not handling relations to sub-national governments. Another is that the issue may be too sensitive for civil servants in the national government administration to comment on. It is thus noticeable that the countries covered by the country notes are all countries where the national government either has a clearly stated policy for administrative decentralisation or a cooperative relation to sub-national governments.

206. It is at the same time possible to draw an implicit conclusion from the scarcity of country notes; that human resource management in sub-national government administrations has not created any noticeable problems for national governments.

207. The paper often uses the phrases “normally”, “typically” or “reasonable hypothesis” when describing different features. This is done when it seems possible to draw a conclusion from the existing information, but when it cannot be excluded that more complete information would provide exceptions or even change the picture.

208. In this paper *State* is used for both federal and unitary countries. The *states* or *federated levels* are the entities that together form a federal country (states, provinces, regions, communities, lands). The *regional level* is the second (intermediary) tier in a unitary country, and the *local level* is the third tier in both federal and unitary countries (regions, counties, municipalities, communities, etc.). *Sub-national* includes all other governments in a country than the national government.

209. The paper will make a distinction between responsibilities and competences. By *responsibilities* is meant the functions entrusted to sub-national governments, such as the nature of the public authority exercised by them and of the services provided by them. By *competences* is meant the freedom of action of sub-national governments in managing their own organisation, financial matters, investments and human resources.

210. It also uses *governance* as a very broad concept. In addition to the traditional command-and-control systems, it could also refer to other models for exercising a central influence on delegated or devolved decision making.

I.3. THE ISSUES INVOLVED

I.3.1. The public administration in OECD countries

211. The public administrations in OECD countries play an important role for the well-being of their societies. They serve the democratic system, and ensure that the will of people as expressed in free and transparent elections will also be faithfully implemented. They provide the basic security without which no society can survive. They also provide the institution that reduce transaction costs for both citizens and enterprises, and enable private enterprises to trust legally binding agreements and undertake long-term investments. They serve the citizens by managing urban centres, ensuring an adequate infrastructure for energy and communications, and providing important educational, social and medical services. If the public administration fails, then the whole society will suffer.

212. Government in OECD countries is as a rule composed of several layers, and each layer has its own administration. The theoretical basis for this structure is the so-called subsidiarity principle. It can be defined as the idea or principle that matters ought to be handled by the smallest, lowest or least centralized competent public authority. The concept or principle is found in several constitutions around the world (see for example the Tenth Amendment to the United States Constitution). It is presently best known as a fundamental principle of European Union law established in the 1992 Treaty of Maastricht. According to this principle, the EU may only act (i.e. make laws) where member states agree that action of individual countries is insufficient.

213. Decentralisation is however not only a question of administrative rationality, but also of self-governance. This is clearly expressed in the European Charter of Local Self-Government adopted in 1985. The Charter commits the ratifying member states to guaranteeing the political, administrative and financial independence of local authorities. It states that the principle of local self-government shall be recognised in domestic legislation and, where practicable, in the constitution. Local authorities are to be elected by universal suffrage. Local authorities, acting within the limits of the law, are to be able to regulate and manage a substantial share of public affairs under their own responsibility in the interests of the local population.

I.3.2. The challenges of public human resource management

214. Multilevel government also means multilevel human resource management, especially in countries with legally or constitutionally guaranteed sub-national self-government. National governments have, as is shown later in this document, a number of interests in the human resource management at sub-national levels of government.

215. Decentralisation will inevitably create a potential for differences, since decisions will be taken by several separate decision-makers. This is not a side effect. Instead, the decentralisation of responsibilities and competences is intended to enable an adaptation of government arrangements to local needs, conditions and priorities, and this entails a certain level of differentiation and variation. There is however at the same time factors that will reduce the actual differences. All employers can for example be expected to act rationally on the basis of acknowledged good employer practices, and a well functioning labour market will tend to ensure that similar skills and efforts are rewarded similarly.

216. Work on public human resource management has so far mainly concerned the national level, and little attention has been given to the effect of an independently governed sub-national level. Although there are parallels with independently managed government agencies, there is also a fundamental difference in that the sub-national governments are independently elected and only responsible to their own electors.

217. This paper is intended to complement earlier studies by describing the challenges, practices and experiences of human resource management in multi-level government structures. It will focus on the potential tensions between national and sub-national interests, and on the challenges that sub-national decisions might create for the national government. The financial dimension is an unavoidable part of these features, and the document will therefore also cover related aspects of macroeconomic and financial policies. It will however not cover aspects related to national supervision of sub-national adherence to the general labour laws of the country. Nor will it cover aspects related to bailouts of sub-national governments that have failed; financially or otherwise.

218. Human resource management consists of a broad range of arrangements, covering the legal basis for the public employment, any variations in employment arrangements, the number of public employees, their remuneration and other employment conditions, efforts to recruit, train, develop and retain sufficiently skilled employees, and internal consultation arrangements including formal negotiations with organisations representing the employees.

I.3.3. National vs sub-national government interests

219. The national governments are, in almost all countries³³, assumed to have residual responsibilities for the country's economic and social development and for the well-being of citizens, even if and when relevant functions are the responsibility of sub-national governments. Decisions taken by sub-national governments can also have a major influence on the national government's ability to handle its own responsibilities, including macro-economic and social stability, sustainable growth and social equity. The fragmentation of public investments and public service provision also entails important challenges in maintaining coherence, whole-of-government perspectives and aggregated efficiency in the public service.

220. Sub-national governments are only accountable to the electors within their own geographic area, and these may have different priorities than the majority of the country's citizens. They typically have more limited responsibilities than national governments³⁴. The extent of these varies across countries, but they never include monetary issues and macroeconomic developments.

221. Sub-national governments promote economic growth within their own geographic area, and compete for employment-generating investments. They also compete for mobile qualified and skilled labour, and want to offer as attractive living conditions as possible for these persons and their families. The increasing mobility of both capital and labour intensifies this competition. Sub-national governments also compete with the national government for labour for public employment, at the same time as all governments compete with private enterprises and non-profit organisations. The functions and services provided by sub-national governments may affect such variables as growth and employment within their own territory, but the sub-national governments can normally not be held to account for how these affect the national developments, except by their own electors.

222. Against this background, it is possible to identify five sets of national government interests in the human resource management in sub-national administrations. The first three derive from the national government's responsibility for the macroeconomic developments, including price stability, economic growth, full employment and a high employment ratio. The remaining two derive from the national government's residual responsibility for the outcome of sub-national government activities and includes the need to maintain propriety, trust, integrity and an acceptable value base for all public activities, whether decentralised or not.

³³ The known exception is Belgium, where the federal government does not have a primacy over governments at the federated level.

³⁴ Belgium is again the known exception.

223. Firstly, a national government typically has targets for the extent or volume of the country's total public activities. A national government may have a strong interest in restraining the growth of the aggregated public employment in national and sub-national government administrations, since a too rapid expansion would crowd out private employment and reduce the growth of tax-generating activities. In countries that forecast a shrinking labour force due to demographic development, national governments may even have an imperative need to reduce the total public employment. Conversely, there may also exist governments that are anxious to maintain or even increase total public employment in order to avoid an extra strain on an already depressed labour market.

224. Secondly, a national government typically wants to ensure that the growth of total labour costs per hour is compatible with a maintained or strengthened international competitiveness and reasonably low inflation. This is especially important for small countries with open economies. The national governments therefore have a strong interest in the evolution of remuneration in sub-national administrations, just as they have an interest in promoting responsible wage setting within the private sector.

225. Thirdly, a national government typically wants to ensure that the country's labour market functions in an adequate and appropriate manner. It therefore normally pursues policies aimed at improving the labour supply, facilitating mobility, reducing job vacancy and unemployment durations, promoting a better match between demand and supply of different skills, and ensuring a relatively low level of industrial conflicts. They therefore have an interest in promoting human resource management practices in sub-national administration that contribute to these efforts.

226. Fourthly, it is rare that public policies and services can be completely isolated from each other. The health service, for example, would have to interact and be coordinated with services for inter alia education, consumer protection, alcohol and drug use, social security, employment, immigration and integration. The responsibilities for these services would typically be divided between national and sub-national government. The advent of e-government and e-services has also generated new demands and opportunities for cross-government coordination in service provision and information management.

227. Finally, the national government has an implicit residual responsibility for the outcome of sub-national government activities, especially in non-federal countries. Citizens may expect public functions and services to be of relatively equal quality or accessibility across the country, even in cases where the responsibility is devolved, and the national government may find it difficult to dismiss such complaints without taking any action. The devolved functions may also be of importance for the country's macroeconomic development, social stability and/or international commitments. Sub-national governments may also need national government interventions in crises that they are unable to cope with themselves.

228. The exact nature of such concerns varies across countries depending on what has been devolved or delegated to sub-national governments. They typically focus on the quality and accessibility of the decentralised functions and services. The national government is also responsible for maintaining the rule of law, and may actively promote specific public service values such as openness, professionalism, correctness, responsiveness and non-partisanship in both national and sub-national government administrations.

I.4. CONTEXT MATTERS

I.4.1. The relations between national and sub-national governments

229. The formal relations between national and sub-national governments vary across OECD countries. The character of these relations determines the options available to national government in governing or influencing sub-national government actions in different fields, including human resource management.

230. OECD-countries can be classified as federal, regionalised or unitary countries. The challenges facing a country would depend on which of these groups it belongs to, since the competences of a federal government would typically be curtailed by the country's constitution. They can also be grouped in two broad groups depending on the history and nature of the relation between their national and sub-national governments.

231. The first group can be described as countries with a history of a centralised public administration; regional governors appointed by the national government and subordinated sub-national governments. These countries are typically unitary countries, and often have a period of autocratic rule behind them. These countries have almost without exception entered a phase where they introduce directly elected regional governments, transfer competences and responsibilities to regional and local governments, and seek an appropriate balance between the centralised administrative tradition and the new elements of sub-national self-governance. Among the countries that have provided country notes, Chile, France and Spain belong to this group. The German federation can also be said to belong to this group. It was created during the reconstruction of Europe after 1945, and represents a combination of centralised administrative structures and regional and local self-government, but has like the previously mentioned countries began to transfer competences to the regions.

232. The second group can be described as countries where sub-national government is based on an unbroken tradition and regarded as self-evident. These countries may instead have to deal with a need to strengthen the capacity of existing regional and/or local governments to manage existing responsibilities that are essential for the evolution of the country's economic competitiveness and social cohesion, and to find an appropriate balance between national standards and sub-national self-governance. Among the countries that have provided country notes, Denmark and Iceland belong to this group. Federations that have been formed by already existing political entities such as Australia, Canada, Switzerland and the United States can also be said to belong to this group.

233. The classification of an individual country can of course always be discussed, and there are countries that don't fit easily into either of these countries. Belgium, where the federal structure has evolved out of controversies between the country's two main regions, is one example. The United Kingdom with its complex structure and specific legal-administrative tradition is another.

234. The number and structure of sub-national governments vary across OECD-countries, not only between federal and unitary countries but also within each of these groups.

Table 1. Sub-national governments in OECD countries

Federal States	Municipal tier	Second tier	Federated States
Australia	694 local governing bodies ¹		6 States and 2 Territories
Austria	2,359 municipalities		9 Länder
Belgium	589 municipalities	10 provinces	3 Regions and 3 Communities
Canada	ca. 4,000 local governing bodies ¹		10 Provinces and 3 Territories
Germany	13,854 municipalities	323 districts	16 Länder , including 3 "City-States"
Mexico	2,438 municipalities		31 States and 1 Federal District
Switzerland ²	2,636 municipalities		26 Cantons
United States ³	35,992 local governing bodies	2,975 counties	50 States and 1 District

Notes:

1 The generic names of Australian and Canadian local governments vary across states/provinces/territories

2 Switzerland is formally a Confederation

3 The organisation and generic names of US local governments vary across states.

Unitary States	Municipal tier	Second tier	Third tier
Czech Republic	6,258 municipalities	14 regions	
Denmark	98 municipalities	5 counties	
Finland	432 municipalities	6 provinces	
France	36,684 municipalities (including 114 in the overseas departments)	100 departments, including: 1 city-department and 4 overseas departments	26 regions, including 1 special status authority and 4 overseas regions
Greece	1,031 municipalities including 901 towns and 130 rural municipalities	50 departments	
Hungary	3,158 municipalities	19 departments	
Iceland	79 municipalities	23 counties ¹	
Ireland	85 municipalities	29 counties	8 regions
Italy	8,100 municipalities	104 provinces	20 regions, including 5 "special status"
Japan	659 cities, 1,991 towns, 567 villages	47 prefectures	
Korea	72 cities, 94 counties and 69 districts	9 provinces and 7 metropolitan cities	
Luxembourg	118 municipalities		
Netherlands	467 municipalities	12 provinces	
Norway	434 municipalities	19 counties	
New Zealand	16 city councils and 57 district councils (4 of these are also regional councils)	16 regional councils and 1 territory	
Poland	2,489 municipalities	373 departments	16 regions
Portugal	278 municipalities (4,257 parishes ²)		
Slovakia	2,920 municipalities	8 regions	
Spain	8,106 municipalities	50 provinces	17 autonomous communities
Sweden	289 municipalities	21 counties, of which 2 are designated as "regions"	
Turkey	923 districts	81 provinces	

United Kingdom	36 metropolitan districts	34 counties	
England	238 districts		
	47 unitary authorities		
London	1 Greater London Authority +32 London Boroughs		
Scotland	32 unitary authorities	Regional Parliament	
Northern Ireland	26 districts	Regional Assembly (suspended since 2002)	
Wales	22 unitary authorities	Regional Assembly	

Notes:

1 Iceland's 8 regions are merely used for statistical purposes

2 Portuguese parishes are infra-municipal authorities.

The data in this table has been collected from a number of different sources, and has not been checked for accuracy. The table is merely intended to provide an overview and information about individual countries should be verified before re-use.

Sources: Dexia (2006), CIA World Fact Book (internet), UNPAN Country Profiles (internet), Wikipedia (internet), US Census 2002 (internet),

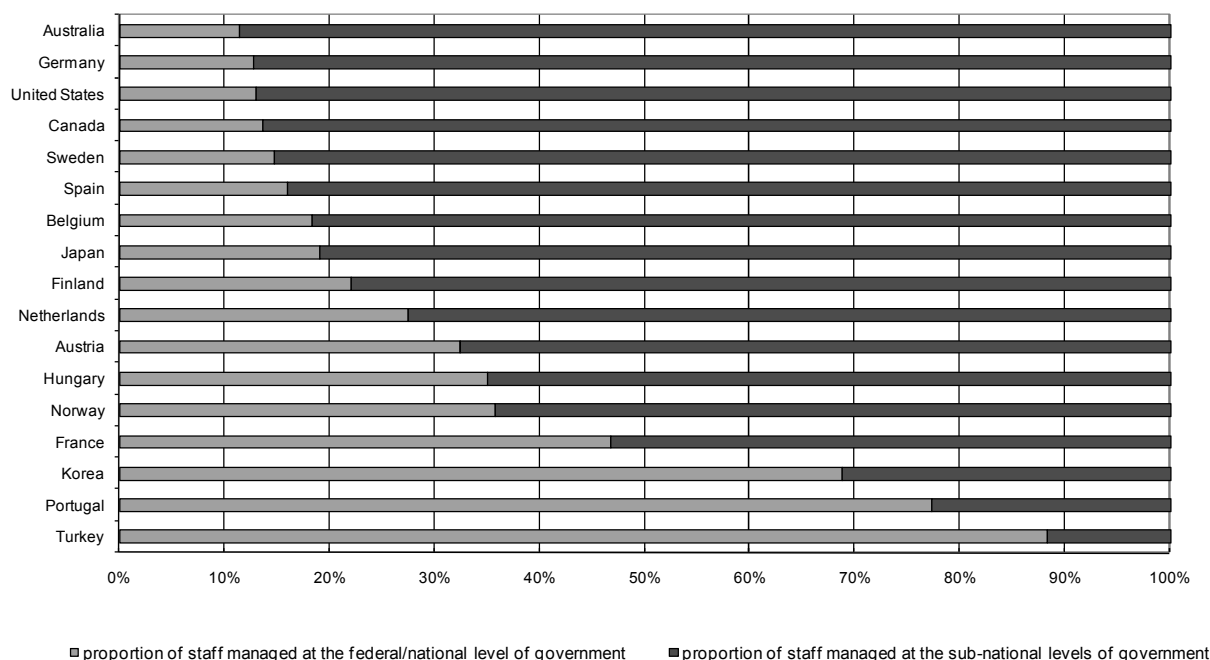
I.4.2. The responsibilities of sub-national governments

235. The responsibilities of sub-national governments also vary across different types of sub-national governments in OECD countries. The extent of these responsibilities is important. A reasonable hypothesis would be that the need for a sufficient capacity and professionalism in sub-national governments will grow as the responsibilities increase, and that the demands on the national governance system would increase accordingly.

236. There are no easily available sources detailing the distribution of responsibilities in different countries, and the country notes are too few to draw any meaningful conclusions from. As a minimum, local governments tend to be responsible for urban functions, but the extent to which other functions and/or responsibilities have been delegated or devolved to sub-national governments vary. The most extensive devolution seems to exist in Belgium, where all six governments at federal and federated level are considered equal, and where there is no clear sphere reserved for the federal government.

237. One indication of the variations is each levels share of the public employment. Data on OECD countries indicate that the share of national government employees varies in federal countries between 12 % in Germany and 32 % in Austria. The corresponding spread for unitary countries is between 14 % in Sweden and close to 90 % in Turkey.

Figure 1. Employment in government (General Government) by level of government (2005)



Source: CEPD survey, OECD

Notes:

* Data are in number of employees, except for Austria, the Netherlands and Sweden.

** Employment in social security is not taken into account at the national level in Austria, Belgium, Finland, France, Hungary, Japan, Korea, Netherlands, Spain, Sweden, and Turkey. Employment in social security is not taken into account at other levels of government in Australia, Canada, Germany, Norway, Portugal (for 2005), and the United States. This concerns relatively small numbers of staff and thus has only minor consequences on the graph above.

Austria: Data do not include private non-profit institutions financed by government
Data for 2004 and 2005 have been mixed. Data for public corporations are partial and only include universities that have been reclassified.

Belgium: Data are for 2004

Finland: Data have been mixed for 2004 and 2005

France: Data exclude some Public Establishments
Data are for 2004

Korea: Teachers and police officers are included at the national level and account for 75% of the workforce at national government level.

238. Finally, the Denmark country report points out that shared responsibilities can lead to difficulties in identifying the responsible part, for example when the service level guaranteed by the state to the citizens is not achieved. It might be the sub-national governments because they are not efficient enough, but it may also be the national government because it has not ensured that the sub-national governments have sufficient resources to carry out their tasks in an adequate manner. One of the aims of the Quality Reform launched by the Danish national government is thus to create coherence and a clearer distribution of responsibilities.

Box 1. The Quality Reform in Denmark

Apart from regulations affecting the labour market in general (including private companies), there is little regulation imposed by national government on regional and municipal governments on how they should manage their staff. Nor is there direct involvement of national government in establishment control, remuneration (apart from pensions for civil servants only, which are regulated at the national level), or management principles.

The system, however, maintains a high degree of coherence across governments. First, the legal rules of employment conditions in the public service are broadly the same across governments in Denmark. Like in many other OECD countries, sub-national governments have built on traditional existing employment frameworks at the national level to develop the basis of their employment regulations.

Second, a very high level of coherence is maintained through informal co-ordination and through the negotiation processes with unions in which national government is involved.

The Quality Reform, promoted by national government, reinforces dialogue on HRM across levels of government. It was first presented in the summer of 2006, was then the object of exceptional negotiations with unions in 2008, and contains 180 initiatives. Its goal is to "ensure that the public sector will continue to be able to deliver high quality services to the citizens even though future public sector workforce inevitably will decrease due to demographic changes in the population." National government will fund part of the initiatives for a total amount of around 10 billion Danish Crown, to be distributed to cities and regions until 2015 (shared funding of individual projects). While the initiatives are wider than HRM, and include themes such as improved regulation or the promotion of innovation and user centric organisation, a large part of the initiatives concern HRM very directly. They include themes such as improving the image of the public employer, the provision of incentives for older workers to stay on, improving the management of competences, leadership training, and increased training in the social sectors.

I.4.3. The impact of public governance structures and reforms

239. A reasonable hypothesis is that the nature of the employment arrangements at the national government level strongly affects the governance of employment arrangements at sub-national government. A country where statutory controls over employment arrangements in the national administration have not been relaxed is less likely to relax similar existing arrangements for the sub-national administrations. A country, which has acquired experience of how to govern delegated employment arrangements in the national government administration, is on the other hand more likely to attempt to govern devolved employment arrangements in sub-national government administrations in a similar way.

240. The public employment arrangements vary across OECD countries in a number of respects. There is a spectrum from career-based to position-based systems, and another from uniform statutes to differentiated contracts. The statutory systems cover all national government employees in some countries, but only core government employees in others. In some countries they cover public employees at all levels, but in others only national government employees. These different aspects of the public employment arrangements are not necessarily linked to another.

241. There are other elements in the human resource management context that are of importance for the choice or balance between centralised or decentralised arrangements. If the country has a benefit-defined system for pensions, then public servants would have vested interests in this system and want to retain it even after a decentralisation. A country with a contribution-defined system would however not have similar problems. The trade unions for public employees might also play a role, provided that they are sufficiently representative. A country with separate trade unions for national and sub-national government employees would probably meet resistance to decentralisation and be less likely to change its employment arrangements at the same time. Centralised trade unions would oppose decentralisation, while decentralised trade unions would welcome it.

242. It is possible to identify three main areas of reform that are on the agenda in most countries at all levels of government, namely:

- the dissolution of previously centralised and standardised arrangements and structures, and the growth of spheres of decentralised managerial discretion within public administrations;
- an increased focus on performance (including result-oriented governance, use of internal market-type mechanisms, and performance-related pay elements) and the introduction of quality assessment systems
- the increased reliance on commercial and other non-governmental organisations for both input services and service provision.

243. The change process is however far from homogeneous across OECD countries. All three areas involve changes to the human resource management arrangements. The first one entails a transfer of competences and a need for adequate human resource management function at the recipient end. The second one implies a shift from uniform - often statutory - rewards to differentiated rewards based on performance assessments. The third entails a shift from hiring people to contracting suppliers, partners and service providers. It therefore also implies a reduction of the number of public employees, and a changed composition of the public work force.

I.5. HOW ARE COUNTRIES RESPONDING TO THE DIFFERENT CHALLENGES OF HRM ACROSS LEVELS OF GOVERNMENT?

I.5.1. The challenges to financial stability

244. Transferring responsibilities to sub-national governments leads to them being responsible for a large share of the public activities, employment and expenditure. It also implies a weakening of the national government's control over public employment and expenditure. Concerns about the sub-national governments' ability and willingness to subordinate themselves to the requirements of responsible finance policies may affect both the willingness to transfer responsibilities and competences to sub-national government, and the regulatory framework surrounding such transfer. A recurring component in political discussions about transferring responsibilities and competences to sub-national governments is thus that these might behave imprudently and, under pressure from their electors, be unable to hold back both employment numbers and remuneration levels, and to prevent a continuously growing debt burden.

245. The globalised financial markets have set new standards for the public financial management. When States have to turn to globally active investors for loans instead of to their own citizens, they are forced to give more attention to their public deficits and to the evolution of the public debt. The best example of this is the criteria used by the Stability Pact of the European Union for the total public budget deficit and the total public debt. These aggregate the deficit and debt of all public institutions in a country, including the sub-national governments.

246. An IMF (IMF, 2005) working paper concludes that giving unconstrained borrowing authority to sub-national governments is unlikely to be an optimal solution. At the same time it notes that fiscal rules may take a wide variety of forms. Some rules establish a debt ceiling or target fiscal deficit, while others cap expenditure. Coverage also differs. In addition, borrowing constraints may be enforced in different ways. In some countries, it is left to financial markets to sanction fiscally undisciplined sub-national governments.

247. The IMF working paper classifies regulatory regimes for sub-national government debt into the five categories Central rule, Administrative, Cooperative, Self-imposed rules and Unrestricted. The paper also lists 13 cases during 1992 – 2000 when a national government in an OECD country has intervened in some way to bailout one or more indebted sub-national governments (IMF, 2005, appendix1). The regulatory regimes has however been classified as "Unrestricted" in only five of these cases. The paper concludes that no single institutional arrangement seems to be superior to all the others under all circumstances. Three of the countries covered by country notes have entered or are about to enter a decentralisation phase. Their handling of debt issues varies. Sub-national government borrowing will continue to be controlled by the national government in Chile and Spain and was not regulated in France.

248. Sub-national government borrowing is subject to central controls in Denmark, but not in Iceland. In Germany, borrowing by the federated level is only subject to administrative regulations, but the federated level controls borrowing at local level. At present there is a project to amend the constitution so as to create a new and stricter regulation governing public borrowing which would provide sufficient flexibility to cope with difficult situations, but at the same time also ensure sustainable public budgets.

249. There is no evidence that sub-national governments have contributed in significant ways to a destabilization of public finances in OECD countries during recent years. This should however be seen against the attention given to these risks by the OECD and the World Bank under the last decades, and can be interpreted as an indications that national governments have maintained the structures and consensual relations necessary to manage or prevent imprudent sub-national debt accumulation.

250. There are however indications that an increased decentralisation may lead to increased employment and expenditure. A possible reason might be that the country doesn't manage to reduce the national administration at the same pace in which the sub-national governments increase theirs.

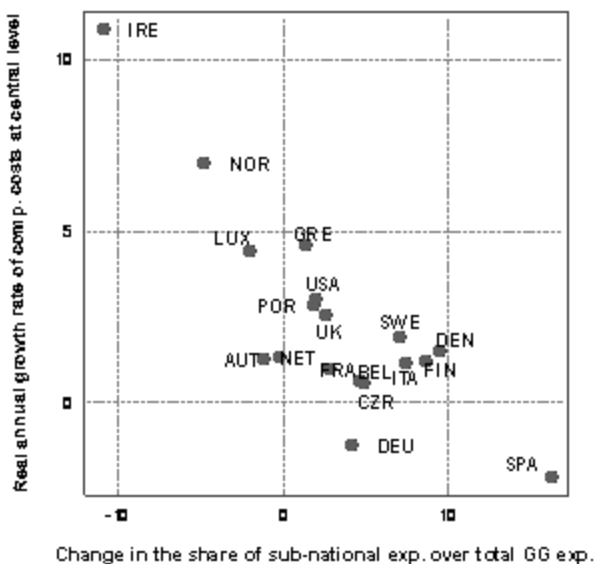
251. The data available is inconclusive about all countries, but may still provide some insights for some countries. The data show that in some cases the decentralisation of expenditures might not be followed immediately by similar decreases of compensation costs at central level, driving in some cases overall compensation costs in General Government spending up. The net effect might however be an increase in total public employment, as for example observed in the OECD review of human resources management in the different governments of Belgium.³⁵

252. Figure 2 below indicates that there is probably a negative relation between the growth of sub-national share of total general government expenditures and the real growth of total compensation costs for central government employees, but this is compatible with an assumed displacement of national employment by sub-national employment, The indicated general real growth (a correlation line would pass above) could be interpreted as a reflection of a general growth of OECD economies during this time period.

