

1 Problems of multi-level democracies

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”Only a few years ago the inhabitants of Gothenburg were faced with just two ballot forms, one for the Riksdag (the national parliament) and one for the municipality,” Olof Petersson writes in his contribution to this book. “Today the people of Gothenburg are represented by politicians at six levels: the European Parliament, Västra Götaland (