253. However, Figure 3 shows that in some countries, and particularly in Italy, Finland, Sweden and Denmark (and less clearly in countries such as Czech Republic, Germany and Greece), the decentralisation of expenditures has been concomitant with increases in the share of compensation costs in government expenditures at central level. This could however be related to the nature of decentralised spending or to other factors affecting central government remuneration linked to economic growth.

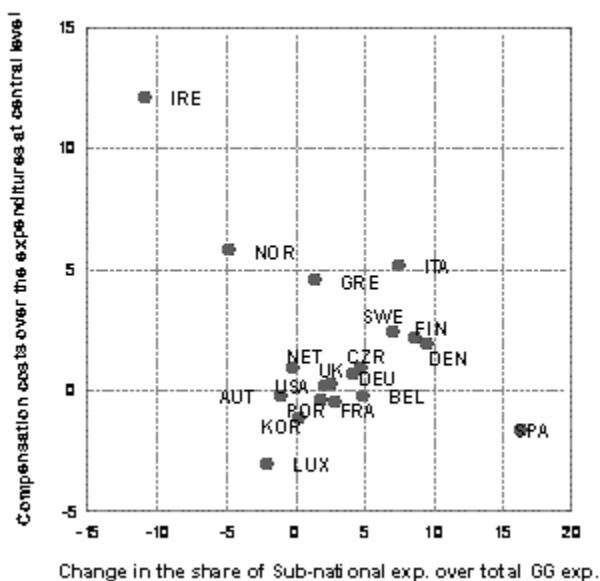
³⁵ OECD Reviews of Human Resources Management in Government—Belgium, OECD, 2007

Figure 2. Changes in the share of sub-national expenditures in total General Government expenditures and real annual growth rate of compensation costs of central government employees (1995-2006)



Source : OECD National Accounts Database; US Bureau of Economic Analysis

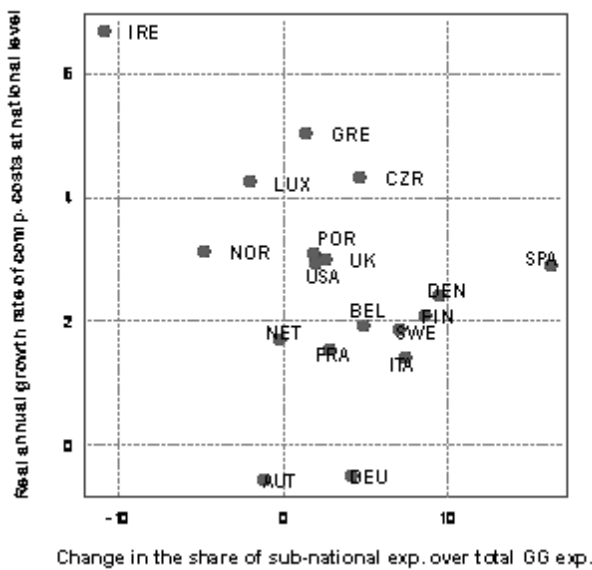
Figure 3. Changes in the share of sub-national expenditures in total General Government expenditures and changes in the share of compensation costs of central government employees (1995-2006) in central government expenditures



Source : OECD National Accounts Database; US Bureau of Economic Analysis

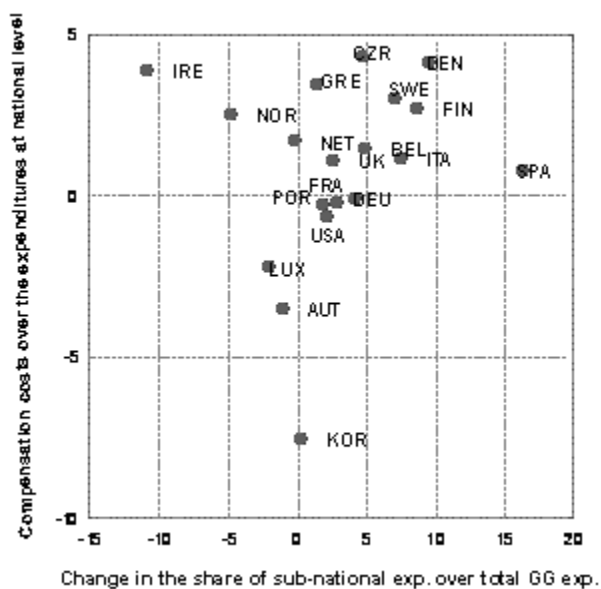
254. Figure 5 does not indicate a significant relation between the sub-national share of total general government expenditures and the real growth of total compensation costs for all government employees in all countries. However, for some countries such as for example Denmark, Sweden and Finland, relatively large decentralisation is concomitant with increases in compensation costs in government spending at the level of the economy. Once again, this may be due to other factors than decentralisation.

Figure 4. Changes in the share of sub-national expenditures in total General Government expenditures and real annual growth rate of compensation costs of General Government employees (all levels of government) (1995-2006)



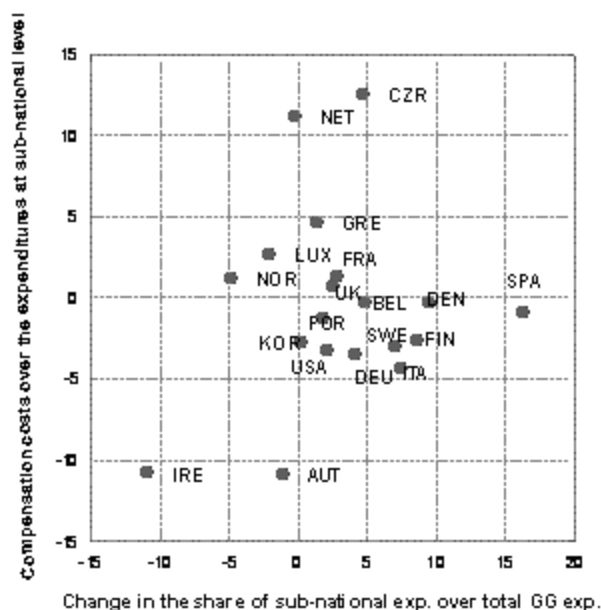
Source : OECD National Accounts Database; US Bureau of Economic Analysis

Figure 5. Changes in the share of sub-national expenditures in total General Government expenditures and changes in the share of compensation costs of all government employees (1995-2006) in all government expenditures



Source : OECD National Accounts Database; US Bureau of Economic Analysis

Figure 6. Changes in the share of sub-national expenditures in total General Government expenditures and changes in the share of compensation costs of sub-national government employees (1995-2006) in sub-national government expenditures



Source : OECD National Accounts Database; US Bureau of Economic Analysis

255. Comparing Figure 2 and Figure 6, the first and the fifth graph, seems to show that only in the Czech republic we find significant decentralization of spending with increases in compensation costs in sub-national government spending. Overall, at least in the short run (10 years), it seems that, with decentralization, compensation costs at central level decrease less quickly than the decentralization of spending, and increase less quickly at sub-national level than decentralization of spending.

256. This can, as noted before, be the effect of other changes at national and/or sub-national level. It does signal, however, a need for care and attention to compensation costs when decentralising spending, especially at central level of government.

I.5.2. Macro-economic challenges

257. The dramatic increases in overall public expenditure and public employment in OECD countries over the last half century reflect the very significant expansion of the role of government as States have assumed more active roles and broader responsibilities. A growing affluence has entailed a continuously increasing public demand for services in the form of both higher standards for established public services and calls for new types of services. These services are provided by sub-national governments in many countries, and are in the process of being transferred to sub-national government in other countries. In many OECD countries, sub-national governments are thus responsible for a substantive part of the country's public expenditure and public employment.

258. OECD countries present a very varied picture when it comes to the scope of public activities and public employment. Available data for OECD countries show that sub-national governments have more employees than the national government in 14 of the 17 countries. The share of sub-national government employees varies from slightly above 10 percent in Turkey to more than 85 percent in Australia percent in Ireland to almost 90 percent in Turkey.

259. A national government typically has targets for the extent or volume of the country's total public activities. These can be expressed in terms of the tax quote (the share of the gross national product that is collected as taxes and compulsory fees), the expenditure quote (the public expenditure as a share of the gross national product) or of the employment quote (the share of the available labour force that is employed in the production of public goods and services).

260. The reason is normally a concern that a public expansion might crowd out private sector activities and private employment, but could also be a desire to expand public services to meet urgent needs or to avoid an unduly high unemployment, either globally or for a specific group of job seekers. It should be underlined that the issue at hand is not the actual evolution of sub-national government employment, but its relation to the national government's expectations.

261. The country notes indicate that controls, if any, tend to be on the expenditure side. There are no national controls or limits on sub-national staff establishments in Belgium, Denmark, France, Germany, Iceland or Spain. In Chile, all decisions relating to the creation or elimination of public posts including those at sub-national level still require national legislation. The Constitution was however modified in 1997 so as to allow local governments to modify their own administrative structure and staff establishment.³⁶

262. A discussion of the reasons behind the absence of direct establishment controls is of course only speculative, but they seem to include the following:

³⁶ The new powers have to be defined in an enabling law, which is still being processed in the Parliament.

1. A first observation is that central establishment controls are considered to be incompatible with both local self-government and efficiency. The Chile country note for example states the following:

“It will clearly not be possible to modernise municipal management and increase its efficiency if this process is not accompanied by more appropriate mechanisms for the administration of human resources, an area in which Chile’s municipal governments have historically had a total lack of autonomy. ...sought to remedy this inefficient situation by transforming the creation and elimination of municipal posts into an administrative decision to be taken by the respective municipal authorities ... These new powers for municipal governments seek to increase their efficiency and ensure better provision of services for the community while, through their proper exercise, guaranteeing improved working conditions and remunerations for municipal employees.”

2. A second observation is that the growth of procurements of input services and of out-contracting of public services to non-public service providers³⁷ weakens the effectiveness of direct controls. The main effect of central establishment controls might thus be to increase the incentives for outsourcing as a way of circumventing the controls.
3. The regulatory regime for debt accumulation covered in the previous section is an important element in expenditure controls. Another important element is the sub-national governments’ own tax resources and authority to set tax rates. The tax issues are both complex and technical, and will not be covered in detail in this paper. One should however note that sub-national governments that receive their main revenues from national government transfers or from taxes set by the national government are more easily controlled by the national government than sub-national governments have access to broad tax bases, and that can set their own taxes.

At one end of the spectrum is Chile, where all taxes are set at national level, even if the revenue is destined for the local governments. At the other end is Denmark, where the municipalities have the right to collect taxes from citizens, and receive the major part of their revenues from this source.

In Sweden, the Law Council has found that permanent restrictions on sub-national taxes are incompatible with the right to self-governance guaranteed by the Constitution.

263. A key issue in expenditure and/or establishment controls is who decides on the extent and/or quality of the services provided by sub-national governments. Many countries pursue policies for equal access to and an adequate quality in such public services as education and health services across the country, even if the responsibility for the actual provision is delegated or devolved to sub-national governments.

264. A decentralisation of substantial responsibilities to sub-national government presumes that the sub-national governments have a sufficient capacity for managing these responsibilities. Later we will discuss the occurrence of mergers of sub-national government and the creation of multi-government cooperative structures. Many countries also take action to ensure that all sub-national governments have the financial resources available that are needed for hiring the staff that will provide the decentralised services.

265. In France, the national government is responsible for ensuring that local governments have adequate resources to provide the expected levels of services, and thus indirectly for the volume and quality of services provided. France also has a constitutional rule that states that each transfer of

³⁷ Voucher programmes – that is tied financial transfers to households that then select the provider – can be regarded as a form of outsourcing.

responsibilities to sub-national governments has to be accompanied by equivalent resources. Iceland has many local governments with varying numbers of inhabitants and differing potential for raising revenue, and there is therefore a great need for financial equalization schemes. These are managed by the national government.

266. In Denmark, an agreement is negotiated each year between the national government and the sub-national governments concerning their budgets. The agreement covers both the size and distribution of the government's block grant to sub-national governments as well as how much the local governments³⁸ can collect in taxes. The system entails that every time a new law is signed or an administrative change is undertaken, the national government and the municipalities negotiate about how the municipalities' budget should be changed accordingly.

267. Germany has several types of financial equalisation. The horizontal financial equalisation seeks to ensure an equalisation of the disparate financial capacities of the states at the federated level. The vertical financial equalisation regulates the apportionment of tax revenues between the three governmental tiers, i.e. the federation, the states and the local level. The municipal financial equalisation is regulated in laws adopted at the federated level, and provides for the distribution among municipalities within a state. It is designed to provide the municipalities with a financial basis for their self-government and entails a vertical equalisation between a state and its municipalities.

I.5.3. The challenges to cohesion in the public service

268. National governments may have an interest in preserving and promoting cohesion across all levels of government, defined as (a) shared culture and core values, and (b) coherent remuneration and employment conditions. These two dimensions of cohesion will be explored in the following subchapters.

269. The strength of this interest varies however across OECD countries, and a reasonable hypothesis would be that the interest is stronger in countries where responsibilities and competences have recently been transferred from the national to sub-national governments than in countries with a tradition of local self-government. Asian, continental European³⁹ and Latin-American countries would typically belong to the first group, while Anglo-Saxon and Nordic countries would typically belong to the second group. The interest would also be stronger in large and culturally diverse countries than in small and more coherent countries. It would also depend on the role of government in maintaining cohesion in society, in relation to civil service organisations such as religious and other non-profit organisations.

270. Mobility between the different public administrations in a country is generally regarded as positive, since it would tend to strengthen the cultural cohesion. One can at the same time note that the increased heterogeneity of the public administrations and the increased professional specialisation within their staffs would entail unavoidable restrictions on mobility. It might thus be easier to achieve a significant mobility between different sub-national administrations with similar responsibilities and competences, than between the national and the sub-national administrations. One should also note that an increased mobility would not always be regarded as positive by operational managers desiring stability within their own organisations.

271. Furthermore, governments may desire a horizontal mobility of senior managers across their administration in order to promote cohesion and the sharing of experiences.

³⁸ Danish regional governments no longer have own taxation.

³⁹ Switzerland would be an exception, having more in common in this respect with the Nordic countries than with other continental European countries.

1.5.3.a. The employment systems

272. There seems to be a fair consensus across OECD countries about the value and merits of cultural consensus across the whole of government, although the views on the optimal level might vary. There are however very diverging opinions about how to achieve that end, and one might even speak about two different archetype cultures or models, a civil service model and a public employment model. These could also be called statute-based and contract-based arrangements. The pure models are theoretical, and the employment systems within OECD countries represent a spectrum of mixed or intermediary systems. The description in the table below is also by necessity schematic.

Table 2. The civil service and the public employment models

The civil service model or “career based model”	The public employment model or “position based model”
Employment based on public law (“service”)	Employment based on private law (“employment”)
Employment for life	No guaranteed employment for life
Recruitment for starting points in careers, promotions reserved for insiders	Recruitment for specific positions, all positions open for external competition
Emphasis on formal diplomas and certificates	All experiences and qualifications can be taken into account
Remuneration governed by statutes, seniority elements	Remuneration governed by contracts, performance and market orientation, no seniority elements
Focus on loyalty, objectivity and due processes	Focus on achievements and performances
Special retirement schemes	Same retirement schemes as for private employees

273. The argument for the civil service model and for statutory governance would typically be that it is necessary in order to preserve the service nature of the relation between the employer and the employee, and to prevent differences that would be perceived as inequitable and that would hamper internal mobility across the different public administrations in the country. The argument for the public employment model and for contract governance would typically be that it enables a continuous adaptation to developments on the labour market and to the specific needs and conditions in different parts of the public administration. This would facilitate mobility and enable the public organisations to be a competitive employer for scarce skills.

274. One advantage of the civil service model seems to be the way ethics and core values are preserved and protected by these systems. The service nature of the relation between the employer and the employee would typically be well established in the administrative and political culture, and embodied in the civil service statutes and in career systems. These would often include statutory codes of ethics and integrity. Countries that use public employment systems also for the core government functions would have to find other adequate ways of preserving and promoting the core public service values.

275. The public service was of old normally the exclusive preserve of civil servants in all countries. The existence of public employment models is thus typically either the result of employing labour outside the civil service or of system changes. These systems are not always recent, and may have coincided with the growth in public responsibilities during the 20th century.

276. Chile has a civil service system covering both national and sub-national government employees. It has initiated reforms intended to decentralise human resource management for the sub-national government administrations. It is still too early to say how this will affect the evolution of the employment systems at the sub-national government levels. The country note indicates however that it intends to retain a legislated national framework defining the decentralised competences.

277. Belgium, France and Spain have dual employment systems, with a civil service system for permanent government employees at both national at sub-national level, and a public employment system for contracted staff. They seem intent on retaining and merely modernising these systems.

278. The public employment systems in these countries are primarily intended for temporary employees. There are however indications that the increased professional specialisation has led to the appearance of specialists that move freely between public and private employment, and that it is more rational to use a public employment system for this staff. The recent OECD review of human resource management in Belgium shows that rigidities in the determination of the civil service establishment and in the shared recruitment service for all national and sub-national civil servants have caused sub-national administrations to use contract employment as a substitute for civil service employment.

279. Germany has a more pronounced dual system, with a civil service system for core public employees in both national and sub-national governments, and a public employment system for other public employees. Germany also extensively uses non-profit private organisations for the provision of public services.

280. About two-thirds, or 3 million of the 4.8 million public employees are employed under the public employment system. The Germany country note states that this large share reflects the fundamental change in the State's perceived role and in its responsibilities. It is no longer seen exclusively as the custodian of public order, but is also considered responsible for the growth and well-being of the community. The latter types of tasks have been assigned to a great extent to public employees, while civil servants are mostly allocated to the classic sovereign functions (police, inland revenue, customs administration and ministries).

281. Denmark also has a dual employment system, but its civil service is very limited and mainly used for uniformed staff such as the police forces. The situation is more or less the same in Iceland and in the other Nordic countries.

282. The dominance of the public employment systems in the Nordic countries is not an ancient feature. Half a century ago, most national and sub-national government employees in the Nordic countries were employed under civil service systems. The transitions to public employment systems have typically been driven by desires to decentralise human resource management competences, and gradual as the national and sub-national government employers acquired experience and competences in human resource management. It was also typically accepted or even promoted by the trade unions representing public employees.

Table 3. Employment systems in OECD countries

Chile	Civil service systems Has initiated decentralisation of competences
Belgium, France, Spain	Dual systems, with dominating civil service systems Intends to modernise the civil service system
Germany	Dual system Has initiated decentralisation of competences in the civil service system Full devolution in the public employment system
Denmark, Iceland	Dual systems, with dominating public employment system Full devolution in the public employment system

283. It is not possible to draw any conclusions about the relative merits of two alternative models from the information available for this study, and it isn't even certain that there is a general answer to that issue. One plausible hypothesis is that traditional arrangements may be better suited for some countries and market-oriented arrangements for others, due to differences in the historical and cultural context.

284. One can for example note that Belgium with its strong drive towards devolution still has a Royal Statute⁴⁰ on the general principles of the administrative and remunerative statutes for public servants that cover both the federal and the federated levels. This would not be possible unless the traditional model was seen to be appropriate, given the specific Belgian context. One can also note that countries, which have special employment arrangements for public employees, tend to retain these when responsibilities are transferred from national to sub-national government.

285. None of the countries covered by the country notes seem to have structural differences between national and sub-national government employment systems. This should not be surprising. Even if there are no formal restrictions, one should not expect any immediate differences if and when human resource management competences are delegated or devolved. The recipients of the transferred competencies normally lack experiences of designing employment arrangements, and may even lack the necessary professional competence. In these cases, it would be rational for them to merely copy the national government arrangements.

286. Still, it is possible to make a number of interesting observations. A first one is that the Denmark country note describes an alternative model for achieving cohesion in employment arrangement and remuneration levels across the national and sub-national governments, relying on the fact that most Danish public employees are members of a trade union. Denmark has reduced the special employment arrangements to a minimum. Both the employers and the trade unions in the national and sub-national administrations co-ordinate their negotiations in order to ensure equal pay for equal tasks and competences. The employment arrangements and remuneration levels in the very decentralised Danish public sector are thus as least as cohesive as those in countries with extensive statutory governance.

287. The traditional systems are obviously exposed to increased strains at both national and sub-national level. There are several reasons for this. One is the increased heterogeneity of the public activities. As public administrations took on new functions in addition to the core tasks related to the governance of the country and the exercise of public authority, new specialised professional groups entered public employment. These perform similar tasks as in the private sector, and they often identify themselves with

⁴⁰ The label 'Royal Statute' implies in the special Belgian context that is a common legislation and not an act of the federal government.

their profession and not with the public service. An increased use of private organisations for the delivery of public services would have a similar effect. An increased focus on performance and efficiency would probably also be more evident in service production, and this might be difficult to correlate with the traditional employment arrangements.

288. The incidence of these strains is related to the type of activity and not to the level of government. A possible hypothesis is however that sub-national governments would be more exposed to these strains, since the new functions often involve service production than the traditional sovereignty functions. More information is however needed on the distribution of responsibilities and on the effects of the attempts to modernise civil service systems in order to get a clearer picture.

289. France has retained traditional arrangements and an all-encompassing civil service system covering both national and sub-national government administrations. It has instead met the strains by dividing the civil service system into a very large number of specialized corps. The result is a complex and fragmented system with a number of internal barriers and insider groups. The France country note highlights a number of problems and weaknesses in this system:⁴¹

“There are many informal restrictions on internal mobility within the public service. An employee can only advance to a new grade or a new corps through an internal competition or a promotion. There are a large number of models for mobility and recruitment and they vary from one part of the public service to another (590 competitions annually, 2000 different procedures). It is thus not easy for an employee to find the competitions in which he could participate, and the contents of the tests can be questioned; the subjects are often very scholastic and without a connection to the actual tasks. Furthermore, the practice of detachment is not yet widespread; it is difficult to get information on vacant posts within another corps or another part of the public service.

The internal mobility is hampered by the strong corps culture. Before an employee can be detached, he must appear before a joint administrative committee of the relevant organisation, but this commission only meets once each time per annum, and priority is often given to the persons that come from the same corps, which disadvantages persons from other corps.”

290. Germany's dual model is a seemingly successful way of combining a civil service system for core government employees with a public employment system for other employees. In this way, they continue to stress cohesion, internal mobility and whole-of-government perspectives among the staff engaged in the machinery of government and the exercise of public authority, and at the same time facilitate a performance orientation and adaptation to market conditions in other parts of the public services.

291. A final observation is that the attitudes and values of the citizens change with rising affluence, and this in a coherent pattern across countries. Scientific studies⁴² show that citizens become more interested in job content and personal development than in the status and job security traditionally associated with civil service employment, and that they want to make their own judgments instead of relying on traditional and established authorities. They also show distinct cultural patterns, and that these changes are the most far-reaching in the Nordic countries.

292. These value shifts are an important part of the context for the evolution of employment arrangements. It is possible to hypothesize that the attractiveness of a civil service system is less affected at the national level than at sub-national levels due to the proximity to the political arena, but there is so far little to substantiate such a hypothesis.

⁴¹ This text is an informal and somewhat abridged translation of the French original.

⁴² See www.worldvaluessurvey.org for more information on the value changes.

1.5.3.b. Employment conditions

i. Pay

293. There are several reasons why a national government may seek to influence or control remuneration and other employment conditions for staff in the sub-national administrations. One is that differences in employment conditions might hamper a desired mobility across public administrations and government levels. Another is that the national government might want to limit or cap the growth of public expenditure. The most important reason would however probably be an urge for coherence in public employment conditions. Cost-increasing improvements at the sub-national government level are likely to drive similar demands at the national level, especially when the labour market is tightly integrated.

294. A national government therefore typically wants to ensure that the growth of total labour costs per hour is compatible with a maintained or strengthened international competitiveness and low inflation. This is especially important for small countries with open economies. Both sub-national governments and private enterprises are however prone to sub-optimisation. They typically regard the macroeconomic developments as exogenously generated, and assume that their own decisions will not affect these variables. Their actions therefore tend to be more affected by the expected behaviour of other employers than by macroeconomic concerns.

295. There is a substantial literature about the political governance of pay setting activities in market economies, although this is more oriented towards restraining the growth of the average total labour costs in the private sector than in sub-national governments. The problems are however relatively similar in both cases.

296. The constitutional arrangements governing the relations between the national government and sub-national administrations vary across OECD countries. One can, without assessing their practical, legal or political feasibility, point to a range of options available for a national government that wants to influence sub-national remuneration.

- Entities that are under direct government control (that is the government can issue binding directives) can be governed through an appropriate centralised control,
- The government could, when appropriate, propose laws and other generally applicable statutes that would establish coherent remuneration conditions in entire public sector, and even on the entire labour market.
- Any entity that receives a state subsidy or grant can be governed by making these subsidies or grants, wholly or in part, conditional on adherence to an appropriate set of bargaining or remuneration parameters.
- The government could ensure that there are adequate consultative and cooperative arrangements enabling national and sub-national government employers to act in concert.

297. In Spain, the law that regulates the Civil Service also regulates the structure of the pay system for civil servants at both national and sub-national level. The annual increment of the wages is contained in the general State Budget. Contracted staff are employed under normal labour market conditions. In Chile, all decisions relating to the setting or modification of pay or other economic benefits for public employees, including those at sub-national level, require national legislation. These competences are to be transferred to the sub-national governments, but the new powers have to be defined in an enabling law, which is still being processed in the Parliament.

298. Each local government in France can determine remuneration and other employment conditions for its employees, but their actions are regulated by law and by the fairly complex regulations for the French corps (or career) systems.

299. Sub-national governments in Denmark set their own wages. However, the State Employers Authority has an informal, ongoing dialogue with the associations of the municipalities and the regions that function as central employers for the sub-national administration. The State Employers Authority is also represented on the municipal and regional Boards of Wages and Tariffs that function as employer representatives in negotiations with the unions in these sectors, and has veto powers in the regional Board.

300. The local governments in Iceland determine the remuneration and other employment conditions for their employees within the legal framework set for the local authorities in Iceland. Most of the local authorities have the same remuneration system and other employment conditions as they have delegated to the Association of Local Authorities to manage the wage and employment system for them

301. Sub-national governments in Belgium also set their own wages. The national government has no possibility or even legal capacity to introduce or strengthen a framework for controlling or capping overall compensation costs. There are mechanisms for consultation and cooperation, but these seem to be less formalised than in Denmark

302. Measures to control sub-national government remuneration are, as noted previously, largely interchangeable with measures to control or discipline sub-national government spending due to the dominance of labour costs in sub-national government expenditure. National controls on sub-national remuneration seem however to be much more common than establishment controls. One should also note that informal employer co-operation may generate similar outcomes. Trade unions also typically strive for coherent remuneration structures when negotiating pay contracts.

303. It is possible to argue that there is a correlation between decentralisation and differentiation; either because the goal of decentralisation is adaptation to different needs and contexts, or merely because single decisions are replaced by multiple decisions. If this results in multiple civil service systems, then cross-administration mobility would be hampered. If it on the other hand results in an increased market orientation of remuneration decisions, then one can presume that the market forces will limit incoherences.

ii. Pension

304. Retirement benefit schemes present special challenges for national government due to their long time frames. What is most worrying is that the full economic consequences of a rule change may not be fully visible until after a considerable time. Changes in pension schemes are also politically very sensitive due to the substantial vested interests. The systems described in the next paragraphs can serve as an illustration of the options and potential complexities.

305. France has a traditional defined benefit scheme. National civil servants are covered by a State pension scheme, while sub-national civil servants are covered by a pension scheme for sub-national government employees. The benefit level is linked to the period of service and typically reaches its maximum when the civil servant is between 50 and 60 years old. The gradual ageing of the public work force necessitates a gradual increase in contributions, and the government has been concerned about the sustainability of the system. The government has therefore initiated reforms intended to slow the evolution of the costs for retirement benefits including an increase in the number of years that a civil servant has to serve in order to reach the maximum benefit level. These reforms are controversial and have been the subject of protest manifestations.

306. Chile has a defined contribution scheme. Since 1982, public employees in Chile (at both the central and sub-national levels) and private sector employees have shared the same pension system.⁴³ This is based on individual savings accounts into which the employees are obliged to pay a monthly contribution. The savings accumulated in these accounts during an individual's working life, plus the yield on their investment in the financial market, determines a retiree's pension. This type of system is inherently more stable, but the final retirement benefit level is more uncertain, since it depends on the soundness of the investments.

307. The vast majority of public employees in Denmark are covered by a statutory labour market pension scheme or a labour market pension scheme under a collective agreement. Pensions for the relatively small number of civil servants are regulated under the Civil Servants' Pension Act, and are financed over the national budget. Other public employees are covered by collectively agreed pension schemes managed by special pension funds or insurance companies. These pensions are financed by pay-related fees paid by both the employee and the employer. That retirement benefits are based on collective agreements, which mean that the same parties negotiate the expected benefits, fees and net salaries. They are thus able to balance these three aspects while taking the evolution of the total labour costs into account.

308. Belgium has a traditional defined benefit pension system for both national and sub-national civil servants. The entire pension system is financed over the federal budget. This entails an awkward imbalance, since the federal government has no influence over the establishment and remuneration levels in the regions' and communities' administrations.

309. Previously all German national and sub-national civil servants were covered by a similar system, and received pensions calculated on the basis of the pensionable length of service and the pensionable pay of the last pay grade held. In 2006, the competence to determine retirement benefits for sub-national civil servants was transferred from the federal to the federated level. This will probably in the future lead to differences in retirement benefits between national and sub-national civil servants in Germany. In Iceland, all public employees are insured by the general Social Security system.

I.5.4. The challenges of capacity building and innovation

I.5.4.a. Capacity building

310. It was noted initially that the national governments could be assumed to have residual responsibilities, even if and when relevant functions are the responsibility of sub-national governments. One prerequisite for transferring responsibilities and competences to sub-national governments – or for allowing them to retain their functions - is therefore obviously that they are capable of handling them. Historical developments have however, as can be seen in table 1, left many OECD countries with a large number of sub-national governments. Some of these are quite large, but many are small, have limited resources, and can be assumed to be unable to assume any more demanding responsibilities.

311. The political, cultural and historical context can make it difficult to reduce the responsibilities and competences of sub-national governments, and might even make it difficult to resist demands for decentralisation. The most common solution to this problem seems to be mergers of several small sub-national governments into economically viable units better able to provide adequate local services. Historical data also indicate that transfers of responsibilities to sub-national government levels are often combined with a reduction in the number of sub-national governments.

⁴³ The Chilean armed forces and police service have their own pension system that is different from the general system.

312. Denmark thus reduced its number from about 1400 to 275 in 1970, and then in 2007 to 79. The number of Danish regional governments has also been reduced at the same times, first from 25 to 14 and then to 5. The last reduction was achieved by voluntary decisions in the concerned local governments. The national government had however set a deadline for achievement of a sufficient concentration and had indicated that it might consider forced mergers if the result was not acceptable. Sweden similarly reduced the number of municipal governments in 1952 from 2 498 to 1 337, and then during 1962 -74 to 278⁴⁴. These mergers were decided by the national Parliament.

313. In 1831, Belgium was divided into 2 739 municipalities. The number of municipalities was reduced to 2 508 when the Belgian borders were redrawn in 1839 as 124 municipalities were ceded to the Netherlands and another 119 municipalities became the Grand Duchy of Luxembourg. New municipalities were created until 1928 and in 1929 there were 2 675. In 1961, the executive branch was authorised by the Parliament to abolish municipalities. Municipalities could be merged on financial grounds or on grounds of a geographical, linguistic, economic, social or cultural nature. When this authority expired in 1971, Belgium still had 2 359 municipalities. In 1975, a new law reduced the number to 596.

314. In 1982, France set up 26 regions in addition to the already existing 100 *départements* and 36 773 *communes*. The creation of these regions was motivated by a desire to devolve the responsibility for territorial development and therefore also by a need to create a government level capable of handling these responsibilities. The future of the French *départements* is now under discussion. Denmark's recent decision to reduce its number of regions to five was motivated in the same way as the French decision to create regions.

315. Similar mergers of sub-national governments have taken place in several OECD countries. They are usually carried out with the consent of the communities involved and within a legal framework, but there are also examples of enforced mergers. This amalgamation process is very protracted in some countries, and does not exist at all in others. The ability of the municipalities concerned to resist mergers depends on the extent of their autonomy. Where there is a strong tradition of municipal independence, it has bred opposition to any kind of imposed merger, as in Finland where a large number of small municipalities survive despite government efforts to achieve a more rational structure. Other countries with an old tradition of self-governing local communities, such as France, Germany, Italy, Switzerland and the United States, also have a very diverse sub-national government structure with many small entities.

316. Another way of strengthening the capacity of local governments is to establish associations of neighbouring local governments. The Iceland country report notes that in many cases, two or more municipalities will join forces to deal with particular services, mostly in connection with joint projects that entail greater efficiency and lower costs. Examples of such co-operation include homes and services for elderly, waste management and pollution prevention, co-operation in the fields of culture, sports, public transport, fire services, environmental health, sewage, water and electricity works and central heat.

317. This is also the case in France. In order to mitigate the disadvantages of small municipalities, inter-municipal co-operation has been substantially enhanced. In 2005, there were 20 500 groups of municipalities, of which 2 525 had their own tax-raising power. Legislation in 1999 on the enhancement and simplification of inter-municipal co-operation brought an increased transfer of powers and employees from the municipalities to public establishments for inter-municipal co-operation (EPCI) with their own tax-raising powers (urban communities, municipal communities, urban communities), an increased supply of services and a rise in the number of officials in management positions.

⁴⁴ 12 new municipal governments have since then been created in Sweden, mainly in the urbanized areas, by splitting existing government areas. All such splits have been conditional on both parts maintaining a sufficient financial capacity for handling their responsibilities.

318. Also in Germany is it common that municipalities pool their resources to discharge specific tasks jointly. They also to an increasing extent cooperate in management and administration. The latest trend is the joint provision of services in what is called back offices, which are organised jointly by several municipalities. German municipalities often form what is known as joint authorities (*Zweckverband*) to cooperate. Some Länder also allow their municipalities to form administrative communities which discharge all or some tasks jointly. In Finland, the national government has launched a structural reform which charges sub-national governments with developing structural plans for extending and deepening organisational co-operation with neighbouring local governments.

319. Similar groupings of municipalities occur in most countries. Inter-municipal co-operation of this nature is often voluntary, based on shared interests, arranged within a legal framework, and allows each municipality to retain its own identity. The type and degree of autonomy of these associations or inter-community organisations vary across countries, and they may in some countries constitute an additional administrative tier. In most countries, metropolitan areas have also emerged, which require an extended cooperation between the local governments within the area.

320. A few countries have also started to experiment with an asymmetric distribution of responsibilities. A few Icelandic municipalities have for example, on an experimental basis, signed service contracts with the state about services, mainly for health-care and services for the handicapped and the elderly. Sweden is also discussing an asymmetric distribution of responsibilities as an option when mergers are not realistic, that is for small isolated local governments in the inland northern parts of the country.

321. Yet another structural development in some countries is the creation of a large number of non-territorial specific purpose bodies. These may be set up at all government levels. Their freedom of action varies, but is often limited to a particular field. This type of organisations is especially common in the United States and Canada.

1.5.4.b. Innovation

322. It is difficult to find comparative information on the incidence of innovation, especially in the human resource management field. It seems plausible to assume that devolved human resource management competences will lead to more experimentation with new and innovative arrangements and/or practices, merely because of the existence of a number of independent decision-makers. The fact that the scope of the systems tends to be smaller might also contribute (assuming that smaller systems are more agile). On the other hand, smaller system may have less capacity for innovation and thus tend to imitate instead of innovate. The jury is thus still out on this issue.

323. Some indications are however available. The France country note notes that sub-national governments have pushed the national government to establish a more managerial attitude to human resource management, and states the most of the sub-national governments have a more dynamic approach to public employment. A scientific study⁴⁵ of HRM innovation in the United States public administration notes that

“... Multiple examples of HRM innovations targeted at each of these goals can readily be found. ... Every conceivable nook and cranny of the HRM function is being probed, dissected, sliced, and diced by someone, somewhere in state or local agencies. Space limitations preclude even a superficial analysis of the variety of activities that are taking place daily across the nation. ...”

⁴⁵ Hays (2004)

324. Finally, one should note that the most important factor behind innovation is probably not the devolution of competences per se, but the creation of pluralism in public human resource management and decision-making, since this would facilitate the testing of alternative solutions. Thus, one might speculate about the potentially restraining effects of efficient coordination systems, such as the one in the Danish delegated employment system.

I.6. CONSULTATIONS BETWEEN NATIONAL AND SUB-NATIONAL GOVERNMENTS

325. The national governance of sub-national arrangements is not necessarily in the forms of legislation, by-laws and commands. One of the major trends in management arrangement is thus the increased dominance for dialogues and consultations, and of formal and informal agreements. The actual consultation arrangements vary however across countries due to the different administrative, political and cultural context.

326. Spain has a very formal system. The Basic Statute of the Public Employee imposes compulsory cooperation between public administrations at the three government levels. The main cooperation body is the Sectoral Conference, which groups representatives from the State, the Autonomous Communities, Ceuta and Melilla, and the Spanish Federation of Municipalities and Provinces and works with the highest representatives from each area. Below the Conference, there are other bodies that work from a technical approach. These bodies reach their agreements on public administration issues by consensus.

327. One of the subsidiary groups is the Coordination Commission of Public Employment with frequent meetings in different Autonomous Communities in order to coordinate the development of the Basic Statute of the Public Employee as well as other issues that may need its attention. Last year, its composition was broadened to include a representation for the local governments. The Monitoring Commission for the Acts and Rules of the Autonomous Communities is charged with reacting against all the acts and rules of the Autonomous Communities that threaten the balance in the distribution of jurisdiction between the State and the Autonomous Communities.

328. Belgium has probably the most advanced and therefore complicated system for consultations between the levels of government. This reflects Belgium's constitutional arrangements with no primacy for the federal level, and the high level of conflicts between the different federated entities. The collaboration between the levels of government has been institutionalized by creating a Consultation Committee and Inter-ministerial Conferences. The first is composed of members from each government and treats ad hoc cases; the latter is used to for the preparation and development of joint policies for a certain policy field. There are also Collaboration Protocols for situations when competencies are shared and when the proper execution of competencies necessitates cross-government collaboration.

329. In Chile, the Undersecretariat for Regional Development consults with the National Association of Regional Councillors and the Association of Chilean Municipalities on matters of a more political nature, such as the transfer of responsibilities and the dynamics of regional government. A National System of Municipal Information provides a comprehensive source of information about the management of the country's 345 municipalities and includes data on budgets, human resources and services that have been transferred to municipal administration as well as a number of management indicators.

330. Denmark has no national government organisation charged with relations to sub-national governments or with evaluating their activities and HRM practices. Consultations on political issues are handled by the national government and the association of Danish municipalities. Coordination of human resource management is informal and not entirely systematic. The State Employers Authority as the central employer in the State sector has an informal, ongoing dialogue with the associations of the municipalities and the regions. An interesting feature is the Forum for Top Executive Management set up a few years ago. Together with Danish and international researchers, chief executives in the Danish state and local authorities have provided the ingredients for Denmark's first code for chief executive excellence.

331. The situation is similar in Germany. There is no national government organisation charged with assessing and/or evaluating government practices and experimentations conducted by the federal Länder or the municipalities on their own responsibility. There are conferences of heads of government and of special ministers at the Länder level, and an intensive exchange of experience among the Länder as part of these conferences. They have a large number of working groups, which meet regularly and on the basis of long-term agendas. They also serve to prepare the agreements between the federation and the federal Länder. Federal employees take part in the special conferences of ministers as guests. The employers are represented jointly by the Federal Interior Minister, the Employers' Association of the German Länder and the Association of Local Authorities Employers' in order to speak with one voice vis-à-vis the trade unions and to conclude collective agreements.

332. The relationship between national government and sub-national governments in France is particularly complex due to the wide diversity of local government bodies and the difficulty in determining their respective jurisdictions and degree of financial and political autonomy vis-à-vis national government. Relations between national and sub-national governments are still strongly marked by the principles of autonomy and free administration enshrined by decentralisation. The relations are still problematic and often characterized by mistrust. National government still has problems in seeing territorial authorities as fully fledged partners since local authorities have only limited financial autonomy.

333. There are no formal forums in Iceland where national and local authorities discuss and exchange experience and best practice in the field of human resource management. The municipalities in Iceland cooperate through the Association of Local Authorities in Iceland. It serves in an advisory capacity, and disseminates information about particular aspects of local government affairs through education, conferences and various specialised publications. There is a formal co-operation between national government and the Association of Local Authorities in Iceland concerning pay setting and bargaining.

I. 7. CONCLUSIONS

334. It is difficult to draw any firm conclusions from the results of this study, except the most obvious; that context matters and that employment arrangement, human resource management practices and reform strategies vary across OECD countries.

335. The selection of the available country notes has not been at random. One can assume that they represent countries with an interest in or experience from transferring responsibilities to sub-national governments and from governing delegated and/or devolved competences. There are other OECD countries such as Ireland and New Zealand, where local governments have more limited responsibilities and are more subordinated to the national government. When the following paragraphs speak about 'countries', they only refer to the seven countries covered by the country notes.

336. A first implicit conclusion from the scarcity of country notes is that human resource management in sub-national government administrations has not created any noticeable problems for the national governments.

337. The countries that have a history of delegated and/or devolved responsibilities have found models for managing the relations between national and sub-national governments in a way that is appropriate, given the national context. The case for this is implicit and rests on the observation that none of country notes refer to significant problems. The only exception might be France, where the traditional corps system seems to generate some problems.

338. One can also note that the countries that recently have begun to transfer responsibilities and competences to sub-national governments do so carefully and within the confines of the existing employment arrangements. This seems sage, since it will allow both the national and the sub-national government to adjust gradually. It does not exclude the possibility of continued transfers as the national and sub-national administrations gain experience.

339. Formal establishment controls on sub-national government hiring seem to be rare. Most national governments rely instead on different types of financial controls to prevent local governments from building up debt, and thus to establish and affordability restriction.

340. National governments seem more concerned about determination of remuneration and other employment conditions, and there is a range of different coordination measures ranging from very formal to very informal. One can deduce from the conclusion in the preceding paragraph that the main concern is not the financial costs but the need to prevent a wage-driven inflation. A key aspect is here the need for cooperation between and coordination across a country's local governments, since these compete for the same type of skills.

341. The countries tend to have the same type of employment arrangements at national and sub-national level. This means that if countries have civil service systems (career-based systems), then these systems cover both national and sub-national administrations. One argument in favour of such systems is often the need to enable mobility between public administrations. One can however note that the countries

that have extensive public employment systems (position-based system) do not seem to have any mobility problems. A reasonable conclusion is therefore that the potential for problems lies in having parallel but different civil service systems.

342. Local government capacity has evidently been a major concern for the countries that have a history of delegated and/or devolved responsibilities. Several of these countries have undergone a process of forced or voluntary mergers of local government. Other countries have enabled and promoted formal cooperation between neighbouring local governments leading to joint organisation and joint services. A more recent and experimental feature is an asymmetric distribution of responsibilities between the national and the sub-national governments.

343. Finally, there are some indications that local governments might be more innovative than national governments, for example in modernising services and developing new human resource management practices. The information is very limited, and one cannot exclude the possibility that the key issue is the provisions of managerial freedom rather than decentralisation to sub-national governments.

344. Further work in this field would either require more precise survey questions and a broader coverage of different OECD countries, or in-depth studies in selected countries. It is thus possible that the study might be of use in preparing for and implementing future OECD country reviews of public administrations and of public human resource management.

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CHAPTER 3: MULTI-LEVEL REGULATORY GOVERNANCE ISSUES – POLICIES, INSTITUTIONS AND TOOLS FOR REGULATORY QUALITY AND COHERENCE

This chapter identifies policy issues related to multi-level regulatory governance and contributes to the development of an analytical framework for this topic. This area is a priority for OECD member and non-member countries as high quality regulation at one level of government can be compromised by poor regulatory policies and practices at other levels.

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KEY ISSUES OF MULTI-LEVEL REGULATORY GOVERNANCE

- The management of multi-level arrangements is faced by most OECD countries. The distinction between federal and unitary countries may not fully catch the entire range and variety of these institutional contexts. Although institutional and procedural settings vary from country to country, a set of common challenges is emerging from the fact that more than one level of government plays an important role, from supra-national to local level, in designing, implementing and enforcing regulations.
- In terms of regulation, the most common problems that affect the relationship between the public and the private are duplication of rules, overlapping and low quality regulations, and uneven enforcement. This issue is critical as it impedes adequate public service delivery at local level, citizen's perception of local and national authorities. It also places unnecessary burdens on business services and activities as well as to investment and trade. High quality regulation at one level of government can be undermined by poor regulatory policies and practices at other levels, impacting negatively on the performance of economies and on business and citizens' activities.
- An analytical framework for multi-level regulatory governance should address a number of issues conducive to inter-level regulatory policies, including:
 - a) *On regulatory policies and strategies*: harmonisation regulatory policy, including competition principles, at all levels of government; and horizontal and vertical co-ordination for regulatory quality at different levels of government.
 - b) *On regulatory institutions*: the role, scope and influence of the supra-national level for regulatory policy; defining roles and responsibilities of the institutions responsible for regulatory policy; and strengthening institutional capacities for regulatory quality: resources, training, capacity-building.
 - c) *On regulatory and policy tools*: consultation and communication mechanisms as a way to improve transparency at different levels of government; the introduction and use of Regulatory Impact Analysis (RIA) at sub-national levels of government; reducing administrative burdens at lower levels of government; the use of alternatives to regulation; and tools to improve implementation, compliance and enforcement of regulations.
- Regulatory policies in a multi-level context can only be effective if they reflect the diversity of needs and interests and encourage co-ordination (horizontal and vertical) and co-operation mechanisms across levels of government. The use of multi-level forums seems to provide an effective framework to achieve this goal. Harmonisation in the use of high regulatory quality standards across levels of government is essential to improve policy objectives and to make a better use of regulatory policy.
- Setting up regulatory institutions at lower levels of governments should take into account the strengthening of capacities (resources, training, capacity-building). A clear definition of roles and responsibilities among the institutions dealing with regulatory policy, which is fundamental to avoid overlapping and duplication, may however give rise to constitutional questions that can only be addressed in the political arena or through jurisprudence. The regulatory stock is often a factor giving rise to different interpretations.
- The use of regulatory and policy tools should be strengthened at lower levels of government. But identifying the "optimal level" for that may require a deep analysis of which level is better place to solve problems that affect citizens and businesses. Bottom-up solutions can provide valuable insights on this process. Indeed innovations which emerge at lower levels of government may deserve to be adopted more widely. Core issues that need to be addressed in a multi-level context concerning the use of regulatory and policy tools are: misalignment to reduce burdens, improving compliance and inspections, assessing the impacts of regulation produced at lower levels of government, strengthening transparent mechanisms in the regulatory process, and encouraging the use of alternatives to regulation.

INTRODUCTION

345. Multi-level regulatory governance is becoming a priority in many OECD countries. High quality regulation at a certain level of government can be compromised by poor regulatory policies and practices at other levels, impacting negatively on the performance of economies and on business and citizens' activities. The most common problems that affect the relationship between the public and the private sectors are duplication, overlapping responsibility and low quality. These affect public service delivery, citizen's perception, business services and activities, as well as investment and trade. More positively, following certain principles and good practices for high quality regulation in a coherent way as well as facilitating co-ordination among regulatory institutions at different levels of government can bring improvements to the regulatory system as a whole.

346. The objective of this note is twofold. First, it will identify some of the key policy issues related to multi-level regulatory governance, understood as the exercise of regulatory authority and the various dimensions of regulatory relations across levels of governments (rule making and rule enforcement at all levels of government). Second, it contributes to a "Framework for Analysis of Multi-level Regulatory Governance", taking as a basis the concept of high quality regulation and following the OECD Guiding Principles for Regulatory Quality and Performance and previous analytical work on multi-level regulatory governance.⁴⁶ This note also draws on the work already done in the Regulatory Policy Division (chapter on "Multi-level Regulatory Capacity" of the 2006 OECD Review on Regulatory Reform of Sweden, and the 2007 Review of Italy "Ensuring Regulatory Quality Across Levels of Government") as well as the work contained in country reviews on regulatory management and reform.

347. The 2005 OECD Guiding Principles for Regulatory Quality and Performance encourage "better regulation at all levels of government, improve co-ordination and avoid overlapping responsibilities among regulatory authorities and levels of government." The OECD work conducted so far has mainly concentrated on the centre of government, which is primarily responsible for that co-ordination. What is then the real scope of that principle when it comes to other levels of government? Governments are innovating and learning in this process. A comprehensive transposition of the principle to lower levels of government requires further analysis and raises some important questions:

- How can "high quality regulation" at lower levels of government be achieved?
- What are the principles that lower levels of government should follow?
- How could co-ordination, coherence and harmonisation be improved?
- How could overlapping of responsibilities among levels of government be avoided?

348. OECD countries are confronted by multi-level arrangements in different ways. Challenges stem from the fact that more than one level of government plays an important role in designing, implementing and enforcing regulations. The economic implications of this are evident. The question of the quality of regulation is essential to improve economic and social welfare. In the same way, high quality regulation contributes to boost economic activity by providing certitude to economic actors, reducing regulatory risks and eliminating unnecessary costs and burdens on businesses and citizens. Regulations are important to cities and regions as they develop their strategies for growth and sustainable developments. Therefore, ensuring regulatory quality, *i.e.* adopting and maintaining regulations so that they contribute fully to

⁴⁶ OECD (2003), *Regulatory Policies Co-ordination among Levels of Government. Some Lessons from the OECD Country Review Programme*, Background Report, Paris; OECD (2004), *Multi-level Regulatory Governance*, GOV/PGC/REG(2004)4, Paris.

achieving public policy objectives without placing needless restraints on competition, innovation and growth, has become a political priority for many OECD countries.

349. While the OECD has conducted some work on this topic, a comprehensive analytical framework that could serve as a basis for future work is still missing. This paper contributes to closing the existing analytical gap on this issue by challenging perceptions, providing examples,⁴⁷ highlighting challenges and raising questions about how multi-level regulatory governance works and could be improved.

OUTLINE

This note is composed of two parts as follows:

- Part I.

350. The first section of Part I focuses on the link between multi-level regulatory governance and decentralisation. The main goal of this section is to describe the interrelation between them and to highlight the challenges produced by different governance arrangements in OECD countries. The second section frames the problem of regulatory governance in a multi-level context, highlighting two main focuses: a) the need to spread regulatory quality principles in a multi-level context and how to cope with the regulatory management in that environment; and b) the implications that regulatory governance has on the delivery of public services. The third section presents an overview of different arrangements for regulatory quality in a multi-level context in OECD countries.

- Part II.

351. The fourth section addresses some key issues relevant for an analytical framework on multi-level regulatory governance. This provides some answers to fundamental questions on the management of regulatory systems: a) how different levels of government can integrate the same high quality principles for regulatory policy, b) how they can set up regulatory institutions and strengthen their capacities and c) how they can make a better use of regulatory and policy tools. This section is however not exhaustive and opens the possibility for future work and analysis.

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The examples illustrating multi-level regulatory governance arrangements in this document come from official information available via Internet, reports and publications from OECD and non-OECD countries and particular cases identified during the process of preparing the analytical background reports on “Government Capacities for Assuring High Quality Regulation”. A survey on multi-level regulatory governance practices and arrangements could be envisaged to deepen the understanding of this issue in the future.

PART I: 1. MULTI-LEVEL REGULATORY GOVERNANCE AND DECENTRALISATION

352. The 2005 OECD Guiding Principles for Regulatory Quality and Performance encourage “better regulation at all levels of government, improve co-ordination and avoid overlapping responsibilities among regulatory authorities and levels of government.” This summarises one basic concern that most OECD countries are facing today: high quality regulation at one level can be undermined or reversed by poor regulatory policies and practices at other levels, while conversely, co-ordination and coherence can vastly expand the benefits of reform.

353. Decentralisation is a process that has had important consequences for the way different levels of government produce and enforce regulation. Understood as a process of devolving powers and reforming the assignment of responsibilities across levels of government, decentralisation has implications for any regulatory management system: in most OECD countries there are complex layers of regulation stemming from sub-national, national and international levels of government, which have been the subject of concern with respect to the efficiency of national economies and the effectiveness of government action.

354. OECD countries provide a rich experience on multi-level regulatory governance issues. While some countries have strong federal traditions in which regions and States are active in drafting and producing regulations, others interact in more unitary frameworks, leaving to local authorities a key role in their implementation (enforcement and compliance). In addition, as a large number of OECD countries are part of the European Union, their governance structures have been adapted to the supra-national nature of the European Union. This has added a layer of complexity in terms of policy and regulatory development and implementation.

355. The historical record contains many examples of regulatory innovations which emerged at local or regional level before being adopted more widely. This variety of regulatory governance arrangements linked to the decentralisation process imposes enormous challenges in terms of economic performance, institutional architecture and social development for different reasons:

- *Regulation to boost economic activity and growth at all levels of government.* Regulatory action should try to attain better economic and social objectives while reducing unnecessary costs to citizens and business, fostering economic activity and investment, and identifying the costs and benefits of regulation. Therefore, the question of regulation becomes essential to understand the way governments affect citizens’ and businesses’ activities.⁴⁸ Many regulations that affect business services most directly are essentially a local and regional matter: land-use, zoning, construction, water, transport. In a multi-level context, this issue implies not only reducing the risk of overlapping responsibility and duplication, but also having in place appropriate mechanisms that create incentives for economic activity, such as policies towards reduction of administrative burdens, simplified and clear rules to be enforced, etc.
- *Achievement of effective national regulatory policy objectives in a multi-level context.* Central governments face the need to make national policy objectives effective and valid for all levels of government. Some harmonisation in terms of processes seems to be an appropriate balance to achieve this goal since uniform regulations might conflict with local needs. But this requires intensive negotiation, continuous political support and permanent dialogue between different layers of government.

⁴⁸ In Australia, there is an increasing recognition that there is a move “into more areas that require joint federal-state decision making and co-operation across portfolio boundaries, necessitating the use of mechanisms to facilitate whole-of-government action.” Productivity Commission (2006), *Productive Reform in a Federal System*, Productivity Commission, Canberra, p. 13.

- *Regulation and better provision of public services at lower levels of government.* As there is a trend to devolve powers to lower levels of government for providing public services, sub-national authorities are concerned with a more efficient way to deliver them and to increase capacities to manage this task. The regulatory dimension deserves special attention in this process, since lower levels of government can be confronted with overlapping roles, as direct providers and as regulators. Moreover, regulatory obligations may be imposed by a higher level on a local level without adequate compensation (“unfunded mandates”). The boundary between both roles is not always easy to define, but regulations and the regulatory process should be as transparent as possible to make governments accountable for their actions.
- *Integrating principles of high quality of regulation at different levels of government.* Evidence from OECD countries shows that there is a need to improve the effectiveness of the relations between levels of government in terms of the quality of regulation. There is a growing understanding of the importance to apply principles of high quality regulation at all levels of government. The challenge ahead is to find effective and efficient ways to do it since a simple transposition of those principles from the national level to lower levels of government does not always correspond to the appropriate solution. While there is not a “one size fits all” solution, governments are concerned about the way regulatory institutions should be set up and strengthened, the optimal use of regulatory and policy tools for high quality regulation and the definition of policies that are in line with national objectives.
- *Improving co-ordination among levels of government.* The multi-level dimension is a fundamental part of the design, implementation, enforcement of and compliance with regulation, playing a decisive role for co-ordination and coherence of the regulatory management system. The relationships between levels of government that are defined by constitution require the co-ordination of divided and overlapping designated areas for regulation making. In some cases these areas are clearly defined and governance mechanisms to deal with them are in place, but in others there are also “grey” areas produced by unclear division of responsibilities or even by innovation and economic activity that impose an urgent need for harmonisation and co-ordination.
- *Financing better regulation at all levels of government.* Multi-level governance brings economic costs with it. In terms of regulation, financial resources to support and technical capacities for regulatory quality at sub-national levels of government are not always evident. Countries are innovating in this, and some good practices should be shared. The shared goal should be the reduction of costs for citizens and businesses and the improvement of service delivery in an efficient way and without additional burden on bureaucracy.

356. The interaction between complex regulatory arrangements in a multi-level context and the decentralisation process has accelerated some trends concerning the way national and sub-national levels of government want to achieve certain objectives. In this dynamic process, national governments seek sometimes to maintain prerogatives already established by law while sub-national levels intend to gain and to expand them. Handling this tension is challenging, and in most cases current mechanisms do not provide an efficient framework for solutions. Decentralisation continues playing therefore a decisive role in the way different levels of government try to attain economic and social goals and defining limits for regulatory action.

2. REGULATORY GOVERNANCE IN A MULTI-LEVEL CONTEXT: FRAMING THE PROBLEM

357. All OECD countries face multi-level arrangements that correspond to particular historical, political, legal, economic and social conditions. At first glance, these arrangements are associated in most cases to the constitutional framework and reflected in primary legislation. But their impact goes beyond that point: the application of constitutional principles in practical terms is reflected in very detailed legal instruments that permeate most of the interaction between public institutions at different levels of government. The rules that result from regulatory activity of the State and have to do with the multi-level dynamics are expressed through laws, regulations, guidelines, codes, standards, and even rules that are embedded in the transfer of funds from one level to the other, such as grants or levered-partnered funding.⁴⁹ The degree of decentralisation and the assignment of roles and responsibilities attached to the different actors in charge of implementing and complying with those instruments vary accordingly.

358. As a consequence of these arrangements, the regulatory dimension of this process implies that multiple layers of government and actors produce and/or enforce regulation that affects citizens and business in different ways. The complexity of a regulatory system increases in a more decentralised system composed by more layers of regulatory actors. Business and social activity, however, do not follow the same path as the institutional organisation. People and businesses confront multi-level issues only when they have to interact with the public sphere and multi-level arrangements interfere in their activities. In economic terms, there are two main points to consider in this relationship. On the one hand, bad regulations impose costs on businesses and citizens, which have clear consequences on the economic activity as a whole. Businesses have growing concerns about regulatory costs, skills and capacities of local institutions and competitiveness that are linked to multi-level regulation.⁵⁰ On the other, there is a tendency to make lower levels of government more responsible for the provision of services, which requires an analysis of the different possibilities in which public action can make more efficient and effective the use and delivery of public services. Local governments tend to mix their roles of regulators, service provider or owner of public firms. This creates important conflicts of interests, which may breach the competition laws and distort the functioning of markets.

359. While the OECD Regulatory Policy Division has concentrated more on the first issue through efforts to understand how governments can make a better use of a harmonised, coherent and co-ordinated regulatory policy supported by the right set of regulatory institutions and the use of policy and regulatory tools, the second issue has deserved less attention.⁵¹ Even if the main objective of this paper is to shed

⁴⁹ Doern, B. and R. Johnson (eds.) (2006), *Rules, Rules, Rules, Rules. Multi-level Regulatory Governance*, University of Toronto Press, Toronto, p. 6.

⁵⁰ In a research report prepared by The Better Regulation Executive on business perceptions, the participants were asked spontaneously to describe the role of local authorities' regulatory function. While most participants could identify areas that related to their own businesses' role, many were surprised to learn the areas of regulation enforced by local authorities; they did not conceive that they had the available resources (in terms of both people and money) to cover such a wide remit. The Better Regulation Executive (2007), *Business Perceptions of Regulations*, Research Report, London, March, p. 64. In the Canadian province of Newfoundland and Labrador, the Red Tape Reduction Task Force conducted consultations with external stakeholders who have found that businesses feel they are over regulated. The Task Force heard similar concerns from individuals about the frustrations with, and complexity of, dealing with government. Newfoundland Labrador Government (2007), *Report of the Red Tape Reduction Task Force to the Minister of the Department of Businesses*, St. John's, February, p. ii and iii.

⁵¹ The OECD is currently undertaking a review of Italy with a special chapter on multi-level governance. This chapter will address in particular regulatory quality as well as issues related to the liberalisation of sectors such as commercial distribution; energy distribution; and local public transport, where regions, or even sometimes municipalities, have explicit regulatory powers.

some light on those elements that need to be taken into account to establish a regulatory environment of high quality for the benefit of society and economy as a whole, the second part should be subject of future work. In this sense, a framework of analysis could serve as a starting point to understand regulatory policies in a multi-level context aiming at improving not only the interaction with businesses, but also the provision of public services.

3. MULTI-LEVEL REGULATORY GOVERNANCE IN OECD COUNTRIES

360. OECD countries present a broad spectrum of multi-level regulatory governance arrangements. This section intends to highlight the most visible differences in order to understand the current trends. Whereas a simple division could lead a separation between federal and unitary countries *grosso modo*, the way regulatory powers are exerted and implemented depends on particularities and exemptions of each country since there is no uniformity of practice in the world with regard to the division of powers and responsibilities. This fact is also complemented by a general tendency to decentralise and to devolve powers to local governments in both federal and unitary countries, leaving in some cases policy areas to unclear competence or competence sharing between levels.

361. Throughout the world, functions of governance are divided between national and sub-national governments. The distinction between federal and unitary countries may not fully cover the entire range and variety of institutional contexts. Two central issues are the *degree* of sub-national autonomy and the *mechanisms* to allocate and control responsibilities. However some trends and categories can be discerned. A general framework of regulatory governance interactions between levels of governments seems to appear in terms of degrees of regulatory autonomy. Note that for a country (federal or unitary) a regulatory relationship may belong to one or to another category depending on the policy and sector. Based on the different OECD reviews,⁵² the most common categories to assign regulatory responsibilities between levels of government can be classified into four⁵³:

Sub-national governments have *no discretion* when applying regulations developed at central level (Hungary).

Sub-national governments have *some discretion to implement* regulations developed at central level (the Czech Republic, Belgium, Denmark, Ireland, Finland, the UK).

Sub-national governments have *limited powers* to create regulations (the Netherlands). These powers often concern local policy issues (Greece).

Sub-national governments have *extensive regulatory powers* (Australia, Canada, Switzerland, Mexico, the USA).

⁵² A preliminary taxonomy of the different multi-level regulatory arrangements was made in 2003, based on the different OECD country reviews on regulatory reform. OECD (2003), *Regulatory Policies Co-ordination among Levels of Government. Some Lessons from the OECD Country Review Programme*, Background Report, Paris, p. 5.

⁵³ A similar taxonomy can be used for the supra-national regulatory responsibilities applicable to OECD countries that belong to the European Union. Regulatory competences (EU exclusive, shared, national) are defined by the EU Treaty and implemented at national level via different legal instruments. These may or may not allow discretion to national governments (EU regulations, directives, and decisions) on how common rules are to be implemented. This categorization may concern primary as well as secondary EU legislation (i.e. implementation rules falling under the European Commission executive responsibilities).

362. In Categories 1 and 2 only a part of the regulatory process is assigned to lower levels of governments. In Category 2, though, a significant degree of autonomy in implementing regulations is assigned at local level. For these categories, the centre maintains a specific policy and rule-making role. The categories include a wide range of institutional contexts. At one extreme, national standards are developed at the centre but adapted and implemented with significant discretion at sub-national levels according to their own circumstances (*i.e.* institutional and functional organisation, compliance strategy). At the other extreme, sub-national governments merely execute policies, which are fully decided at the central level.

363. The regulatory relationships included in Category 2 permit local jurisdictions to differ in their approaches to implementation. At the same time, this type of relationship maintains homogeneity at national level on the elements considered relevant for the country: competition and free movement of goods and services; quality of the environment; health services; etc. This type of relationships nonetheless raises the key question on how the central level can oversee the adherence of local policies to national standards.

364. Categories 3 and 4 cover relationships between levels where more independence to the local levels of governments has been assigned: each layer has responsibility in specific policy areas. Both categories include regulatory relationships in which both central and sub-national governments participate in regulatory policy-making (that is, concurrent and overlapping responsibilities). The central level usually has no power to interfere with sub-national-level decisions, despite the fact that too much independence of regulatory decisions at local level raises the risk of duplication, inefficiencies or even contradiction. It is for these categories where the design of co-operation and co-ordination mechanisms to exploit economies of scale or to avoid barriers eroding the national jurisdiction is the most pertinent.

365. A sizable number of OECD countries are part of the European Union and have therefore adopted governance structures and legal orders meeting the supra-national nature of the European Union regulatory system. This concerns, in particular, the obligation to comply with the fundamental principles of subsidiarity, proportionality and mutual recognition imposed by the EU Treaty. As the policies and laws of EU's member states are increasingly influenced by common EU rules that are transposed into national laws in accordance with different institutional and administrative cultures, using a variety of legal instruments, the multi-level governance structures of many OECD member states are becoming increasingly complex.

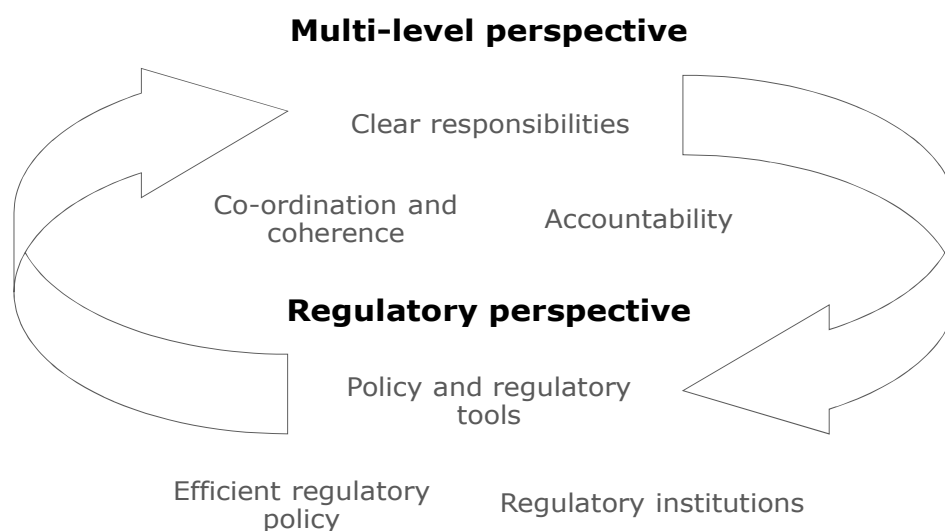
366. In all countries, however, mayors represent government to citizens at the level of everyday interaction. Citizens and business who must cope with administrative burdens and comply with regulations do not necessarily care at what level of government a particular regulation was adopted or on the basis of what kind of impact assessment. The first door through which the citizen or businessman passes is often city hall.

PART II : 4. ANALYTICAL FRAMEWORK FOR MULTI-LEVEL REGULATORY GOVERNANCE

367. The 2005 OECD Guiding Principles for Regulatory Quality and Performance encourage countries to “commit to regulatory reform at the highest political level, recognising that key elements of regulatory policy – policies, institutions and tools – should be considered as a whole, and applied at all levels of government.”

368. The implementation of this principle is a challenging task that reveals the complex nature of multi-level regulatory governance. While central governments have made improvements in managing regulatory complexity and integrating principles of high quality regulation at national level, much remains to be done at sub-national levels to strengthen human and technical capacities for implementation, to improve the quality of regulation when it is drafted and produced at lower levels of government, to set up the right institutions that deal with this issue and to make effective use of policy and regulatory tools.

Figure 1. Multi-level regulatory governance: framework for analysis



4.1. Regulatory policy and strategies in a multi-level context

369. In most OECD countries as well at the level of supra national government institutions, regulatory policy is recognised today on its own and as a relevant part of the governance agenda. A core question for national governments is how to ensure regulatory quality at all levels of government, since the coherence of government action is only achieved through the complementarity of different regulations and sub-national levels are responsible to a large extent for the application of national norms.

370. OECD countries are looking for innovative and responsive policy design to ensure that regulatory policy is exercised at the level where market and regulatory failures are most effectively tackled. In the same way as for the national level, regulatory policy should serve to boost economic development and consumer welfare by encouraging market entry, innovation, and competition at sub-national levels of

government. In economic terms, controlling regulatory costs and reducing unnecessary barriers, in particular to SMEs, is fundamental to improve productivity. Regulatory policy should also be seen as part of improving public sector efficiency, responsiveness and effectiveness.

371. The following issues are of relevance to achieve and to improve regulatory policy in a multi-level context:

4.1.1. *Harmonising regulatory policy, including competition principles, at all levels of government*

372. The growing devolution of powers to sub- and supranational levels of government imposes the need for coherence in regulatory policy. This could be understood in two different senses: one, concerning the harmonisation of the framework for regulatory quality and second, harmonisation of the content of regulatory policy at different levels of government. Regulatory governance has a dual meaning, *i.e.* it refers both to rule making at different levels of government and to overall implementation, compliance and enforcement. The scope, definition and content of regulatory policy, but also the different tools and methods used to produce and implement regulation at all levels of government should follow general principles to reduce uncertainty in regulatory action and to establish a general framework for regulatory quality.

373. Achieving regulatory uniformity is not always necessary or appropriate and because of the issues of jurisdictional sovereignty and the challenges of attaining co-ordinated agreement, achieving harmonisation of the content of regulation can be problematic. Jurisdictions within countries sometimes compete by improving their regulatory policy to attract and retain investment. However, where regulations affect a large number of businesses or citizens and impose significant costs in terms of taxes or transaction costs, there are likely to be opportunities to improve economic productivity and the welfare of citizens by introducing regulatory reforms which promote the free flow of goods and services. A key element is to have in place governance processes which allow jurisdictions to co-operate in a consideration of uniform regulatory systems to eliminate barriers to trade, maximise the simplicity and ease of comprehension of regulatory requirements, and reduce transaction costs taxes and charges.

374. Regulatory harmonisation does not imply that the content of regulatory policy formulated at national level should be uniformly adopted by sub-national levels of government; in some cases some national regulatory systems may provide a better model for national regulation.

375. In addition, achieving uniformity might be a slow and politically difficult process due to the need to bridge different views and negotiate outcomes acceptable to all parties. Nevertheless, with an increased number of actors with regulatory powers and interconnected policy areas that require government action, finding coherence and harmonising the content of regulatory policy at different levels of government is essential. Even without achieving regulatory uniformity, harmonisation of regulatory policy at all levels should follow certain principles, including competition principles that could lead to the attainment of common economic and social objectives. This can be done without interfering with the sphere of autonomy of sub-national powers. The objective is to maximise the efforts of regulatory reform at all levels of government. The State must retain regulatory oversight as an essential function, look for innovative approaches to improve quality in the regulatory framework and establish clear regulatory policy objectives.

4.1.2. *Co-ordination for regulatory quality at different levels of government*

376. Co-ordination is fundamental for the attainment of regulatory goals. As an important component of co-ordination, better communication between levels of governments may help to prevent conflicts and ineffectiveness. Making information available reduces inefficiencies and duplication of regulations,

providing a sound legal framework. In addition, co-ordination also helps in sharing good practices and in spreading the benefits of diversification of regulatory policies.

Box 1. Regulatory policy in a multi-level context

In **Australia**, it is acknowledged that initiatives to improve regulation are required at all levels of government. Regulatory reform has been an important undertaking for state and territory governments, with most implementing or continuing regulatory reform. In March 2008, the Council of Australian Governments (COAG) agreed to a regulatory reform agenda covering 27 specific areas of business regulation where significant gains could be made through applying a nationally consistent approach, as well as broader work on regulatory reform processes and an invigorated program to progress a series of national competition reforms. On 29 November 2008 COAG agreed a new National Partnership that will provide funding of \$550 million over five years to the states and territories to facilitate and reward the delivery of these reforms. The COAG has also published "Best Practice Regulation: A guide for Ministerial Councils and National Standards Bodies". This document provides guidance on best-practice regulation making and review, as a way "to maintain effective arrangements to maximise the efficiency of new and amended regulation and avoid unnecessary compliance costs and restrictions on competition."

In **Canada**, a Federal, Provincial and Territorial Working Group on Regulatory Reform has been created as a forum to help build a shared approach to regulatory reform. Its work includes developing common regulatory principles, developing a consistent approach to regulatory impact analysis and sharing best practices. The aim of the group is to develop governments' capacity to produce quality regulation and encourage regulatory co-operation across jurisdictions. Over the last 10 years, municipalities have been the object of provincial regulatory reform – moving from a traditionally rule bound system to today's more flexible framework. This reformed legislative framework allows municipal councils much greater discretion in making decisions on behalf of their electorate in an open and accountable manner.

In **Sweden**, there is no explicit regulatory policy framework for multi-level governance. The democratic basis of local government is set out in the Constitution, as the basic notion that local governments are mainly the implementers of national policies, laws, and regulations while retaining some limited areas where they may regulate as well. General principles on regulatory quality are stated in different binding ordinances and several guiding documents to ensure uniformity and high quality in the legislation.

In **Belgium**, the regulatory policy is framed by the progressive federalisation started in 1970 which aims at the distribution of competences between national and regional governments (the government of the 3 regions and the 3 communities are federated authorities whose competences remain at the same level as those of the national government). Each federated entity houses its own legislative, executive and administrative powers. Law is issued by federal parliament, royal and ministerial orders by the federal executive power and the federated entities rule through decrees and ordinances. Local governments, provinces and communes, have a residuary power derived from either decentralisation or deconcentration. Cooperation mechanisms among federal entities have been established in parallel to guarantee the harmonisation of rules and equal treatment.

In the **European Union**, the European Commission embarked on a far-reaching 'Better Regulation' programme that was fully endorsed by the other European Institutions (European Parliament and Council) and its member states governments. The programme was launched in 2002 with the aim to simplify and generally improve the EU's regulatory environment. It is designed to streamline EU's legislative procedures, cut red tape, modernise, improve the quality regulation and design better laws for consumers and business alike. Actions are being taken at different stages in the policy cycle: new initiatives, proposals still under legislative process and legislation already on the books. The programme includes a mix of inter-linked measures destined to :

- Introducing a system for assessing the impact and improving the design of Commission's policy and legislative proposals;
- Implementing a rolling programme of simplification and modernization of existing legislation;
- Testing Commission proposals still being looked at by the legislator (Council of Ministers and the European Parliament);
- Factoring consultation into all Commission initiatives;
- Looking at alternatives to laws and regulations (such as self-regulation, or co-regulation by the legislator and interested parties).

377. This co-ordination affects not only the relationships between the different levels of government (vertical co-ordination), but also those mechanisms in place among different institutions at the same level (horizontal co-ordination). Co-ordination mechanisms first tend to emerge at the international level and in

countries where levels of government are more independent (that is, mostly in federal or quasi-federal countries). However, due to the greater complexity of public intervention, co-ordination mechanisms are increasingly spreading to unitary countries. This is particularly true when devolution processes are underway.

4.1.2.1. *Horizontal co-ordination mechanisms*

378. Horizontal co-ordination suggests that lower levels of government should also put in practice mechanisms for increased co-operation among bodies responsible for regulatory reform, following efforts already undertaken at the national level, but also among other entities at the same level of government. This co-ordination is only possible when there is awareness of the importance of regulatory policy and when political support exists to mobilise the different actors involved in the regulatory process. Trying to achieve a “whole-of-government” perspective for regulatory quality at lower levels of government requires increasing support and commitment from actors and institutions responsible for the implementation of regulatory policy.

379. Horizontal co-ordination between different actors at the same level of government is essential to share practices and to understand better the challenges ahead. Consolidating a permanent dialogue in which regulatory quality is commonly understood can help to improve conditions for economic activity and to make regulatory decisions more effective to solve a given policy problem. Horizontal co-ordination can also facilitate the exchange of experiences about the costs and benefits that regulation might impose on citizens and businesses.

Box 2. Horizontal co-ordination and a “whole-of-government” perspective for regulatory quality at sub-national levels

The Better Regulation Initiative of Nova Scotia in **Canada** has a “whole-of-government” perspective and horizontal co-ordination is essential for its implementation. The Initiative falls under the responsibility of the Chair of Treasury and Policy Board and every department of the Province of Nova Scotia is involved in it. Within government, the Better Regulation Initiative is led by a strong and dedicated steering committee of assistant / deputy ministers and senior people from the following major regulatory departments: Treasury and Policy Board (Chair), Environment and Labour, Service Nova Scotia and Municipal Relations, Economic Development, Justice, Finance and Communications Nova Scotia. This group has also made use of their contacts in other governments and gained insight on what they are doing to measure the impact and improve regulation.

Source: www.gov.ns.ca/betterregulation/

Box 3. Horizontal co-operation at the same level of government

In **Italy**, the Inter-regional Legislative Observatory (*Osservatorio Legislativo Interregionale*, OLI) was created in 1979 as a tool for exchange and training among all the legislative offices of the national Parliament (*Assamblea*) regional councils (*Consigli*) and regional Executives (*Giunte*). It is a forum for discussion and exchange of experiences, but also for continuous training of those participating in its periodical meetings. The functions of the Inter-regional Legislative Observatory are: i) to provide new information on the status and knowledge of the tendencies regarding the legislation; ii) to stimulate a better understanding about the legislative activity and the quality of the legislative decision-making process; and iii) to develop a methodological body to understand the evolution of the legislation. The OLI has a permanent secretariat in the region of Tuscany and organises periodical meetings in which a detailed agenda is discussed, including issues of interest for the regions, such as recently approved laws, discussions about issues of specific challenging objectives, the sentences of the Constitutional Court, the acts of the EU that are relevant to the regions, etc. Members of the national assembly, the Senate, the central government, universities and research institute are also invited to participate in the debates. The Observatory published in 2002 a Manual on Legislative Techniques, which contains rules and suggestions for the drafting of legal instruments. Some of the Italian regions use it as a point of reference to harmonise practices in legal drafting.

Source: OECD (2007), *Italy – Ensuring Regulatory Quality Across Levels of Government*, Paris.

4.1.2.2. Vertical co-ordination mechanisms

380. Vertical co-ordination is a political priority for many OECD countries. In the cases where sub-national levels of government are constitutionally responsible if the law or the Constitution does not expressly assign a given power to the State, the problem of vertical co-ordination seems to be more acute. The principle of subsidiarity reflects a real concern for clarity and calls for finding more appropriate co-ordination mechanisms that can help to avoid overlapping and duplication.

381. Origins of vertical co-ordination mechanisms vary from country to country. The centre, however, is not always the main driver behind this process, even if it has more resources to support the co-ordination initiatives. The devolution processes tend to speed the need for co-ordination, and also trends in the opposite direction, in cases where the centre would like to recover powers that have been devolved to other lower levels. The tension arising from this process undoubtedly generates the need for certain mechanisms to avoid conflicts and prevent inefficiencies.

a) Co-operation and co-ordination mechanisms: agreements and permanent institutional bodies

382. Most OECD countries dealing with a multi-level dimension have set up co-operation and co-ordination mechanisms and permanent institutional bodies to streamline the relationship between levels of government. Those mechanisms are either formal or informal, depending on the political and legal tradition and tend to have a more permanent structure, rather than an *ad hoc* basis.

383. In most countries, regulatory co-ordination has been promoted by associations and local authorities, for instance among municipalities and between different levels of government. This has provided a good basis for advice and better understanding of the needs and problems at different levels of government. But co-ordination has been improved mainly by special bodies and institutional mechanisms that serve lower levels of government to submit comments, to put forward specific measures and to negotiate with the central level. Co-operation agreements have also improved co-ordination by establishing specific plans with clear frameworks for implementation and financing.

Box 4. Co-ordination mechanisms for regulatory quality in some OECD countries

Australia has recognised a need for formal and informal institutions to co-ordinate different levels of government. The Australian Constitution created a 'federal' system of government, in which power was divided between the Commonwealth Government (or national government) and the six state governments, with clear separation of national and sub national responsibilities. The different levels of government within Australia interact through meetings of ministers and officials. The Council of Australian Governments (COAG) is the peak intergovernmental forum in Australia comprising the Prime Minister, State Premiers, Territory Chief Ministers and the President of the Australian Local Government Association (ALGA). COAG was established in May 1992 and it first met in December 1992. Meetings are chaired by the Prime Minister. The role of COAG is to initiate, develop and monitor the implementation of policy reforms that are of national significance and which require co-operative action by the Commonwealth and state and territory governments. COAG meets on an as needed basis. The then Prime Minister John Howard stated after the April 1999 Premiers' Conference that, since there would be no further Premiers' Conferences following the landmark Intergovernmental Agreement on the Reform of Commonwealth-State financial relations, COAG would meet at least once a year from 2000. Alternatively, COAG may settle particular issues out-of-session by correspondence. In the past decade, a number of issues have been settled in this manner. The outcomes of COAG meetings are contained in communiqués released at the end of each meeting. Where formal agreements are reached, these may be embodied in Intergovernmental Agreements (IGA). Following the change of national government in November 2007, COAG has met more frequently. It met on four occasions in 2008 and is expected to do so again in 2009. During this time, COAG addressed a large reform agenda to boost productivity, increase workforce participation and mobility, and to deliver better services to the community. The COAG reform agenda also contributes to the broader goals of social inclusion, closing the gap on Indigenous disadvantage and environmental sustainability. In addition, a historic new IGA was signed in 2008, providing an overarching framework for the Commonwealth's future financial relations with the states and territories. Other issues may be considered by COAG, from Ministerial Council deliberations, major infrastructure, climate change and national security initiatives and structural reform of government. The COAG Secretariat is located within the Department of the Prime Minister and Cabinet.

Germany places a greater premium on a common response through shared or joint tasks. The Bundesrat plays a key role in co-ordinating different levels of government. The *Länder*, or federal states, work together within their own sphere of responsibility in the Conference of Minister-Presidents (*Ministerpräsidentenkonferenzen*) and the various sector-specific Conferences of Ministers (*Fachministerkonferenzen*). These bodies are neither federal organs nor part of the Parliament as such. There are, however, close links between the *Bundesrat* and each of these Conferences, as the politicians represented in the *Bundesrat* are also members of the various Conferences. Some of the sector-specific Conferences also have their co-ordination offices in the *Bundesrat* Secretariat. The Conferences give the federal states scope to co-ordinate their own work within the federal co-operation system. In these meetings the *Länder* agree upon their strategy for shared problems and define their position vis-à-vis the Federation but also seek to arrive at consensus-based solutions together with the Federation. As a rule, decisions on points of substance are only made if there is unanimity. However, such decisions do not have direct legal effect, although they are binding as political recommendations.

In **Switzerland**, there are a number of forums facilitating dialogue between federal and cantonal (as well as municipal) authorities, offering possibilities to debate proposals of cantonal authorities and to transmit them to federal authorities. The most relevant are the following: a) Conferences of Cantonal Directors, composed of the directors of the 26 cantons in 13 policy areas, serving two purposes: i) co-ordination between the cantons; and ii) co-ordination between cantonal and federal authorities. Although officially run by the cantonal governments, the relevant members of the Federal Council and high-ranking federal public officials are invited to these meetings. Federal authorities present plans and proposals for new laws/regulations, which are discussed with the cantonal ministers. The cantonal ministers on the other hand present proposals or requests or point to problems in federal-cantonal relations; b) A Conference of Cantonal Governments, created in 1993, serves as a co-ordinating organism among cantons and as a lobby group of cantonal interests in all matters that go beyond the range of the 13 policy oriented "conferences of cantonal ministers" as well as of the conference of cantonal chancellors. The "Conference of cantonal governments" thus discusses institutional matters of overall importance, highly important matters (mostly of cross-sectional character) and those matters that go beyond a single policy domain (e.g., foreign policy with regard to European integration); c) Federal Dialogue, is a forum in which a delegation of the Federal Council and a delegation of the "Conference of cantonal governments" biannually discuss questions and projects of overall importance; d) A Tripartite Agglomeration Conference assembles representatives at the federal, cantonal and municipal level. It serves to streamline policies for the metropolitan areas and urban centres of Switzerland.

In **Norway**, several mechanisms are in place to ensure co-ordination of regulatory proposals affecting local governments. First, regular formal meetings are held between representatives from central and local government. At the political level a process of four consultative meetings per year (since 2000) brings together key ministries of the central government with high level representatives from the Norwegian Association of Local and Regional Authorities (*Kommunenes Sentralforbund*, KS). Similar meetings are held addressing issues pertaining specifically to county and municipality issues. Second – as part of the public consultation on draft laws and regulations – local government and local government organisations (KS) receive for comment those government draft regulations considered of special relevance for local governments. Third, and probably most importantly, continuous informal dialogue takes place between central

and local government representatives at different levels, in many different forms, and on political as well as technical and professional issues.

In **Belgium**, co-operation between the federal state and the federated authorities (regions and communities) is institutionalised through Committees for Consultation and Inter-ministerial Conferences. As soon as a decision affects another authority's competences, this institutional framework operates to eliminate disputes derived from a complex division of responsibilities. They also facilitate co-ordination to ensure a complete and harmonious transposition of European directives.

In the **European Union**⁵⁴, Better Regulation is a shared responsibility. The European Commission submits proposals for adoption to the European Parliament and the Council. The EU laws are transposed into national law by national governments and parliaments and often applied at regional and local levels. The responsibility for regulating well is hence a shared one as well as a political priority. The European Commission relies on the close cooperation of the other European institutions, the Member States and local administrations to achieve Better Regulation goals. To enhance coherence and cooperation, a number of formal and informal mechanisms exist since the early 2000s to co-ordinate the EU's Better Regulation programme. In the European Commission, the Secretariat General oversees the regulatory and policy activities of the various departments (Directorates General). In 2006, an independent Impact Assessment Board was also established to issue opinions, addressed to the College of Commissioners, on the quality and policy coherence of the mandatory impact assessments produced by the various departments and attached to Commission's proposals. In the 2003 an Inter-institutional Agreement on Better Law-Making was concluded with the European Parliament and the Council setting down on paper how they can work together to legislate better. The agreement also includes provisions for a 'common approach to impact assessments'. The three institutions have set up the High-Level Technical Group for Inter-institutional Cooperation (HLTG) to monitor the implementation of the Inter-institutional Agreement. The European Economic and Social Committee and the Committee of the Regions are also consulted on Commissions' proposals.

To ensure coordination with national governments in pursuing the EU's Better Regulation goals, a number of additional ad hoc networks were created; the High-Level on Better Regulation chaired by the Commission, the group of Directors and Experts on Better Regulation chaired by the rotating presidencies and other thematic groups such as the independent High Level Advisory Group on the reduction of administrative burdens and the Standard Cost Model Network. All these groups meet on a regular basis to monitor and coordinate developments taking place both at Community and national levels.

384. Designing the ways of co-operation and co-ordination vertically and unilaterally does not seem to be an appropriate approach to tackle this issue. Top-down solutions might not always reflect the diversity at the bottom. In the same way, substituting this process by a simple juxtaposition of autonomy for lower levels of government is neither the solution. OECD countries have realised that it is essential to establish a strategic framework prior to the transfer of powers, and to define the necessary support mechanisms for this process. In particular, this is essential for the improvement of public service delivery at sub-national levels of government.

Box 5. Co-operation to improve public service delivery at local levels

Denmark, a unitary state, has regional and municipal levels of government in addition to the national government. As a result of a sustained process of decentralisation, particularly since the fusion of local authorities in 1970, much government service delivery is carried out at lower levels of government. Regulatory policy remains concentrated at the national level, although there is significant consultation with local government as a result of its major role in implementation. From the perspective of local government, the key regulatory issue is that of increasing the freedom to act to be able to achieve efficiency gains needed to allow services to be delivered within tight fiscal restraints. To achieve this goal, the Government initiated a local government reform and a five-year work reform took place in 2007. Structural setting and relations between local and central government were redefined. According to the new system, there are new mechanisms and areas in which national and central governments co-operate and co-ordinate their service delivery. For instance, prior to the local government reform of 2007, the central government was responsible for recipients of unemployment insurance benefits through the Employment Service and each municipality managed its own job centre to provide assistance to people without insurance. Under the new municipal structure, the central government seeks to

⁵⁴ For further information consult the European Commission Better Regulation websites:

http://ec.europa.eu/governance/better_regulation/index.en.htm

http://ec.europa.eu/governance/impact/index_en.htm

http://ec.europa.eu/governance/better_regulation/admin_costs_en.htm

ensure consistency between the national employment policies and local activities through four employment regions (corresponding to the regional boundaries except that two regions, the capital region and the neighbouring Zealand region are combined in one employment region). These employment regions have resources to help with prevention and mitigation of labour supply bottlenecks and reaction to the closure of large companies. The local job centres, which are currently staffed by both local and central government employees, are planned to be managed solely by the local municipalities from August 2009. The purpose of this reorganisation is to secure an optimal spending of the available resources and to avoid having two separate administrative systems. Hence, by creating a unified employment system the local centres should be able to provide a better service. The job centres have become a single access point for all citizens and companies needing assistance with employment matters. However, there are a large number of job centres given the size of the labour force and the municipal focus may hinder labour mobility by focusing the unemployed on services and jobs within the municipality. Consequently, the co-ordination role of the regions is particularly important.

Belgium accounts for 589 communes under the authority of the regions, Communes Associations and other more informal groups are in place to facilitate co-operation at local level on policy implementation. In addition, federal institutions also facilitate co-ordination among local level authorities when undertaking delegated responsibilities.

385. In the same way, co-operation is fundamental in the national interest in some areas of inter-governmental and inter-jurisdictional relations. But other solutions are also available: a competitive dimension provides incentives for governments to improve public sector efficiency as well as the effectiveness of regulatory and institutional frameworks. Interregional competition can be highly profitable because it encourages an optimal cost-benefit ratio and fosters innovation in the provision of public services. This process, however, must not result in regulatory dumping where local governments may practice unfair competition in their zeal to attract investment or retain jobs.

Box 6. Consolidating the internal market in Switzerland

In **Switzerland**, inter-cantonal co-operation is facilitated by a dense network of inter-cantonal agreements and conferences. Even if this "horizontal" co-operation has been less important than the "vertical" one between the Federation and the cantons, this trend is changing. Federalism can be seen as a political laboratory in which the cantons constantly experiment with new policies: if a solution is successful, it is likely to be adopted by other cantons as well. In this context, it is possible to distinguish between pioneers, imitators, and laggards.

A major concern in terms of economic efficiency and improvement of economic conditions for competition is the consolidation of the Swiss internal market. The diversity of regulations across levels of government (Confederation and cantons) has a direct effect on the consolidation of the internal market with the implications for the whole Swiss territory for goods, services, people and capital. Switzerland's federal organisation and its linguistic diversity are contributing to the segmentation of the domestic market in a large number of sectors. While competition policy is a federal competence, cantons do have extensive powers to intervene in markets for safety and social concerns and by the use made of public property. They often exert strong influence on the supply and pricing of public utilities, such as water, electricity, regional transport, etc. Cantons also have a marked influence on industries such as construction and professional services with very diverse regulations that de facto constitute entry barriers.

Efforts have been made to eliminate the market restrictiveness generated by cantons and localities. The Internal Market Act helps to aid professional mobility and trade in Switzerland, in order to foster competition in the national economy. As a framework law, its aim is not to harmonise regulations of a different nature at lower levels of government, but to establish the principal mutual recognition among federal jurisdictions and outline some needed basics for the effective functioning of the internal market. First and foremost, the Internal Market Act defines the principles governing free access to the market. Any person possessing an establishment and any enterprise having its registered office in Switzerland is entitled to offer goods and services on Swiss territory. Access to the market is governed by the rules of the place of origin. At the same time, certificates of qualification issued or recognised at canton level, permitting the exercise of a lucrative activity, are valid anywhere in Switzerland. The law on freedom of access to the market also includes cantonal and communal public procurement.

Source: OECD (2005), *Government Capacity to Assure High Quality Regulation in Switzerland*, Paris.

386. Setting up co-operation arrangements - and institutionalising them - can be difficult. Local levels of government do not always have the same needs and proper incentives for strengthening co-operation may not be clear to them. Tensions with the centre may be more acute if the devolution of powers does not clearly set the limits of regulatory powers between different layers of government. Weak political support,

constraints in human and technical resources, financial costs associated with the co-operation process and vested interests at different levels are some of the barriers to more formal co-operation mechanisms.

b) The principle of mutual recognition

387. The principle of mutual recognition is a low cost and pragmatic approach to addressing the mobility and transaction of goods and services across borders. It lowers the costs of associated regulatory barriers between jurisdictions, without the need for full harmonization of laws which, in some instances, are difficult or nearly impossible to achieve within a reasonable timeframe. Mutual recognition encourages free trade and can lead to economic efficiency gains.

388. Mutual recognition is an effective tool for promoting economic integration within a given area or region and is hence particularly well-suited to the multi-level dimension. The principle operates in a simple way: the acceptance of a good or service by a Party or country mutually recognizing compliance with each other's requirements without further testing or regulation. Mutual recognition is an effective way of reducing barriers to the movement of goods and services.

Box 7. The principle of mutual recognition in practice⁵⁵

Mutual recognition came about in **Australia** upon acknowledgement by the national, state, and territory governments that regulation and mandatory standards in each jurisdiction can act as barriers to the movement of goods and labour within Australia. These barriers can increase the transaction costs of moving or providing goods and services across borders, and create disincentives for firms and workers to venture beyond their home jurisdiction. Mutual recognition was agreed in Australia in 1991, and adopted legislatively in 1992 by the Commonwealth and most states and territories. It aims to lower regulatory and technical barriers to the movement of goods and labour between Australian states and territories. It involves each jurisdiction mutually recognising compliance with each other's regulatory or technical requirements for a particular good or service, where the equivalent regulation could vary from their own requirements. Mutual recognition of goods enables most goods which are sold in accordance with the regulations of one jurisdiction, to be sold freely throughout the country. In addition, members of registered occupations can also practise an equivalent occupation in other Australian states and territories without any further testing. The mutual recognition system in Australia is based on a "cross-border model" where there is a focus on reducing barriers to the movement of goods and labour between different jurisdictions. It does not interfere with the regulation of goods within each jurisdiction. In addition, it does not impact on the regulations governing entry to registered occupations by new entrants within a jurisdiction. The Australian arrangements extended to New Zealand in 1997 through the *Trans-Tasman Mutual Recognition Act 1997* (TTMRA). This agreement represents a model example of how mutual recognition arrangements can be established between two countries.

Source: Office of Regulation Review (1997), *Impact of Mutual Recognition on Regulations in Australia: A Preliminary Assessment*, Canberra.

4.1.3. The role, scope and influence of the supra-national level for regulatory policy

389. The supra-national dimension plays a relevant role in many OECD and non-OECD countries when it comes to designing and implementing regulatory policy. The impacts of regulatory institutions and processes cut across national borders. Today, new regulatory arrangements range from supra-national institutions (the European Union) to international, multilateral and bilateral agreements (NAFTA, TBTA in the GATT, etc.), as well as co-operative agreements between countries.

390. Concerns to improve the quality of regulation can be found also at the supra-national level and this has become an important driver to optimise regulatory quality. Scope for improvement remains valid,

⁵⁵ The EU's approach to mutual recognition is largely similar and serves identical purposes.

in particular concerning the specific role of local governments finally affected by this complex regulatory system.

4.1.3.1. *Impact of the European Union*

391. The European Union (EU) decision-making has a significant impact on the EU Member States. EU principles, legislation and case law affect Member States politically, legally and organisationally. The regulatory impact of the EU spills over to third countries, which have to comply with EU regulatory requirements as part of their economic and trade relationships. For these reasons, both the EU institutions and national governments have worked towards improving co-ordination vertically (across the levels of governance) and horizontally (across jurisdictions).

392. In the Community context, EU decision making takes account of Europe's diversity. While the European Commission represents the common interest, the Council of Ministers and the European Parliament represent the States and the peoples, respectively. The European Court of Justice is the independent judicial branch. Any relationship between the different layers relies on the principle of subsidiarity, which is a fundamental principle of EU law and is enshrined in the Treaty Establishing the European Community (Art.5). In important areas the presence of European requirements has strengthened reformers in several countries and has had a very positive influence on the market orientation of the regulatory system. Competition policy is a point in case. The Single Market programme conveyed a robust, market-based, regulatory regime in product standards and services. In the environment and public safety areas, the EU has worked towards establishing EU-wide thresholds for scientific standards, risk assessment and management.

393. On the other hand, European legislation may prompt less favourable conditions for regulatory reform. Efforts to search for and adopt alternative regulatory solutions might sometimes be inhibited, and in some countries transposing and implementing EU law has had unintended effects on the traditional law system, rendering the regulatory system more complex. In the case of EU directives, nonetheless, Member States maintain the choice of the form and method of transposition, while they are bound by the objectives to be achieved.

394. The institutionalisation of the transposition process of the *acquis communautaire* has led to the creation of co-ordination units at the national level, which vary in power and size. Some differences are also visible in terms of strategies, co-ordination capacity, inter-ministerial consultation, the role of parliaments and the existence of fast-track procedures. National parliaments play varying roles in the transposition processes. Some have adopted specific procedures for this process, others have not.

395. The flow and quality of information from and to Brussels has been steadily enhanced. This has covered both the preparatory as well as the implementing stages of policy-making. The EU institutions have fostered their consultation practices as well as the access to EU legislation through a series of initiatives on Better Regulation, transparency and good governance. Discussions about how to further improve the supranational-national interface are ongoing on various fronts, including on how to best convey timely and useful national inputs to the impact assessment procedure of the Commission. On their side, most of the countries have established dedicated bodies and specific procedures to manage the relationships with the EU. Scholars speak in this respect of an "europeanisation" of national administrations and the emergence of a European administrative space.

396. Finally, Member States must ensure that the new regulations are implemented and enforced properly and in a timely way. These issues go beyond the traditional formalistic scoreboards process as they focus on outcomes and real life changes. The involvement in this respect of the sub-national authorities throughout all phases of the decision-making process is therefore critical. At the EU level, the

Committee of the Regions is an advisory body representing the regional dimension (see Box 8). National as well as regional representations have also blossomed in Brussels and work as an increasingly important interface.

Box 8. Some mechanisms in the EU to deal with lower levels of government

Established by the Maastricht Treaty in 1993, the Committee of the Regions (CoR) participates in the legislative process of the EU. It is composed by 334 members, appointed for a four-year term by the Council, acting on proposals from the member states. Each country chooses its members in its own way, but the delegations all reflect the political, geographical and regional/local balance in their member state. The members are elected members of or key players in local or regional authorities in their home region. The Committee organises its work through six specialist Commissions, made up of CoR members, who examine the detail of proposals on which the CoR is consulted and draw up a draft opinion, which highlights where there is agreement with the European Commission's proposals, and where changes are needed. The draft opinion is then discussed at one of the five CoR plenary sessions which take place each year. If a majority approves it, the draft is adopted as the opinion of the Committee of the Regions and is sent on to the Commission, Parliament and Council.

After the European Council decided in spring 2005 to focus on relaunching the Lisbon Strategy, Community Strategic Guidelines for Cohesion (CSG) were adopted in 2006 and require future cohesion policy to target resources on three priorities: improving the attractiveness of member states, regions and cities; encouraging innovation, entrepreneurship, and the growth of the knowledge economy; and creating more and better jobs. In response, all member states have been preparing a National Strategic Reference Framework (NSRF), which describes how each country proposes to implement these priorities on its own territory.

Source: www.cor.europa.eu; http://ec.europa.eu/regional_policy/sources/docoffic/2007/osc/index_en.htm

4.2. Regulatory institutions in a multi-level context

397. Regulatory institutions are fundamental to ensure regulatory implementation and the appropriate use of regulatory instruments. In a multi-level context, the challenge for most countries is to ensure that the right institutions are in place, at the right level, with the right powers and accountability to allow them to exploit endogenous strengths and tackle the particular weaknesses of each area.

398. There are many kinds of institutions responsible for moving the regulatory agenda forward in a multi-level context. Given this multiplicity of actors, it is fundamental to identify those that complement the leadership and the political will for introducing a reform agenda that will bring benefits to the whole system. This implies finding ways to solve particular tensions between technical bodies and representative institutions that might not always have the same policy priorities. Institutions for regulatory quality at the centre of government can only succeed in implementing broad programmes of regulatory reform if they find support from other institutions at different levels of government.

399. In some federal countries, states have established oversight bodies for regulatory reform, emulating the ones at the central level, responsible for introducing quality controls to the way regulation is produced and enforced. These bodies also take the lead as co-ordinators and managers for reform with a “whole-of-government” approach and introduce the use of policy and regulatory tools in a systematic way. This trend, however, is not common to all federal countries and further research and evidence is needed on the impact such institutions can have on the regulatory framework as a whole.

Box 9. Regulatory institutions at lower levels of government in OECD countries

In **Canada**, some provinces and territories have established specific institutions dealing with regulatory reform issues. Some examples of this trend are the following: the Ministry of Small Business and Revenues of British Columbia has established a Deregulation and Regulatory Reform Office, which is in charge of cross-governmental activities to streamline and modernise the regulatory environment. In Quebec, the Secretariat of the Ministerial Committee in charge of economic prosperity and sustainable development (*Comité ministériel de la prospérité économique et du*

développement durable) is responsible for regulatory and administrative streamlining and co-ordinates with other interested parties in the government.

In **Mexico**, regulatory improvement commissions at state level have been established following the structure and functions of the Federal Improvement Regulatory Commission (*Comisión Federal de Mejora Regulatoria*, COFEMER). In some cases, such as the State Commission for Regulatory Improvement of Puebla (*Comisión Estatal de Reforma Regulatoria*, CEMER), these bodies have a governing board composed by the Governor of the State, the president of the biggest State business association, Ministers from key State ministries and representatives from academia and civil society. In other States, institutionalisation of regulatory management is conducted by ministries of economic development, such as in the case of Aguascalientes.

Sources: www.regulatoryreform.gov.bc.ca; www.mce.gouv.qc.ca/allegement/index.htm; www.puebla.gob.mx/cemer; www.aguascalientes.gob.mx/economia/mejreg/cte/default.aspx

400. Oversight bodies are not the most common institutions at lower levels of government. At sub-national levels of government, there are local authorities with regulatory powers, regulatory agencies in specific utility sectors, legal departments of executive and legislative branches at regional or state level in charge of producing laws and regulation, and many other institutions dealing with enforcement and compliance issues. This complex institutional landscape calls for stronger partnerships between central and local agencies and authorities as a way to solve the lack of clarity of responsibilities, the costs of duplication and the possible conflict of interests resulting from an ambiguous definition of roles.

4.2.1. Empowering different institutions for regulatory quality: defining roles and responsibilities

401. Institutions are fundamental for regulatory reform and to maintain coherence in policy design and implementation. Institutional organisation is normally laid down in constitutions. Decentralisation has brought significant modifications to administrative arrangements as most countries are confronted by greater allocation of competences and as a consequence of responsibilities to sub-national levels, both in federal and unitary countries. In terms of regulation, the key challenge of this process is to identify clearly who is regulating what.

402. The right set of institutions to ensure regulatory design and implementation is fundamental at any level of government. In OECD countries, regulatory institutions have appeared at sub-national levels of government, as a way to maintain coherence and to support co-ordination. The challenge is to define clear roles and responsibilities, in particular in those areas that are of shared competence with the central government to avoid duplication and contradiction.

403. While defining roles and responsibilities, institutions need to be responsive to citizens' and businesses' needs, and while trying to avoid adding a new layer of bureaucracy and more red tape. Many countries have not yet found appropriate solutions to this challenge, which in part is due to particular legal and political specifics.

4.2.2. Strengthening institutional capacities for regulatory quality: resources, training, capacity-building

404. Institutions can only be effective if they have the necessary resources to implement policies and make use of policy tools. Without real financial means, the regulatory powers transferred to local governments will be not exerted. National agencies for better regulation depend for success on implementation at the local level.

405. Spreading the concept of "regulatory quality" requires training those dealing with regulations and building capacities across the administration. National governments have encouraged and assisted the development of capacities among local and regional governments, *inter alia* by providing training and development opportunities, as well as forums for developing policy.

Box 10. Supporting local governments for regulatory quality

In the **United Kingdom** a new organisation, the Local Better Regulation Office (LBRO), was set up by the Government in May 2007, to improve local authority enforcement of environmental health, trading standards and licensing and to reduce burdens on businesses that comply with the law while targeting those who flout it. Its overall aim is to secure the effective performance of local authority regulatory services in accordance with the principles of better regulation and the Government is legislating to give it powers to deliver that purpose. Its focus is on ensuring that inspection and enforcement are based on an assessment of risk, so that businesses are supported and regulatory resources are focused on those areas that most deserve tougher scrutiny. LBRO also works to ensure that businesses, particularly those that operate across council boundaries, receive greater consistency in advice, support and inspection from local authorities.

In **Mexico**, the Federal Improvement Commission (*Comisión Federal de Mejora Regulatoria*, COFEMER) has developed guidelines for municipalities on regulatory improvement (*Guías de Mejora Regulatoria Municipal*) in order to provide technical elements to municipalities to support the design of their own regulatory reform strategy. These guidelines cover not only regulatory aspects, but also methodological and technical capacities to improve administrative and institutional capacities. Examples of these guidelines are: Legal Techniques to Elaborate Municipal Regulations, Reengineering of Municipal Procedures, Rapid Business Start-up System, System for Municipal Information and Catalogue of Municipal Procedures, etc.

Sources: www.lbro.org.uk/; www.cofemer.gob.mx.

4.3. Regulatory and policy tools in a multi-level context

406. Regulatory and policy tools for high quality regulation are of diverse nature. While there are some tools that help to improve regulatory design, such as consultation and the use of impact assessment, there are others that improve the implementation of regulations, such as compliance and enforcement mechanisms. In a multi-level context, some of these tools are fundamental for achieving regulatory goals, but evidence shows that there is further scope to explore their better use. It should be noted that this section does not include a discussion of e-government in relation to tools for better regulation, a topic which deserves further study (2008a).

407. The implementation and use of policy and regulatory tools in a multi-level context presents some challenges. In terms of their design and the specific techniques needed to put them into practice, there is certain homogeneity between the tools used at central and sub-national levels of government. The big questions, however, refer to the best strategy to maximise the benefits of certain tools and to make a coherent choice of which level should be in charge of their implementation. Tools for high quality regulation at different levels of government should be designed and used with the aim to reduce transaction costs and to identify the “optimal level” of application. The multi-level dimension requires that policy-makers consider avoiding possible overlapping in the use of certain tools that could be costly if not used in a rational way.

408. Regions and localities need regulatory and policy tools to build on their own assets in order to respond in a flexible way to changing economic conditions and face the challenges of globalisation. Hence the problem is not only how to increase capacities to implement regulatory quality instruments at a specific level, but what the main problems are that arise when regulatory quality instruments are applied to institutional frameworks organised as networks. In a multi-level context, duplication and overlapping in the use of certain policy tools can be even more costly, as this implies additional resources and efforts that could be better afforded by only one level. The challenge is to identify the right level and attach to it the use of certain tools, ensuring that other levels can be part of the network and take advantage of that policy tool.

409. The improvement of regulatory frameworks can only be achieved if there is a clear identification of these problems and challenges occurring associated to the application of different regulatory instruments. It is also essential to reflect on the necessary conditions to ensure their efficient use over time.

410. The following sections make reference to the use of selected regulatory and policy tools for the design and the implementation of regulations.

4.3.1. Better consultation and communication mechanisms as a way to improve transparency at different levels of government.

411. Public consultation and communication are two key elements to improve regulatory transparency at different levels of government. Transparency refers to the organisation of the way the state projects its regulatory powers to the society and the market, and it is fundamental in the regulatory process, from the initiation of the regulation, its formulation and drafting, to its implementation and review. The way all levels of government include participation from the public in the regulatory process and communicate the benefits of reform and the content of regulations is fundamental to the smooth functioning of the regulatory system as a whole. Transparency can address many of the causes of regulatory failures, such as regulatory capture and bias toward concentrated benefits, inadequate information in the public sector, rigidity, market uncertainty and inability to understand policy risk, and lack of accountability. In lower levels of government, these problems tend to be more acute as the interaction with more actors and the diversity of roles and responsibilities increase the complexity of the system. In a multi-level context, there is an increased need to make more information available to the public, to listen to a wider range of interests and to be more responsive to what is heard. Transparency can therefore improve the choice of regulatory policy options and avoid arbitrary decisions in regulatory implementation.

412. Because local governments are closer to the people they administer, local decision-makers can be allies in adapting regulation to changing needs and circumstances. A jumble of often contradictory regulations can impose major costs on the public. A great variety of solutions have been adopted for involving local governments in defining regulations and how they are implemented. What might be called “co-operative” solutions associate local governments throughout the process, or at one stage of the process (formulation of objectives, for example), and make them responsible for all or a portion of the outcomes. Initially, this approach involves negotiation and may appear inefficient, but over time it will foster better adaptation.

4.3.1.1. Public consultations

413. In a multi-level dimension, network structures call for new consultation mechanisms and new bargaining processes to ensure horizontal and vertical co-ordination. Regulatory decisions require the involvement of different actors whose points of view and positions should be heard. However, consultation can only achieve its goals if transparency and openness in the process is respected.

414. The legitimacy of a regulation has to do not only with the authority of the body adopting it but also, and increasingly, with the degree of public input. Thus, decentralisation undoubtedly contributes to the democratic process if it serves to reinforce transparency and the consultation of stakeholders. Introducing a true right of public intervention in the regulatory process can maximise the positive effects by ensuring that public services are adapted to local preferences. However, attention needs to be paid to the increased bureaucracy inherent in multilevel complexity. There is a subtle balance between an excessive formalism that induces judicial inflation and a lack of clarity that prevents citizens from identifying the relevant level and telling them what they expect. The position of citizens varies according to their role as users, taxpayers, etc., and the risk that consultation processes might be taken over or even hijacked cannot be ruled out. The public is not “neutral” and nor is the local authority concerned. It may be tempted to satisfy the wishes of its direct electorate, sometimes to the detriment of national objectives.

Box 11. Consulting with the public at lower levels of government

The province of Nova Scotia in **Canada** has launched a Better Regulation Initiative with a “whole-of-government” perspective, involving every department of the province. Consultations with business groups have been essential to shape the plan and priorities for the Initiative. Among these groups, the government has consulted with the Canadian Federation of Independent Business, the Canadian Restaurant and Food Service Association, the Construction Association of Nova Scotia, the Halifax Chamber of Commerce, etc., under the leadership of various departments on specific topics. These discussions have provided business and the public with the chance to be part of the solution.

Source: www.gov.ns.ca/betterregulation/.

415. While these points need to be borne in mind, it remains true that better knowledge of users is essential in the process of optimising public governance. This may take place in a more or less formal way, depending on particular conditions. Civil society, businesses and individual citizens can all effectively spur the adaptation of regulations to their needs. Determining the right level of government is a necessary but not a sufficient precondition for success.

416. Consultation also refers to the way local voices are heard at national level. In order to improve the design and the implementation of regulations in a coherent way, consultation mechanisms with lower levels of government should be encouraged.

Box 12. Integrating lower levels of government in consultation procedures

In **Sweden**, the process that precedes the development and passage of a new law includes the set up of Committees of Inquiry, whose terms of reference are stipulated by the government and members, special advisers and experts are appointed by the lead minister concerned. Often experts are recruited from local and regional authorities and from the Swedish Association of Local Authorities and Regions (SALAR). The Committee normally holds public meetings and their results are extensively circulated for comments. Even if there are only limited formal consultation mechanisms, groups and citizens present their views through the normal work of local municipal councils and committees in the course of their normal public business. Informal consultation mechanisms also involve contacts with local enterprises and business organisations, municipalities, SALAR or other state agencies.

In **Switzerland**, extensive consultation procedures are used at cantonal level and to integrate their views at the federal level. Cantonal administrations are rather small, but the number of cantonal ministries as well as their internal organisation differs considerably from canton to canton. Cantons participate and influence the decision making of the Federation through consultation mechanisms according to Art. 45 of the Federal Constitution. Since they are in charge of implementation of federal laws, the Confederation informs them in advance and in a detailed way about future projects and it is obliged to involve them into the consultation procedure. The association of cantons in the consultation is an important way to participate, but not the only one. Cantons can also raise their voice through representatives in mixed working groups or institutionalised meetings. The commissions of the Council of States consult with cantons on the applicability of laws. The Federal Law of Cantonal Participation on Foreign Policy (*loi fédérale sur la participation des cantons à la politique extérieure de la Confédération*) allows those cantons that can participate, in an early stage, to the foreign policy of the Confederation.

Sources: OECD (2007), *Multi-level Regulatory Capacity in Sweden*, Paris; OECD (2005), *Government Capacity to Assure High Quality Regulation in Switzerland*, Paris.

4.3.1.2. Communication

417. One dimension of transparency that is relevant for the multi-level dimension is the improvement of the clarity of legal and regulatory frameworks and the effectiveness of communication and access arrangements. In many OECD countries and at different levels of government, there is an increased use of legislative codification and restatement of laws and regulations, to enhance clarity and identify and eliminate inconsistency. In addition, the adoption of centralised registers of laws and regulations, to enhance accessibility, is now widespread.

418. Lower levels of government, in particular in federal countries, have introduced plain language drafting to support the effective communication of legislation by making laws intelligible to citizens. In particular, plain language is essential for achieving high levels of compliance and effective enforcement. It also reduces the risk of complaints and disputes.

419. Communication has been improved by integrating the use of information communication technologies (ICT). Used as tools to disseminate information, this has helped to make regulatory requirements easily and cost-efficiently available for relevant target groups. In terms of transactional aspects, the use of ICT has enabled and facilitated regulatory information transactions between authorities and businesses and citizens. ICT has also contributed to information sharing: ICT has contributed to common store and share information required according to regulations between different government bodies.

Box 13. Communicating with stakeholders and citizens at lower levels of government: examples in Belgium

The Belgian Agency for Administrative Simplification (ASA) is in charge of preparing an annual programme and evaluate the results in a final report available on-line on www.simplification.be. This website offers more information about:

- Fulfilment of projects;
- On-going projects;
- Analysis of administrative impact;
- Administrative burdens measurement
- Reporting on activities
- Conclusions of seminars

The Agency for Administrative Simplification (ASA) organizes conferences for general public as well as training sessions on:

- All four public administration's initiatives each year;
- Impact analysis using the Kafka test;
- On-line consultation of data available to public officers.

In addition, a newsletter is published six times a year.

The Walloon region in **Belgium** has established a Commission for E-Government and Administrative Simplification (*Commissariat à l'E-Administration et à la Simplification administrative*, EASI-WAL) in charge of general co-ordination of cross-cutting issues on administrative simplification, e-government and processing re-engineering. As part of their mission, EASI-WAL places communication at the forefront. The main goals are to inform, to sensitive and to train. In terms of communication towards the users of public services, EASI-WAL focuses on the promotion of simplification improvements directly visible and useful for the citizens in their relationship with the administration.

In 1992 the Flemish parliament approved a decree concerning the control on the Flemish government communication. An expert commission for communication was established and a framework for communication was designed in 1996. It was stated that "*from the Flemish government is to be expected that it strives towards "communication in its policy" meaning that it has to translate its policy in clear and plain language, instead of clarifying unclear policy afterwards by means of government communication*". The framework sets out specific requirements for government communication concerning:

- the government that sends out the message, for instance:
 - A clear distinction has to be made between "in progress" and "approved" policy;
 - A recognizable label has to accompany each communication;
 - Communication has to be planned under strict and professional criteria.
- the message sent;
 - All public administration's information must be correct to ensure and maintain citizens' trust in government;
 - Clear and simple language has to be used
 - Communication means need to be in balance with the expected results

- The receivers of the message, mainly businesses, citizens and local governments:
 - Access to information should be easy and user-friendly for all target groups
 - Information should be free of charge and timely

The Flemish Linguistic Unit monitors the compliance of plain language criteria by draft regulation and provides *ad hoc* linguistic advice to government departments. In order to provide easy access to administrative procedure forms, the Flemish government has built a one-stop shop to make all Flemish forms available through one single website www.vlaanderen.be/formulieren. In total, 1,225 forms are classified and accessible by to topic, target group and type. A quality label has been introduced for forms aiming at improving the quality of these forms. At the end of September of 2008, 553 forms had already received a quality label.

Source: <http://easi.wallonie.be> www.vlaanderen.be.

4.3.2. *The introduction and use of Regulatory Impact Analysis (RIA) at sub-national levels of government*

420. Regulatory Impact Analysis (RIA) is a systematic decision tool used to examine and measure the likely benefits, costs and effects of new or existing regulation. In OECD countries its use at the central level of government has expanded in the last few decades. In those countries where sub-national levels of government have the prerogative to produce regulation, mostly federal countries, RIA could contribute to the policy and decision making by providing valuable empirical data about the consequences of regulation.

421. If RIA is to be implemented in a multi-level context, a number of issues have to be solved given that several institutional actors might be involved in the policy making process. The institutional fragmentation caused by this fact implies that the dynamic relationships between all these actors have to be managed by bargaining processes whose rules and characteristics vary across sectors. Moreover, in case of overlapping rules generated by different levels of government, RIA might be compromised by detailed provisions that are delegated to lower levels of government or by rules which are too specific.

422. Under these circumstances it is worth asking whether RIA should be undertaken at each level of government or what is the “optimal level” to do it. Solutions to these questions will depend on the specific context and sector regulated, but the usefulness of RIA for local regulations is unquestionable. Regulations produced by lower levels of government have normally a direct and decisive impact on citizens and businesses, generating substantial costs and benefits. Lower levels of government can tailor RIAs to the specific needs of their economies, aspects that could be ignored by higher levels. RIA at lower levels of government also contributes to increase efficiency and transparency while considering consequences of proposed regulation. But finding the “optimal level” is not an easy task and so far there is no empirical evidence on how to define it.

Box 14. Making use of impact assessments at lower levels of government

In **Australia**, between 2006 and 2007 regulatory reform was an important undertaking for state and territory governments, with most implementing or continuing regulatory reform programmes. In April 2007, the Council of Australian Governments (COAG) reiterated its position concerning regulatory impact analysis process, by including the requirements in its Regulatory Reform Plan, which is part of its National Reform Agenda. COAG has agreed that all Governments will establish and maintain effective arrangements at each level of government that maximise the efficiency of new and amended regulation and avoid unnecessary compliance costs and restrictions on competition, including by establishing and maintaining “gate-keeping mechanisms”, and improving the quality of regulation impact analysis through the use, where appropriate, of cost-benefit analysis. This commitment was reinforced in November 2008 through the signing of the National Partnership Agreement to deliver a Seamless National Economy, which committed the Commonwealth, states and territories to the development and enhancement of such existing processes for regulation making and review.

Examples of RIA systems in different Australian territories are the following:

- Victoria has a comprehensive regulatory impact analysis process. This includes a statutory requirement to prepare a RIS where a proposed statutory rule is likely to impose an appreciable economic or social burden on

a sector of the public. In addition, there is a requirement for a Business Impact Assessment (BIA) to be prepared for primary legislation that has a significant impact on business or competition. Where any legislative instrument results in a material change in the administrative burden imposed on businesses and not-for-profit organisations, an SCM measurement is required to be undertaken and the results publicly reported.

- In South Australia, all Cabinet submissions require an assessment of regulatory, business, regional, environmental, family and social impacts. Where the regulatory impact is significant, a RIS must be attached to the submission. Where there is a proposed restriction on competition, the assessment must demonstrate that the benefits outweigh the costs and that the objectives can only be achieved by restricting competition. In addition, where there is a significant change proposed in relation to services or infrastructure in regional areas, a formal Regional Impact Assessment Statement (RIAS) must be prepared. After Cabinet consideration, RIAs are lodged in Parliament and published on the website of the Office of Regional Affairs.
- In Queensland, proposed subordinate legislation that is likely to impose appreciable costs on the community, or a part of the community, is subject to the preparation of a RIS as prescribed under Part 5 of the Statutory Instruments Act 1992 (Qld) (the SIA). In accordance with the principles outlined in the 1995 Competition Principles Agreement (CPA), the Queensland Government requires that all new and amending primary and subordinate legislation that restricts competition is subject to a public benefit test (PBT). Where proposed subordinate legislation is likely to impose appreciable costs on the community, or part of the community, and contains restrictions on competition, a combined RIS/PBT can be prepared. The Queensland Office for Regulatory Efficiency (QORE) was established in 2007 to lead the development and implementation of the Queensland regulatory reform agenda. It has now been transferred to the Treasury portfolio to better coordinate the national and state reform agendas across the Queensland Government.
- In New South Wales (NSW), the Subordinate Legislation Act 1989 (NSW) requires the preparation of a formal RIS for a proposed statutory rule. That is, the minister responsible must ensure that the guidelines in schedule 1 of the Subordinate Legislation Act are complied with before a statutory rule is made. The Act requires that the RIS take into account economic and social costs and benefits of proposals, and that costs and benefits be quantified, wherever possible. The objectives of the regulation must be outlined and tested to ensure they are appropriate and not inconsistent with other regulations. Alternative options must also be canvassed. Further to the requirements of the Subordinate Legislation Act, regulatory impact analysis is required for all new and amending legislation and regulation in NSW, and consultation is recommended. The NSW Government established the Better Regulation Office (BRO), within the Department of Premier and Cabinet, in 2007. The NSW Guide to Better Regulation specifies that, from 1 June 2008, all regulatory proposals should be developed in a manner consistent with the 'better regulation' principles of RIA. A Better Regulation Statement, demonstrating the application of the principles, should accompany any significant new or amending legislation or regulations

RIA at regional level in **Italy** is in its initial steps. So far, none of the Italian regions conducts RIA in a systematic way. But since 2003, the Department of Public Administration and FORMEZ (*Centro de Formazione Studi*) have undertaken 14 pilot projects on RIA with 10 regions. The exercise has involved more than 130 officials, participating in working groups from each region and representing, in general, the regional executive bodies (*Giunte*). In some cases, the exercise has involved representatives from the regional legislative bodies (*Consigli*). FORMEZ has published an evaluation on the pilot projects at regional level. For each one of the regions, evaluations contained the specifications of the RIA, technical documentation that supports the analysis and disseminate the results, an assessment of the technical and organisational difficulties encountered during the process, and a list of questions that provide some guidance on how to solve the methodological and implementation problems.

In **Canada** some provinces and territories have introduced impact assessments conducted in a systematic way. The province of New Brunswick started the integration of a Business Impact Test (BIT) in 2002 as part of the process for all new and/or amended legislation or regulations to prevent additional red tape. In 2005 the BIT application was extended to include policy advice to government as part of the original process. BIT's application ensures that decision-makers are aware of the potential impacts of any new policy, legislative and/or regulatory amendment on business. The BIT will determine whether or not regulatory change is the best option to address issues facing government, while taking into account stakeholders' views, the impact on the province's competitiveness, and the cost-benefit to government and business.

Sources: Council of Australian Governments (2007), *Best Practice Regulation: A Guide for Ministerial Councils and National Standard Setting Bodies*, Canberra; OECD (2007), *Italy - Ensuring Regulatory Quality Across Levels of Government*, Paris; www.gnb.ca/cnb/promos/red-tape/index-e.asp

423. The introduction of RIA at lower levels of government requires also an analysis of the costs and technical capacities to conduct it. States or regions producing regulations are not always properly staffed or do not have the necessary resources to undertake a process that might be costly in time and money. In this case, innovative thinking is essential to find appropriate solutions to the shortcomings. Improving

co-ordination and consultation, essential for a successful RIA implementation, are only two ways in which the multi-level dimension could be addressed.

4.3.3. *Reducing administrative burdens at lower levels of government*

424. Cutting red tape is one of the most commonly used tools to improve the quality of the regulations. A recurrent complaint from business and citizens in OECD countries is the number and complexity of government formalities and paperwork. This reflects the fact that registration formalities and also procedures related to land use and construction permits are among the most visible regulatory burdens imposed on business by governments. In a multi-level context, these burdens can be more evident, especially if lower levels of government also have the power to impose formalities and lack quality control mechanisms in place that can avoid unnecessary costs to comply with them. Administrative burdens can impede innovation and job creation as well as create barriers to trade, competition, investment and economic efficiency, discouraging entrepreneurship.

425. A number of OECD countries have implemented programmes to reduce local formalities in order to boost economic activity, to facilitate entrepreneurship and to simplify citizens' lives. As a general trend, simplification strategies mainly focus on business, an area where burdens have the most negative effect on competitiveness and growth. Countries have, however, different priorities concerning simplification, including not only businesses, but also the public sector and citizens. As local governments are closer to citizens, reducing administrative burdens has become a priority for many of them. At lower levels of government, simplification measures try to target SMEs, since this sector is less well placed to deal with administrative burdens and the complexity of regulations can damage its development.

426. The use of ICT tools to reduce red tape at lower levels of government is increasing. While being more in contact with businesses and citizens, lower levels of government are asked for more on-line services to be available so that businesses and citizens, particularly in areas outside service centres, could file documentation from their locations. This also requires a stronger co-ordination inside the government with a more "client oriented" approach in its relationship with businesses and citizens. ICT tools are widely used in order to disseminate information, making regulatory information requirements easily and cost-efficiently available for relevant target groups; to facilitate transactional aspects between authorities and business and citizens; and to share information by common storing and exchanging information required according to regulations between different government bodies.

Box 15. Cutting red tape at different levels of government

In **Mexico**, starting-up a business means dealing with 3 different levels of government: federal, state and municipal. Two major procedures are related to lower levels of government: land use and licences to start-up. The Federal Regulatory Improvement Commission (*Comisión Federal de Mejora Regulatoria*, COFEMER) launched in 2002 the integrated Rapid Business Start-up System (*Sistema de Apertura Rápida de Empresas*, SARE) allowing firms to comply with federal, state and municipal regulations, and start operations in up to two business days. In a country where a large proportion of economic activity is performed by micro and small enterprises (80% of economic activity) this SARE was greatly needed to improve the climate for doing business and investing. The SARE covers today 110 municipalities in the entire country.

In **Belgium**, collaboration between different levels of government has been essential for administrative simplification efforts for two main reasons: citizens and businesses do not distinguish between the federal and the regional level when they are confronted with red tape and the effectiveness and coherence of certain actions are only optimised when they cut across all levels of power. In December 2003, a co-operation agreement concerning administrative simplification was signed between the federal level, the Flemish, French and German speaking communities, the Flemish region, the Wallonie region, the Capital-Bruxelles region, the Flemish communal Commission, the French communal Commission and the common communal Commission. A consultation committee gathers delegates from concerned administrations and ministries. This committee produces an annual programme to set the priorities for concrete administrative simplification

projects commenced at federal level, such as the common data collection through the Crossroad Database for Enterprises (*Banque-Carrefour des entreprises*) and the public markets (*marchés publics*), the transposition of certain directives, the integrated co-operation for the Kafka one-stop shop, and the administrative burden measurement mechanisms such as the Standard Cost Model and the biannual business survey.

In **Portugal**, a number of different simplification activities take place at municipal level: one example is "Digital Cities and Digital Regions" funded through UMIC with support of EU structural funds. It consists of more than 32 projects, covering 96% of Portugal, involving e-government solutions for local governments, conditions for reinforcing the competitiveness of small and medium size enterprises and a variety of citizen-oriented services such as health, education, social support, culture, and safety. These projects have been an effective instrument to mobilise local actors and enhance their qualifications for managing joint local and regional development programs based on ICT.

In the **European Union**, the European Commission launched in 2007 an ambitious Action Programme aimed at reducing administrative burdens on businesses in the EU by 25% by 2012. The Action Programme was endorsed by the European Council which invited Member States to "set national targets of comparable ambition". The Action Programme aim is to measure costs imposed by information obligations (IOs) that impact on business. The purpose is to improve the efficiency of EU rules and suppress unnecessary requirements without jeopardizing the purpose of the legislation in case. A key part of the Action Programme consists of a large-scale measurement of administrative burdens, using the Standard Cost Model methodology, to be followed by major simplification proposals. In parallel, more substantial changes are being considered for inclusion in the EU's Simplification Rolling Programme which reviews and modernizes the body of EU law developed over the past 50 years and which may have become overly complex in certain areas. The reduction target concerns burdens stemming from EU legislation with equivalent targets being fixed by national governments on purely national legislation.

Sources: www.cofemer.gob.mx; www.simplification.fgov.be; OECD (2008a), *Simplifying life for citizens and businesses in Portugal – Administrative Simplification and e-Government*, Paris.

427. Recent experiences show that more quantitative approaches are increasingly used as the primary source for assessing and quantifying the size of administrative burdens. In many OECD countries there are increased efforts to assess burdens more systematically and develop evidence on administrative burdens. This has the advantage of properly identifying the burdens and targeting reform groups, but also tracking burdens over time and to measuring reform success. Following this trend at national level, lower levels of government in many countries have embarked on measurements of administrative burdens, as part of the efforts to cut red tape.

428. Burden reduction might also have financial implications which are not easy to solve. Businesses and citizens recurrently complain about the costs of fees to be paid for services provided by governments, which might be considered as inhibiting business development. But business formalities are sometimes a source of revenue for different administrative authorities. Being the case for lower levels of government, cutting red tape might have direct effects on the way local governments maintain their sources of financing, creating resistance to changes.

Box 16. Measuring administrative burdens at lower levels of government

In **Canada**, different provincial governments have integrated measurements of administrative burdens as part of their efforts to cut red tape. The province of Newfoundland and Labrador, whose 99.7% of all businesses are considered as SMEs, has set up in its Red Tape Reduction Initiative a target of 25% reduction of the number of regulatory requirements within government by 2009. So far, the provincial government has succeeded in reducing them by 10.5%. The government of British Columbia set up a target of 33% for cutting regulatory burden in 2001. Through regulatory reform efforts, the government has exceeded that target by over 40%. Since 2005 and after a first operation to reduce formalities in the province, the Government of Quebec established a strategy for cutting red tape and improving the business environment in the province, setting up a target of 20% reduction by 2010, as part of its economic development strategy called The Québec Advantage.

In **Germany**, with a cabinet decision of 28 February 2007, the Federal Government committed itself to the following goal: "the Federal Government aims to reduce unnecessary bureaucracy significantly and quickly and sets itself the target of reviewing the measured sum of administrative costs resulting from information obligations, while identifying and eliminating unnecessary costs of this kind by the end of 2011. The Federal Government aims to reduce the present administrative cost burden by 25 %." About 10.400 information obligations have been identified at federal level. Separate policies take place at sub-federal level. Some examples can help illustrating the activities in the German Länder (States):

The *Land Brandenburg* started in 2006 a process called Quick Scan to have an overview over the legal framework. As a consequence some measurements of administrative costs in a number of specific laws have been conducted. North Rhein Westphalia, through the decision of the Cabinet from March 2007, has decided to work on 32 decisions of the state government after an analysis of the existing legal framework; on 23 specific projects in different departments and on 100 particular measures. Hessen has included sun-setting clauses for regional laws and procedures aimed at starting a consolidation process of the legal framework.

In **Belgium**, the Standard Cost Model is under use to measure the existence and reduction of all burdens regardless their institutional origin. The Agency for Administrative Simplification has developed a permanent programme to measure regulatory changes to be included in those measures.

Sources: www.gov.nl.ca/redtape; www.regulatoryreform.gov.bc.ca; www.mce.gouv.qc.ca/allegement/index.htm; www.stk.brandenburg.de; www.hessen.de; <http://www.im.nrw.de/vm/13.htm>

4.3.4. *The use of alternatives to regulation*

429. Alternatives to regulation are not always explored in depth by regulators. The choice of policy instrument tends to be based more on habit and institutional culture than on a rational analysis of the suitability of different tools to address the identified policy problem. Consequently, a crucial challenge for regulatory policy is to encourage cultural changes within regulatory bodies that will ensure that a comparative approach is taken systematically to the question of how best to achieve policy objectives. Efficient and effective policy action is only possible if all available instruments are considered as a means of achieving the identified objective. The instruments to be considered include a wide range of non-regulatory instruments, as well as a number of distinctly different forms of regulation.

430. The use of alternatives to regulation is however not risk-free. Using untried approaches and the perception of failure to develop adequate answers are reasons to deny the possibility of using alternatives. But regulators are looking for new policy instruments to meet the expectations of what regulatory action can achieve. A growing demand from citizens and a new environment for regulatory action pressure the need to make better use of alternative mechanisms.

431. In a multi-level context, the use of alternatives to regulation could be explored for two sets of reasons. First, it might be argue that lower levels of government are in a better position to understand if regulation is the only possible way to respond to a policy issue. In many situations, there may be a range of options other than traditional “command and control” regulation available, including more flexible forms of traditional regulation (such as performance-based and incentive approaches), co-regulation and self-regulation schemes, incentive and market based instruments (such as tax breaks and tradable permits) and information approaches or no regulation at all. Second, when used in the right circumstances alternatives can offer significant advantages over traditional command and control regulation, including: greater flexibility and adaptability; potentially lower compliance and administrative costs; an ability to address industry-specific and consumer issues directly; and quick and low-cost complaints handling and dispute resolution mechanisms.

Box 17. Alternatives to regulation mechanisms at the sub-national level

As an example of market-based instruments, auction type mechanisms have been used by governments to purchase environmental ‘services’ or benefits. The Victorian State Government in **Australia** has recently piloted an environmental conservation programme: The BushTender scheme involves landholders bidding to provide management services to improve the quality or quantity of native vegetation on their farm. The State Government provides funds to the farmers on the basis of a Biodiversity Benefits Index, which measures the conservation value of the site and the value of services offered by the landholder per dollar of payment. Those proposals ranking the highest on the Biodiversity Benefits Index receive priority funding.

In **Japan**, the Special Zones for Structural Reform system allows for regulatory exemptions in certain areas based on proposals by local governments and private companies. The aim of the system is to vitalize regional economies by providing a more suitable regulatory environment for each local government. Moreover, if a regulatory exemption is evaluated as a sound one, then the regulation will be reformed so that the exemption can be applied nationwide. This

system was established in 2002 and so far 623 regulatory reforms have been implemented to date: 214 regulatory reforms have been carried out in special zones and 409 at nationwide level.

In the framework of the **European Union**, tripartite contracts and agreements are used to develop the arrangements for the participation of the regions in attaining targets set at European level in co-operation with the national and regional authorities. These contractual tools, which are subject to a general obligation of compatibility with the Treaties, must respect the States' constitutional systems and may not under any circumstances constitute a barrier to the sound operation of the single market. They are justified where they provide added value which may take several forms: simpler implementation, political benefits, efficiency gains resulting from the close involvement of regional and local authorities, or speedier performance.

Sources: OECD (2006), *Alternatives to Traditional Regulation*, GOV/PGC/REG(2006)9, Paris; OECD (2008c), *Brazil – Strengthening Governance for Growth*, Paris; European Commission (2002), *Communication from the Commission – A framework for target-based tripartite contracts and agreements between the Community, the States and regional and local authorities*, Brussels.

432. There might be, however, clear constraints for using alternatives to traditional regulation in a multi-level context. The case of market-based mechanisms is an example. While market-based mechanisms are often used in combination with other policy instruments, there can also be problems in integrating them across jurisdictional borders, for example between national and sub-national levels of government. The use of fiscal instruments, including taxation and subsidies, can be difficult across jurisdictions where the rates may need to be approved by different levels of government. These cross-jurisdictional problems are not necessarily insurmountable, and there are examples of market-based mechanisms being used successfully across jurisdictions (such as the European trading system for carbon dioxide). But the need to ensure consistency with other regulatory arrangements can complicate the introduction and use of market-based instruments.

4.3.5. Tools to improve implementation of regulations

433. To be effective in achieving policy objectives, regulation must also be adequately applied and enforced. Understanding this final link in the regulatory policy chain involves consideration of the related issues of the practical application of the regulations, including the rights of redress accorded to the regulated, and of regulatory compliance and enforcement. All these issues involve the set of relationships between the regulators and the regulated: regulators must apply and enforce regulations systematically and fairly, and regulated groups must have access to administrative and judicial review of those actions of the regulator.

434. Key instruments in establishing the accountability of governments in OECD member countries are administrative procedures acts, the use of independent and standardised appeals processes and the adoption of rules to promote responsiveness, such as legislated time limits to respond to applications and “silence is consent” clauses.

435. The issue of regulatory implementation is receiving substantially increased attention at different levels of government in some OECD countries. There is a need to better understand the different mechanisms used to deal with the wide range of implementation issues that arise as a consequence of that process. This is directly linked to the positive trend of transparency and accountability observed in many OECD countries, in which improvements in enforcement and compliance can be seen as a reflection of more open and transparent regulatory decisions.

4.3.5.1. Regulatory compliance and enforcement

436. In order to achieve policy goals, regulation must be adequately applied and enforced. The level of compliance is the most fundamental determinant of the effectiveness of regulation in meeting policy objectives. Regulatory design and implementation must proceed from an understanding of the factors that determine the willingness to comply of regulated groups. Thus, the question of compliance is fundamental for the quality of the regulation.

437. In a multi-level framework, the issue of compliance deserves attentive analysis for the following reasons. First, compliance starts from a reaction from business and citizens that trust the government. While lower levels of government tend to be closer to their needs, businesses and citizens will be able to respond only if there is a clear understanding of regulatory requirements and of the rules. Local governments need to make an effort to ensure that stakeholders are not only well informed and know the rules, but also that regulations appear simple to comply with. Second, lower levels of government should work on the feasibility of compliance. They must facilitate the assimilation of rules, the way citizens have to comply with them and the confidence in regulators and the regulatory structure. Otherwise, the technicality of rules can lead to non-compliance by encouraging evasion. Third, lower levels of government should have a strategy on monitoring and enforcement, which is not always the case in the present situation. Lower levels of government might be in a good position to provide solutions on the enforcement and implementation phase, combining regulatory and non-regulatory measures to increase the opportunities for compliance, in particular when they are responsible for inspection and monitoring.

438. The enforcement and compliance dimension of regulation is clearly linked to the issue of multi-level regulatory governance. Enforcing regulations is in most cases conducted by lower levels of government as part of their responsibilities for implementation. But there are also national authorities participating in this task setting out the rules to be followed, which calls for co-ordination and coherence in the approach. Most regulators in OECD countries rely on local authorities, for instance, to conduct inspections and provide advice to those businesses that fall into the regulator's remit.

439. Concerns in OECD countries about the costs that are imposed by regulators to businesses and citizens while enforcing regulations are increasing, in particular costs that tend to fall disproportionately on SMEs. Those concerns include a multi-level dimension in many cases. For instance, this relates to the cost of the number of inspections,⁵⁶ as one of the mechanisms used to ensure compliance, which national and local regulators have to undertake in a given sector for a specific period of time in order to fulfil their enforcement responsibilities.

⁵⁶ In the United Kingdom, for instance, local authorities carry out four times as many inspections as national regulators. Hampton, Philip (2005), *Reducing Administrative Burdens: Effective Inspection and Enforcement*, HM Treasury, March, p. 17.

Box 18. Regulatory compliance at lower levels of government: the case of Nova Scotia

In **Canada**, the province of Nova Scotia has launched a Competitiveness and Compliance Initiative (CCI) as part of its Better Regulation programme. CCI has developed an internal checklist to track whether regulatory proposals conform to the principles and goals in the Regulatory Management Policy. This checklist ensures that proposals have considered impacts, costs and benefits, undergone stakeholder engagement, have performance measures, and meet other principles of the Policy.

According to this Initiative, compliance can only be promoted if society is aware of laws and there is a promotion to reduce burdens for citizens and businesses. To achieve these goals, strategic development of compliance promotion plans are envisaged, such as the expansion of the use of tools to promote compliance; the inventory of existing compliance promotion initiatives, such as training, plain language documents, awareness initiatives, capacity building initiatives, stakeholder engagement, website material, etc.; the use of existing initiatives as compliance promotion best practices; the completion of compliance promotion plans for regulatory areas; the profile of a number of specific compliance initiatives.

To improve compliance with the regulatory programmes, the Initiative contemplates the development of a department-wide compliance framework that sets out principles and a model for achieving compliance under which division specific compliance models are based; to work with the Public Prosecution Service to establish a dedicated Crown Prosecutor for regulatory offences with clear expectations and effective communication between the Crown Prosecutor and the department; to review department-wide compliance policies and procedures and work to make them more consistent across inspectorates; and to establish a common Activity Tracking System that tracks compliance activities of all four inspectorates and identifies areas for compliance improvement.

Sources: Office of Competitiveness and Compliance (2005), *Nova Scotia Environment and Labour's Competitiveness and Compliance Initiative (CCI) Strategy Achieving Excellence in Regulatory Practice 2005/06 - 2009/10*, Halifax.

a) **Auditing as a way to improve compliance by the administration**

440. Audit offices have progressively widened their role from a purely accounting perspective. They now often play an important part in assessing the performance of the administration, including its effectiveness in implementing regulation. Audit offices focus on systemic performance and outcomes. They are independent from government (usually reporting to parliaments), transparent in their operations and able to operate in a wide range of areas. But assessing regulatory quality at local levels of government still requires some development and improvement.

Box 19. Auditing municipalities in Sweden

In **Sweden** local levels of government are audited and these audits and reporting requirements certainly reveal some performance issues, successes and concerns. Audits, however, tend to focus on financial matters rather than on regulatory compliance per se and thus auditing cannot be regarded as a systematic tool for assessing regulatory quality. There are some however ad hoc or one-off evaluations of programmes and activities and also local committee review processes.

Source: OECD (2007), *Multi-level Regulatory Capacity in Sweden*, Paris.

b) **Assessing the performance of tasks at lower levels of government**

441. Regulations that are implemented and enforced by agency staffs that are not held accountable for compliance outcomes, and managed to maximise outcomes are less likely to be effective in achieving their goals. Traditionally, however, regulatory agencies' performance and cost-effectiveness are managed and evaluated largely by reference to their level of activity, rather than the outcomes they accomplish.

442. Benchmarking among different states or municipalities is another tool that might allow citizens to know if they are receiving equality in service provision, including regulatory activity and regulatory

compliance activity. There is scope for improving benchmarking at lower levels of government, which requires also better data collection and monitoring.

4.3.5.2. *Conflict resolution mechanisms*

443. In the regulatory process, conflict and dispute resolution plays an important role for making regulation viable and implemented. Successful conflict resolution occurs by different mechanisms that are linked to the legal and judicial tradition of the country. An important component of this process is to listen to and provide opportunities to meet the needs of all parties involved, and to adequately address interests so that each party is satisfied with the outcome.

a) Administrative justice

444. Administrative justice, as one of the non-judicial remedies against regulatory measures, has two main objectives for the regulatory management of a country: to assure an effective public administration and to preserve the rights and interests of citizens.

445. An important general trend in administrative justice has been the more widespread adoption of independent administrative appeals processes. These have, in some cases, been adopted in general Administrative Procedures Act legislation, while in other cases, they are adopted at a more disaggregated level, with a degree of commonality in approach being provided by guidelines, or merely convention. An important principle, that is being more widely implemented, is that administrative review should include the opportunity for a complaint to be heard by an administrative body other than that responsible for making the initial decision. This provides an additional element of independence and accountability to the review process, as well as helping to ensure that standardised review procedures are followed.

Box 20. Administrative justice at lower levels of government

In **Italy**, administrative appeals enable the parties involved to request the adoption of a new decision on the contested case from the administrative authority institutionally superior to the one that took the contested decision or to petition the President of the Republic for cancellation of the contested ruling. These hierarchical appeals have lost importance with the lifting of the finality requirement for acts to be eligible for appeals to administrative justice.

In the **United States**, administrative procedures acts and regulation codes at State level have been issued to deal with the complexity of regulatory inflation and administrative justice. Administrative regulation and adjudication is not limited to the national governmental level. It has become widespread in the states and municipalities, embracing such subjects as public utilities, natural resources, banking, securities, worker's compensation, unemployment insurance, employment discrimination, rents, automobile operation and inspection, corporations, elections, welfare, commercial insurance, land use, and environmental and consumer protection. For instance, in California, the Office of Administrative Law (OAL) is responsible for reviewing administrative regulations proposed by over 200 state agencies for compliance with the standards set forth in California's Administrative Procedure Act (APA), for transmitting these regulations to the Secretary of State and for publishing regulations in the California Code of Regulations. OAL also accepts petitions challenging alleged underground regulations--those rules issued by state agencies which meet the Administrative Procedure Act's definition of a "regulation" but were not adopted pursuant to the APA process.

France experienced extensive decentralisation process in past few decades. However, local authorities only have delegated regulatory power in the areas relating to their field of responsibility. Local authority orders are enforceable after being sent to the prefect who verifies their legality and who can refer them, if necessary, to the administrative court. Consequently, while the reform has reduced the degree of administrative oversight, it has not eliminated it completely in that the prefect, the representative of the State, no longer has the power to exercise *ex ante* control over the appropriateness of local authority legislation but that of *ex post facto* review of the legality of that legislation. Checking local authority decisions for legality by the prefects includes a retrospective check, when the decision is referred to a jurisdictional court and an a priori examination. This a priori examination takes place during a "pre-contentious" phase with the submission of observations on the laws which involves between 2 and 3% of the latter. During the inductive check, the prefect may refer any bylaw approved by the local authority to the administrative Court. This check was reinforced by the law of 29 January 1993 which gave prefects the option to stop a contract from being signed or a public service being

delegated if competition rules have not been observed. This law was indicative of the will to restrict certain abuses of competition responsibilities that had been detected.

Sources: OECD (2007), *Italy - Ensuring Regulatory Quality Across Levels of Government*, Paris; www.oal.ca.gov; OECD (2004), *Government Capacity to Assure High Quality Regulation in France*, Background Report, Paris.

b) Judicial review

446. The availability of judicial review of administrative decisions can be seen as the ultimate guarantor of transparency and accountability and is likely to improve the effective quality of the decisions made during administrative review. In addition to operating in this way as a check on the implementation of regulation in individual cases, judicial review provisions have, in some OECD countries, taken on a wider importance, becoming an important mechanism for regulatory quality control. Effectiveness of the process arises from the ability of the judiciary to consider regulations' consistency with principles of constitutionality, including notably proportionality and the right to be heard. It also arises from courts' scrutiny of whether delegated legislation is fully consistent with primary legislation.

447. However, while administrative and judicial review processes are essential guarantors of fairness and accountability, and thus of the quality of regulatory implementation, it must be recognised that they are generally costly and time-consuming means of obtaining redress. Consequently, many regulated groups, particularly Small and Medium Enterprises (SMEs) and individuals, are unlikely to use these means to obtain redress and enforce their rights as the regulatory burdens falling on each individual are often small (*i.e.* more waiting days, further paperwork). Instead they will tend to accept the regulatory costs, shifting them to consumers or reducing their level of compliance. This highlights the necessity of assuring regulatory quality *ex ante* as well as taking a careful approach to determining the nature and extent of administrative discretions provided in regulation.

Box 21. Judicial review in a multi-level context: the case of Italy and Turkey

Co-ordination and dispute resolution mechanisms are very important for **Italy** since the country has regional governments with extensive regulatory powers. As established by the amendment of Article 126 of the Constitution, the government can appeal the Constitutional Court about a regional law that exceeds the regional competence. In this way, even if the reform does not foresee a preventive constitutional control, the government monitors the regional legislation in order to challenge regional laws before the Constitutional Court. The amount of the constitutional dispute between the State and the twenty regions makes careful monitoring of the judgements of the Constitutional Court necessary, since these in fact define the boundary between the respective legislative competencies of the Regions and the State. Between 2002 and 2006, the Constitutional Court ruled four times on cases brought against laws of the Calabria Region (in the fields of hospital employment, the interim functioning (prorogation) of regional bodies, pollution prevention and phytosanitary products). During this period, Calabria region brought two cases against the Prime Minister's Office asking the court to rule on the constitutionality of national laws (in the fields of the environment and landscape), which are still pending. The Constitutional Court even handed down a ruling on the new Statute of 2004 concerning the labour relation of regional managers, the rules governing the Region's financial autonomy, the mechanisms for electing the President of the regional government (*Giunta*) and Vice-President and for their subsequent designation by the Regional Council (which was the only element found unconstitutional). Of the 104 laws passed by the Regional Council during the 2002-05 period, the Prime Minister's Office challenged provisions contained in 12 regional laws and lodged 12 appeals. With regard to appeals to the Constitutional Court, the Tuscany Region was involved in various constitutional disputes with the government. It was only in 2004 that the national government filed 5 appeals regarding the constitutionality of Tuscan laws and regulations (in fields such as construction, mineral and thermal waters, professions and the adoption of the new Statute), while the Region filed some 11 appeals challenging the constitutionality of State laws in fields such as public finance, finance acts, agriculture, fishing, cinema, energy, health and ports. In nearly all these appeals the Region contested the violation of the principle of loyal co-operation.

Turkey has an administrative court system, composed by District Administrative Courts, Administrative Courts, Tax Courts, and The Council of State. The Council of State is the Supreme Administrative Court responsible also for consultation and scrutiny, and review the appeals brought against the judgments given by administrative or tax courts and judgments rendered in the cases which have been examined by the Council of State as a first instance court; for administrative cases written in the present Act, as a first instance or appellate court; for its opinion on the draft legislation submitted by the Prime Ministry or the Council of Ministers; for examining draft regulations of the Council of Ministers; for presenting its opinion on the conditions and the contracts concerning public services under which concessions are granted; and for

giving its opinion on the matters submitted by the Presidency of the Republic and the Prime Ministry. The First Division of the Council has an authority which is very significant in terms of multi-level governance. The Division examines disputes arising between administrative authorities relating to competence and venue that are submitted by the Prime Ministry. In many cases, the Division has determined competent public authority in delivering specific public service. Local governments are primary competent authorities for city planning according to Municipalities Law, Special Provincial Administrations Law, and Building (Zoning) Act. However, in a controversial case some years ago and according to the Tourism Promotion Law, the Law on the Protection of Culture and Natural Resources and other special laws, in some areas the competent authority is not a local government, but public bodies mentioned in respective laws. In that case, after enactment of a new series of local government legislation, the Council of State resolved the following dispute: the Ministry of Public Works and Settlement brought the issue to the Council of State arguing that after enactment of local government laws, planning activities even for the special areas mentioned above were transferred to local governments, and other public organisations were not competent anymore. The Council of State decided in 2005 that competent authorities for planning are not local governments, but public bodies mentioned in respective laws.

Source: OECD (2007), *Italy – Ensuring Regulatory Quality Across Levels of Government*, Paris; www.danistay.gov.tr/kerisim/container.jsp

448. Judicial oversight as it exists in many countries, where it focuses on enforcing standards without taking the economic dimension into account, is hardly an appropriate solution, regardless of the point at which it intervenes in the process.

449. In this regard, multilevel governance is no exception to the rule, and the courts are not regulatory bodies. The question then arises as to whether decentralised, horizontal networks are needed to prepare horizontal public policies, addressing the question of indicators and assessment, to identify the cost-benefit ratio of each approach. Such networks could perhaps be regulated by independent authorities.

c) Alternative dispute mechanisms

450. Alternative dispute mechanisms are valid methods to implement regulations. They are, however, not always used and exploited as viable channels to solve disputes because there seems to be a limited conception of what they can achieve. In a multi-level context, these mechanisms seem to increase their opportunities to be used, as administrative justice and judicial review are sometimes too costly in economic and time terms.

Box 22. Dispute Managing System between central and local government in Japan

In **Japan**, the Central and Local Government Dispute Management Council is established as a dispute managing system between central and local government. This council is composed by five commissioners and investigates the legality of examining central government's involvement in local government's policy based on the complaint of local governments to the council. If the council deems that involvement is illegal, the council makes a recommendation that the central government should take appropriate actions.

d) The role of local ombudsmen

451. The use of an ombudsman is becoming increasingly widespread in OECD countries, not only a national, but also at local levels of government. The ombudsman mechanism is particularly important in this context for several reasons: it provides a low-cost means of seeking redress, available to virtually all groups in society; it operates informally and has a wide-ranging remit, and it usually reports to parliament, thus providing for a high level of independence and transparency.

Box 23. The role of local ombudsmen in some OECD countries

In the **United Kingdom**, there are three Local Government Ombudsmen (LGOs) that investigate complaints of injustice arising from misadministration by local authorities and certain other bodies, which comprises districts, boroughs, cities and county councils, as well as a wide range of authorities who provide local services, such as education appeal panels, national parks authorities and housing action trust. Each of the LGOs deals with complaints from different parts of the country. They investigate complaints about most council matters including housing, planning, education, social services, consumer protection, drainage and council tax. The LGOs can investigate complaints about how the council has done something, but they cannot question what a council has done simply because someone does not agree with it. Investigators take most decision on their Ombudsman's behalf and they have extensive delegated powers, being responsible for the day to day handling of complaints. The objective of the Ombudsmen is to secure, where appropriate, satisfactory redress for complainants and better administration for the authorities. Since 1989, the Ombudsmen have had the power to issue advice on good administrative practice in local government based on experience derived from their investigations. To this end, they have published six guidelines on good practice notes on the following issues: setting up complaints systems, good administrative practice, council housing repairs, members' interests, disposal of land and remedies. On 1 August 2007 the Regulatory Reform (Collaboration etc between Ombudsmen) Order 2007 came into force. In broad terms the Order enables the Parliamentary Ombudsman, the Local Government Ombudsmen for England and the Health Service Ombudsman for England to work together collaboratively on cases and issues that are relevant to more than one of their individual jurisdictions. Examples of complaints that may fall within this category include the provision of health and social care; complaints about the administration of housing and welfare benefits; and complaints about some planning and environmental issues. Courses are offered for all levels of local authority staff in complaint handling and investigation. In addition to the generic Good Complaint Handling course (which focuses on identifying and processing complaints) and Effective Complaint Handling course (which focuses on investigation and resolution), these courses are also offered specifically for social services staff.

In **Belgium**, there are Ombudsmen and mediators (*médiateurs*) at federal, regional, communal and municipal level. They can investigate a complaint arising from maladministration or in case where the institution responsible for a service did not provide it in a satisfactory manner. They act as mediators between the administration and the citizens and propose recommendations. They publish annual reports available for the public and are presented to the Parliament. They offer a common web site (www.ombudsman.be) at the initiative of the Permanent Consultation of Mediators and Ombudsmen (*Concertation Permanente de Médiateurs et des Ombudsmans*, CPMO), facilitating the citizens to be in contact with the pertinent ombudsman.

Sources: www.lgo.org.uk; www.ombudsman.be

452. The ombudsman provides in some cases an alternative to judicial review. While the ombudsman will not investigate if the dispute turns on a point of law or statutory interpretation, since this is exclusively a matter for the courts, the ombudsman can make recommendations for changes to administrative systems in the way the courts cannot. An ombudsman's investigation can produce a comprehensive explanation about what happened in a way that judicial review proceedings rarely can because of the more open nature of his work. The work of the ombudsman can be relevant if there is a widespread failure in an administrative system which could not be identified satisfactorily without a detailed investigation. This might be relevant for a better performance by lower levels of government providing services to citizens.

453. In terms of costs, an ombudsman's investigation might be a suitable solution to the complaint. The cost of judicial review can be sometimes disproportionate to the remedy sought or the complainant was neither well off nor poor enough to be entitled to legal aid. Where the just remedy is a full explanation, an apology and some financial redress, recourse to the ombudsman might be preferred.

e) Other mechanisms: arbitration, conciliation, counselling

454. The development of other mechanisms of dispute resolution, such as arbitration, conciliation, counselling, etc. has resulted from the difficulties experienced by heavier caseloads and the rising costs and general inaccessibility of court litigation. The success of those mechanisms will depend on the quality of the professional work and stands invested in its delivery both by 'external' providers and by providers from within the court, tribunal and ombudsman organisations. These mechanisms are based in a sense of trust in the system. The regulatory system, therefore, needs to provide fair conditions for these to work well.

Box 24. Examples of the use of other conflict resolution mechanisms between levels of government

As part of the efforts to improve the business environment and client services of the Province of Newfoundland and Labrador in **Canada**, the Public Utilities Board engaged in an Alternative Dispute Resolution (ADR) process with the province's Consumer Advocate and Newfoundland Power. The ADR process, which has also been used with Newfoundland and Labrador Hydro, essentially streamlines the regulatory process and costs, resulting in potential benefits for both the utility and the consumer. As a regulated utility, Newfoundland Power observes that the overall efficiency of rate regulation has improved in recent years, and the Alternative Dispute Resolution process it participated in with the Consumer Advocate, facilitated by the Public Utilities Board, is a welcome example of that increased efficiency. This development has improved the cost efficiency associated with utility regulation, which is ultimately paid by electricity consumers.

In the **European Union**, SOLVIT is an alternative dispute resolution mechanism. SOLVIT is an on-line problem solving network in which EU Member States work together to solve without legal proceedings problems caused by the misapplication of Internal Market law by public authorities. Established in 2002, SOLVIT deals with cross-border problems between a business or a citizen on the one hand and a national public authority on the other, where there is possible misapplication of EU law. The European Commission co-ordinates the network, which is operated by the member states, the European Commission provides the database facilities and, when needed, helps to speed up the resolution of problems. The Commission also passes formal complaints it receives on to SOLVIT if there is a chance that the problem can be solved without legal action. There is a SOLVIT centre in every European Union Member State (as well as in Norway, Iceland and Liechtenstein). SOLVIT Centres can help with handling complaints from both citizens and businesses. They are part of the national administration and are committed to providing real solutions to problems within ten weeks. The use of SOLVIT is free of charge.

Source: www.gov.nl.ca/redtape/; http://ec.europa.eu/solvit/site/index_en.htm

CONCLUSIONS

455. Increased attention has been given to the different issues of regulatory governance in a multi-level context, as countries are realising the importance of avoiding duplication when dealing with citizens and businesses, as well as to boost economic activity and improve the delivery of services at all levels of government. These issues imply not only the definition of regulatory policies that are clear, transparent and consistent at all levels of government while establishing the appropriate institutional mechanisms to implement them, but also a more effective and systematic use of different policy and regulatory tools at the appropriate level of government.

456. Expanding a framework for high quality regulation at all levels of government can only be achieved if countries take into consideration the diversity of local needs and the particularities of lower levels of government. In many OECD countries, national governments have taken the lead in trying to consolidate regulatory systems for producing high quality regulation, but local governments have also proved to be laboratories in which experimental approaches to improve the quality of regulation is facilitated. Bottom-up approaches should be encouraged if they provide a room for experimentation. Building and strengthening capacities at lower levels of government is essential, which requires the allocation of appropriate financial resources to support it.

457. Transposing principles of high quality regulation from the centre to lower levels of government is relevant only if there is flexibility in the implementation phase and innovative solutions can be added to the process. Tensions between different levels of government cannot be solved by a simple duplication of existing models at one level. Particularities should be taken into account. Encouraging innovation in the way the quality of regulation can be improved at levels of government even without a consolidated regulatory system should be promoted, identifying new good practices in the regulatory process.

458. A more dynamic and evidence-based approach for regulatory decisions still needs to be embedded at all levels of government. Co-operation and co-ordination between levels of government are positive mechanisms that could lead in that direction, easing the way to sharing experiences and good practices, but much remains to be done in order to find the most effective and efficient solution. The use of certain policy and regulatory tools like RIA, for instance, can only be successful in a multi-level framework if the most concerned and directly affected level of government has the capacities to make full use of it and its results can have an impact on the decision-making process. This would require not only providing resources to the specific level of government to undertake RIA, but also and most importantly targeting with particular care those regulations that can have the greater economic impact at a particular level of government, which may not be easy to determine.

459. Another challenge to achieve high quality regulation at all levels of government refers to the way regulatory systems can be consolidated over time. The solution is not to add more bureaucratic layers to the existing system, but to make those institutionalised capacities efficient and strong enough to function over the long term. This calls for capacity-building and training. Political support and technical expertise are both essential to make regulatory governance credible across levels of government, serving citizens and enterprises.

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CHAPTER 4: E-GOVERNMENT PARTNERSHIPS ACROSS LEVELS OF GOVERNMENT

This chapter represents the executive summary of a longer report on designing and implementing e-government policies and programmes within the context of multi-level governance. It explores the various challenges and approaches surrounding the creation of collaborative and co-operative partnerships across levels of government for e-government development.

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EXECUTIVE SUMMARY

460. Due to the fallout of the financial and economic crisis, most OECD countries are being called upon to improve overall performance – in order to compensate for stretched resources in both the public and private sectors. This has placed higher demand on governments and public service delivery. One way to improve performance and respond to the crisis is to accelerate e-government implementation in the public sector. Improving efficiency and effectiveness of government functions and its service delivery requires that governments create a public sector that *puts its users at the centre*, and that it is *perceived as one overall entity* in the eyes of citizens and businesses – and not as a fragmented landscape of independently functioning public authorities. The challenge therefore lies in creating appropriate ways and means that allow the public sector to act as one towards its users – be they citizens, businesses or government employees. One of the ways to do this is to encourage *effective partnerships across levels of government*, which ensures coherency and transparency in public service delivery without regard to who is responsible for the services delivered.

461. Governments around the world face the same challenge of improving efficiency, effectiveness and the quality of public services in the context of fiscal pressures and of an ageing population. At the same time, they are called upon to become more focused on citizen and business needs and wishes. Citizens have come to expect new standards of service provision, including flexibility, personalisation and 24/7 availability; businesses requires simpler and more effective interaction with governments. Local and regional governments now deliver a significant number of public services. The last 15 years have brought a dramatic change in public decision making and public policy building, where the demand for more coherent and simple service delivery has been increasingly expressed. This is the reason why governments are seeking to develop and deliver integrated services where the guiding principle is citizen or business needs and wishes, rather than their own.

462. The pursuit to develop and deliver integrated and user-focused e-government services is challenging the way the public sector has organised itself and its work. Responding to citizen and business demand for those services – whether they are on or off line – have questioned whether existing business processes and division of work is optimal for organising the delivery of public services in general – and e-government services in particular.

463. A number of e-government development “principles” have thus emerged:

- one-stop-shop approach, where *ad hoc* online and offline sites are designed to act as a single point of contact for citizens and business dealing with the public sector;
- the no-wrong-door policy, where citizens and businesses can expect to receive relevant public services regardless of the nature of the service or the point of contact within the public sector they may choose to use as entry point;
- one-time data provision, where citizens and businesses have the “right” not to be asked for information and data they have already provided to the public sector;

- participative approach, where citizens and businesses are participating fully in the production and delivery of services with the aim of supporting users in creating and using their own individualised and user-friendly set of services.

464. These basic “rights” to use electronic means to access public services and not being obliged to submit data more than once have been incorporated into policy tools such as:

- e-government laws, such as those approved in Austrian e-government law;
- shared visions and strategies, such as in the Italian shared e-government vision document;
- collaboration and co-operation agreements, such as the collaboration and co-operation agreement in Belgium between the different levels of government;
- voluntary codes of conduct, such as in the Netherlands’ Citizens Charter.

465. How online or offline services are delivered and the degree to which they are integrated is an issue for discussion for the public sector and its different authorities at the central/federal, regional/provincial, and local/municipal government levels. Delivering user-focused services will require collaboration and co-operation, as well as different policy tools (which vary according to the range of state organisations, administrative cultures and traditions, and the degree of autonomy at sub-national government levels).

466. The challenges of, and the approaches to, the *creation of collaborative and co-operative partnerships across levels of government* for e-government development and implementation are the main focus of this report.

Why do collaborative and co-operative partnerships across levels of government matter?

467. E-Government enables major transformational changes in public sector organisations, including in the way they work together. Where such transformation involves a number of independent and loosely connected public bodies, successful strategies must go beyond aligning technology standards or improving the networking of organisations. Collaboration and co-operation among governments and their public sector institutions is both a key requirement and a significant challenge for the efficient and effective exploitation of e-government. Looking at central/federal government policies, the typical goals for collaboration and co-operating with sub-national levels are to:

- Improve coherency of services – making them more accessible, more convenient, more responsive, more cost-effective and easier to integrate (within and between levels of government, and between government and voluntary and private organisations).
- Improve the processes that underpin services and foster public sector innovation – information and communication technology (ICT) provides the opportunity to overhaul the way the “back office” works, making it easier, faster and cheaper to process information and data, to share them between services and organisations, and to present them to different users, whether they are citizens, businesses, government employees, or private and voluntary sector partners.
- Renew local democracy – rendering local/municipal governments more open, transparent, accountable, inclusive, and better able to lead their communities;

e-government can enhance the opportunities for citizens to debate with each other and to engage with their local/municipal politicians and administrations.

- Promote local economic vitality and innovation – a modern electronic communications infrastructure, a skilled workforce, and the active promotion of e-business can help local governments and regions promote employment in their areas and the increase the employability of their citizens.

468. Experience in OECD countries has shown that without collaboration and co-operation, or frameworks that support and enhance collaboration and co-operation, some of the important results that governments seek through e-government development and implementation cannot be achieved.

469. OECD e-government country studies emphasise the need for improved collaboration and co-operation among all actors in the public sector. The resources available for e-government development vary significantly, however, according to local political priorities, economic capabilities and socio-demographic composition. Local political priorities mirror the demands of its population composition: a well-educated, resource-strong and young urban population could expect both a high level of public services and an efficient and effective local administration with well-integrated local e-government services; local political priorities in economically weaker and less populated areas with a high percentage of elderly citizens are often more focussed on using the scarce resources available, indicating that its local population considers primary health care and elderly care needs more pressing.

470. The uneven possibilities due to limited resources available for innovating advanced e-government services among different actors within the public sector (such as among regions/provinces and local/municipal governments) have been highlighted as a major challenge by OECD country studies on e-government. Fragmentation and uneven treatment of citizens on the basis of their place of residence are also risks found in sub-national government structures. And level of service provision varies extensively between different local/municipal authorities: small, resource-weak and rural municipalities struggle to be effectively involved in the ongoing process of innovation.

471. Developments in e-government policies since the mid-2000s reinforce the need for collaboration and co-operation. In the early years of e-government in the mid- to late 1990s the focus was making as many services available on line, an effort which required a lesser degree of change in government processes. It then became clear that this was not sufficient to improve citizen experience of public services, as shown by the low uptake of e-government services provided by governments. Today, governments are focussing more on transforming the whole service delivery value chain to enable improved service delivery. This transformation entails changing the internal machinery of government by improving, among others, information and data-sharing, and management frameworks, and by developing building blocks and interoperability frameworks. These changes support the establishment of the framework and context needed for enhanced co-operation and collaboration among various levels of government.

What are the challenges for collaborative and co-operative partnerships across levels of government?

472. Delivering integrated public services across levels of government raise a number of questions regarding the existing organisation of the public sector in many OECD countries and the way the different government levels interact. These challenges are well known, as they are similar to those encountered through working horizontally across existing organisational barriers and silos within levels of government or even within organisations, and also on cross-cutting policy areas. This means that the main challenges to

effective collaboration and co-operation are not specific to e-government, but are valid for any policy context in a multi-level government environment.

473. The following four main types of challenges emerge:

- **Conflicts of leadership between different government levels.** E-Government development often requires the convergence of different business processes, where different administrations traditionally have sole authority, and none of them wishes to appear marginalised. The party or parties initiating or raising the need for a change in existing approaches to business processes and responsibilities must be ready to discuss and negotiate division of work and minimise possible conflicts over competences. Having an external independent oversight body to resolve potential disputes may be a possibility for conflict resolution.
- **Different priorities regarding e-government between levels of government.** Whilst all levels of government have short, medium, and long term priorities and goals depending on their individual political situation, the central/federal level tends focus primarily on national coherency, while the sub-national level tends to emphasise local needs and demands. The different types of interests and priorities due to the built-in differences in focus include a possible embedded conflict regarding decisions on common e-government priorities and actions.
- **Different priorities between categories of actors, particularly the administration versus elected politicians.** Elected politicians usually have a stronger operative role in local/municipal administrations, including e-government activities, and they tend to put a stronger focus on achieving visible benefits and concrete results that have an immediate impact on their constituents; civil servants are more focussed on keeping the machinery of government running and ensuring a stable and continuous administration that reaches beyond election cycles. The balance between politicians and civil servants, however, may vary over time, as well as within administrations.
- **Competition between administrations for the relationship with the end-user in a multi-level service delivery architecture.** Who reaps the political benefits of being the “public face” of government in the interaction with citizens? This is a typical “channel conflict” problem already seen in the private sector. Regional/Provincial and local/municipal administrations may be concerned about their own visibility and autonomy if services are integrated in portals managed at other levels of government.

474. These challenges are often harder to overcome when different jurisdictions in a country need, or are obliged, to work together across levels of government. Additionally, one of the dominant challenges is to strike the balance between the political wish to display “independence” in decision making from other government levels, and the operational need to ensure that practical service delivery is functioning within, and across, levels of government.

475. Strong e-government leadership creates a joint vision of how e-government can benefit the whole public sector by making it user-focused, and often also drives the improvement of back office functions and coherency. It can also establish partnerships across levels of government. Influencing and changing people, environments, structures, and habits are required. OECD countries use a variety of institutional frameworks (e.g. formal organisational structures or institutionalised informal networking practices) and leadership tools (e.g. formal decisions within an organisation, formal or informal agreements in *ad hoc* co-ordination bodies within or between organisational units, or agreements from informal networking and dialogue between parties) to build capacity for e-government development and implementation and subsequently foster collaboration and co-operation.

476. A review of the strategic e-government approaches of OECD countries shows that public governance structures and decision-making frameworks focus on the following main trends:

- Innovation with the user in mind. User-focused e-government builds on the following principles: (1) know users and their needs: formally and regularly monitor user needs and expectations; (2) customise services to user needs: develop e-government services according to needs and expectations, and establish multi-channel management strategies to meet customisation challenges; (3) create the look and feel of one single public sector entity: simplify, integrate, and standardise front and back offices (e.g. business processes, application navigation structures, databases, etc.).
- Strong inter-governmental organisation. To achieve strong e-government synergies it is necessary to establish a common vision and a set of objectives. Successful governance approaches also include the mapping out of institutional stakeholder profiles, roles, changing influence/competence and motivations to better understand factors affecting inter-government reorganisation and the sustainability of e-government innovation. This also includes a vision for the possible role of intermediaries (from the private sector, non-governmental organisations, or civil society at large) in service delivery *vis-à-vis* the role of the public sector as such.
- Business process re-engineering of the whole of government. To ensure simple and efficient processing in the whole of the public sector and enable easy resource sharing, governments focus on improving the negotiation and transaction processes between administrations. By aiming for frameworks and voluntary arrangements, rather than legislation and regulation on business processes and resource sharing, for example, with the implementation of a number of e-government building blocks (e.g. key registers, data sharing concepts and structures, e-authentication systems, and ICT security support functions), governments avoid establishing rigid structures that could limit future innovative efforts.
- Redesigning public-private partnerships in more realistic ways. Redesigning public-private partnerships as a major asset for joint public-private development projects with mutual benefits, is needed to respond to different levels of success where anticipated results for both the public and the private partner(s) did not emerge or only partially emerged.
- Learning from each other and sharing best practises. To improve innovation capacity and lead to widespread use of e-government solutions, governments are increasingly looking for good practices, spill-over effects, frameworks for e-government development and implementation and critical mass when reorganising their own structures.

How do governments create collaborative and co-operative partnerships for service integration?

477. To understand the multi-faceted issue of partnerships for service integration, it is necessary to understand that e-government, by its very nature, cuts across and goes beyond organisational boundaries. The diverse issues involved in building trusted frameworks for collaboration and co-operation are addressed differently by governments depending on both the administrative cultures and traditions in the country, and on the maturity (and habit) of collaborating and co-operating on e-government within the public sector as a whole.

478. OECD e-government country studies show that a *matured e-government environment* in a country often eases the political dialogue across levels of government and avoids unnecessary politicisation

of

e-government collaboration and co-operation within the public sector. The same experiences show that there is often a *common understanding of the necessity to collaborate and co-operate* among operational e-government civil servants, and they often use *informal channels* to communicate, collaborate and co-operate (such as seen in Australia, Belgium and the Netherlands). In Belgium this is referred to as the “grey zone” – a results-based approach to collaboration and co-operation where actors meet informally and on an *ad hoc* basis.

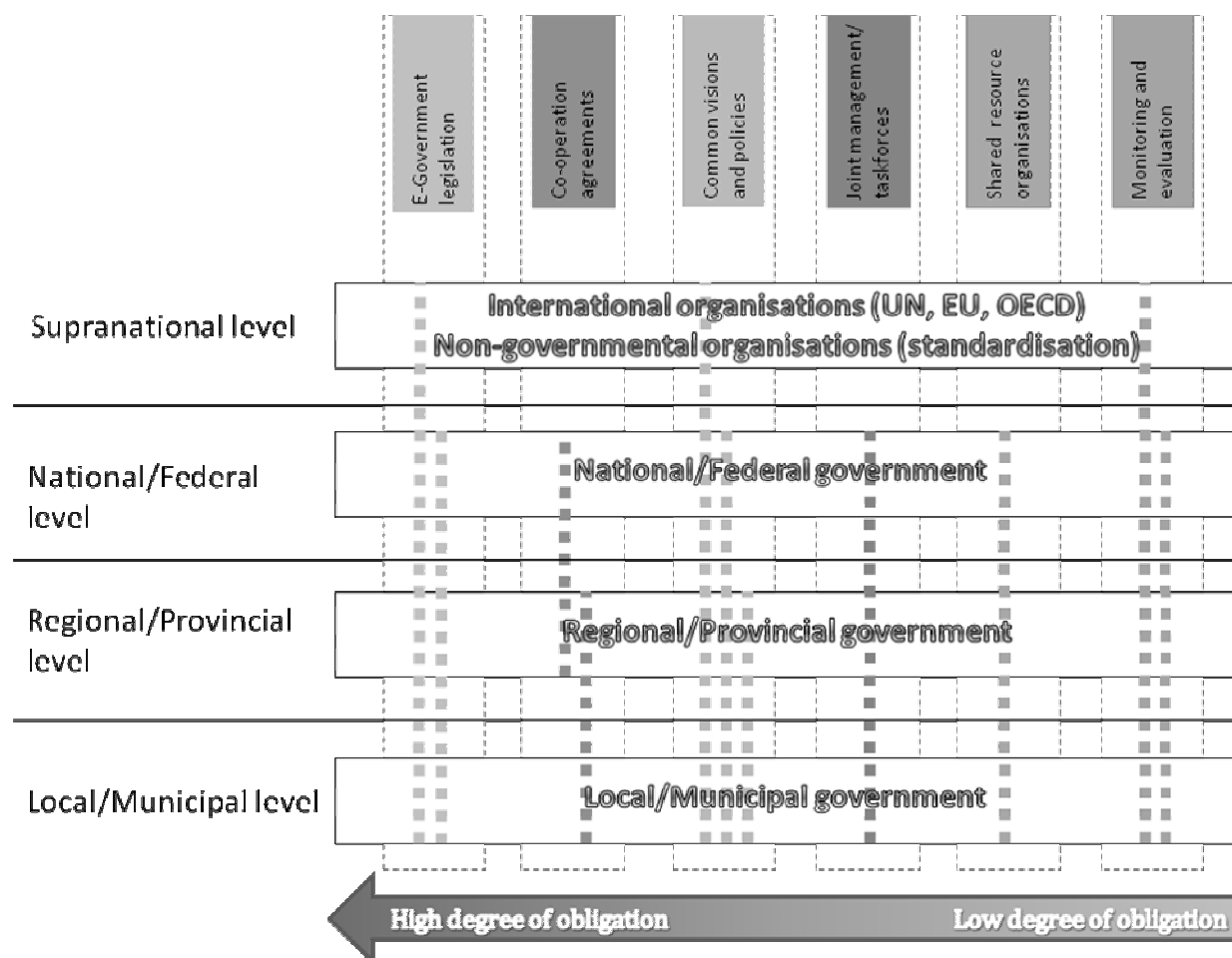
479. Countries use different approaches to determine the most suitable decision-making model given the national multi-level governance structure. OECD country experiences show that the decision-making model is usually built around one of the following three concepts:

- **The resource-sharing concept.** Resource-sharing is seen as one the main drivers behind service integration. Resource-sharing provides a necessary and needed framework for collaborative and co-operative decision making for e-government development and implementation across levels of government. Examples are decisions regarding allocation of financial, human, and ICT resources for common purposes.
- **The enforcement concept.** Enforcing collaboration and co-operation through mutually agreed enforcement mechanisms is a way to ensure that common goals are met; introducing enforcement mechanisms is a stronger expression of a mutual commitment to achieve goals – and thus increase the desire of each of the parties to compromise and make decisions for the common good.
- **The institutionalisation concept.** Institutionalisation is a way to “frame” collaborative and co-operative decision making between different parties; it ensures a systematic approach to decision making and common activities are organised in a structured manner with agreed and known processes and common resources to support and implement decisions made.

Tools for collaboration and co-operation

480. Governments use different types of collaboration and co-operation tools to achieve common objectives for the public sector as a whole. Figure 1 shows an overview of the different types of tools and where they have been, or may be, applied to create a framework for collaboration and co-operation. The types of tools listed in the top of the figure (“E-Government legislation”, “Co-operation agreements”, “Common visions and policies”, “Joint management/taskforces”, “Shared resources organisations”, and “Monitoring and evaluation”) are – from left to right – listed by decreasing level of formal obligation – or “command and control” – for the different levels of government.

Figure 1. Overview of government collaboration and co-operation tools and their use



481. While Figure 1 sets out the tools used to foster collaboration and co-operation in OECD countries, it does not tell the whole story regarding how they are used to advance different ways of making collaborative and co-operative decisions in a multi-level governance structure. Governments should therefore note that the use of a governance tool can support, or enhance, common decision making – the so-called *conceptual decision-making framework* – which, as a result, affects the establishment or strengthening of partnerships across levels of government to varying degrees.

482. The above-mentioned decision-making concepts (resource-sharing, enforcement and institutionalisation) are identified as those most typically used in OECD countries. They are often used in combinations to advance the different conceptual impacts through the choice of collaboration and co-operation tools. Table 1 maps how the different tools could be used to support different choices of decision-making frameworks.

Table 1. Decision-making framework and tools used across levels of government

Levels of government	Resource-sharing concept	Enforcement concept	Institutionalisation concept
Supranational	<ul style="list-style-type: none"> Common visions and policies 	<ul style="list-style-type: none"> E-Government legislation Monitoring and 	

Levels of government	Resource-sharing concept	Enforcement concept	Institutionalisation concept
		evaluation	
National/federal	<ul style="list-style-type: none"> • Co-operation agreements • Common visions and policies • Joint management/ task forces • Shared resource organisations 	<ul style="list-style-type: none"> • E-Government legislation • Co-operation agreements • Monitoring and evaluation 	<ul style="list-style-type: none"> • Co-operation agreements • Common visions and policies • Joint management/ task forces • Shared resource organisations
Regional/provincial	<ul style="list-style-type: none"> • Co-operation agreements • Common visions and policies • Joint management/ task forces • Shared resource organisations 	<ul style="list-style-type: none"> • E-Government legislation • Co-operation agreements • Monitoring and evaluation 	<ul style="list-style-type: none"> • Co-operation agreements • Common visions and policies • Joint management/ task forces • Shared resource organisations
Local/municipal	<ul style="list-style-type: none"> • Co-operation agreements • Common visions and policies • Joint management/ taskforces • Shared resource organisations 	<ul style="list-style-type: none"> • E-Government legislation • Co-operation agreements • Monitoring and evaluation 	<ul style="list-style-type: none"> • Co-operation agreements • Common visions and policies • Joint management/ task forces • Shared resource organisations

The resource-sharing concept

483. The resource-sharing decision-making concept covers discussions across different levels of government (and often within levels of government) on how to share common resources – or contribute to a common pool of resources that adequately reflects a balance of benefits for each of the parties. The main issues are typically:

- **Financial resources**, including how funding is organised in order to support collaborative e-government development.
- **Human resources**, in terms of arrangements and solutions for knowledge sharing and human resource pooling in an area with limited staff or access to staff with the right competencies and skills.
- **ICT resources**, in terms of different models to encourage sharing of software, hardware, infrastructure, and other ICT-related services.

484. Experience shows that the sharing of resources for e-government development is not easy. OECD work on cost-benefit analysis of e-government and e-government country studies show, in fact, that the organisation investing in e-government development of a shareable e-government solution is not necessarily the organisation that will reap the full benefits. This is also known as the “sow-harvest” dilemma. Some e-government solutions are of a generic and cross-cutting character that generates benefits broadly for the public sector as a whole, and thus not necessarily specifically for the organisation that develops and implements the solution.

485. The collaboration and co-operation tools used to support and enhance a decision-making approach based on the resource-sharing concept are:

- **Co-operation agreements.** Co-operation agreements are usually political agreements between a national/federal government, and regional/provincial or local/municipal governments which define specific areas of collaboration and co-operation, budgetary or economic goals/agreements, and the organisational setup within which to discuss issues or resolve conflicts within the scope of the agreement. Examples of co-operation agreements can be seen in countries such as Belgium, Denmark and Finland.
- **Common visions and policies.** Commonly agreed visions and policies as a basis for co-collaborative and operative decision making are probably the most used tool on the supranational level and in OECD countries. Often common visions and policies are easier politically to agree on than more mandatory tools such as legislation and co-operation agreements. Common visions and policies are typically used by international standardisation organisations. Nationally, they have been used in federally organised countries such as Belgium, Canada, Germany and the United States. The tool is also used by unitary organised states such as the Nordic countries, Korea, the Netherlands and Portugal, with historic traditions of extended autonomy at the local/municipal level.
- **Joint management/task forces.** Establishing joint management and task forces within the public sector is a way to break down stove-piped working habits and refocus public service development and delivery on becoming user-centric. Only a few OECD countries, such as Denmark and the Netherlands, make use of this tool as a means to create a collaboration framework which is targeted at whole-of-public-sector integrated service delivery.
- **Shared resource organisations.** An increasing number of OECD countries such as Canada, Germany, the Netherlands, and Norway are creating special organisational structures to facilitate the sharing of generic resources such as information and data, business processes, and internal (*e.g.* budgetary, human resource, and ICT) and external (*e.g.* public online or offline) services. Shared resource centres are increasingly used on sub-national levels to achieve economy of scale or share scarce or very expensive resources (*e.g.* joint operation of selected costly service areas, joint ICT centres, and joint ICT skills and competencies centres).

The enforcement concept

486. A partnership is only a *committed partnership* when there is a mutually agreed common understanding of the “obligations” in the partnership. Even though agreements are achieved among partners, sometimes these partnerships derail over time due to changes in political and managerial priorities. That is why enforcement in decision-making is important – as well as for partnerships for service integration using e-government as a lever across levels of government.

487. The collaboration and co-operation tools used to support collaborative and co-operative decision making come in different forms and are applied differently depending on the situation at hand. The most used tools to support an enforcement approach to decision making are:

- **E-Government legislation.** Legislative tools are used internationally and nationally in some OECD countries. Internationally, the European Union directives are examples of supranational legislation that affects their member states nationally, regionally, and locally. Nationally, some OECD countries with a more legalistically oriented approach, such as Austria, Hungary, and Portugal, have passed specific e-government legislation aimed at removing barriers for e-government development within the country, impacting all levels of government.

- **Co-operation agreements** (see the previous explanation). In some countries, co-operation agreements is a part of the formal conflict resolution process between levels of government, *e.g.* in Belgium.
- **Monitoring and evaluation.** Monitoring through the use of indicators is a powerful leveraging tool for keeping progress on track. Developing indicators for monitoring and evaluating progress made is closely linked to setting goals in policies and strategies, and the implementing of action plans. An increasing number of OECD countries are adopting and implementing national monitoring frameworks in order to enable actors within the public sector to track their e-government progress.

488. Even though e-government legislation is a powerful tool that (at least) formally will oblige target groups to align e-government implementation according to legislative requirements, it may not in all cases be the most effective tool to establish partnerships for service integration. Often, a legislative approach may turn out to be rigid and the least flexible tool to apply in order to achieve collaboration and co-operation.

489. Among the collaboration and co-operation tools under the enforcement concept, co-operation agreements are thus most often preferred. Co-operation agreements do not need to go through a legislative procedure and are thus easier to change according to the needs at hand, as long as all parties in an agreement are in consent.

490. Monitoring and evaluation systems are often crucial for effective implementation – if they are followed up by incentives that act on its results. In that regard, *sanctions* and *rewards* could be considered and include more formalised forms of enforcement such as judicial sanctions or softer forms such as “naming and shaming/praisings”. Most OECD countries have a “reward” structure. No OECD country makes use of “sanctions” as the only incentive structure; “sanctions” and “rewards” are here closely linked – as most incentives – to economic performance such as budget cuts due to expected efficiency and effectiveness increases.

491. E-Government development is often a better case for informal approaches or voluntary arrangements as a mechanism for enforcement; these include the possibility of creating common consensus on results benefitting all parties in a project – creating the sense of quick-wins and tangible results. Most OECD countries are using soft measures as an enforcement mechanism by arguing positively about benefits to each participating organisation in the public sector.

The institutionalisation concept

492. Institutionalising decision making is an effective way to create longer term sustainability in the decision-making framework for collaboration and co-operation across levels of government. For e-government development and implementation, institutionalisation improves the medium to long term sustainability of e-government programmes and their implementations. Collaboration and co-operation tools often used by governments to support institutionalised decision making are:

- **Co-operation agreements** (as above).
- **Common visions and policies** (as above).
- **Joint management/task forces** (as above).
- **Shared resource organisations** (as above).

493. In addition to the collaboration and co-operation tools used within the public sector, governments at different levels are also using outsourcing to engage the capabilities and competencies of the private or voluntary sector. How much, and which part, of public sector operations are outsourced depends heavily on the political environment and priorities within each government level. OECD countries typically tend to outsource the more technical areas that often require highly specialised skills and competencies, such as technical ICT operations and maintenance.

494. Another approach to involving the public sector is the use of public-private partnerships. Using public-private partnerships requires that a common business case can be developed where both the private partner and the public sector benefit from such a relationship. Experiences in OECD countries show limited success with these kinds of arrangements within e-government development and implementation. There is a need, therefore, to redesign public-private partnerships as a major asset for joint public-private development projects with mutual benefits, to address different levels of success, where the anticipated results for both the private and the public partners did not always generally emerge or only partially so.

Lessons learned

495. Creating the right conditions for successful e-government development and implementation for integrated services in the public sector is closely linked to creating the right conditions for a fruitful and trusted partnership across levels of government, despite political, managerial, and legal barriers for such partnerships. An important feature of e-government is that being a recent, non-consolidated policy area, the necessity to learn is higher. In addition, flexible and pragmatic arrangements appear to work best as they are often able to cut through sometimes impenetrable legal, regulatory and cultural barriers.

496. Even though the different types of tools listed in Figure 0.1 and how they are applied in decision-making frameworks in Table 0.1 provides an impression of the broadness of the government toolbox, the key discussion in countries is still how to best achieve trusted and inclusive operational collaboration and co-operation in the public sector as a whole. One of the answers may be flexibility: these tools are used by most OECD countries in *different combinations* to enhance and support the development of integrated services through e-government partnerships across levels of government.

497. The most successful e-government developments are found, too, in OECD countries where the different levels of government have come together in *pragmatic and operational collaboration and co-operation*, rather than through highly politicised collaboration and co-operation with a minimum of trust between the different actors. Experience shows that formal division of work between legal entities is often not a hindrance to e-government progress as long the parties in a partnership have the *sufficient will and determination, a shared common vision, and the necessary political leadership* to carry through joint decisions whether these decisions are taken within a legal framework or taken based on “gentleman-agreements” between parties.

498. The lessons learned are therefore simple and straightforward:

- **Leadership.** The strong and persistent commitment of top political leaders who share a vision of better government is necessary. Commitment is also important as a driver of trust.
- **Trust.** The degree to which people and institutions in charge of running a service trust each other is a prerequisite and a product of collaboration and co-operation. A gradual approach in building trust is necessary, strongly embedded in day-to-day collaboration. Trust in the ICT knowledge of partners is a driver of trust between people and organisations collaborating in, and co-operating on, e-government.

- **Risk management.** Collaboration has to be grounded in realistic expectation, and appropriate risk management tools have to be put in place. Risk management has to address both *external risks* (technological, political and socio-economic environment) and *internal risks* (from participants and their relationships).
- **Communication and co-ordination.** Proper information and data sharing is often more effective than formal collaboration and co-operation structures.

499. Successful collaboration and co-operation is motivated not by an endogenous collaborative and co-operative approach but by mutual advantage. All these factors are gradually put in place through the achievement of visible results by all partners. Future service development and delivery need to take these factors into account as an integrated part of the ongoing innovation in, and change of, the public sector and its service provision – an area that the OECD will further look into in the coming years.

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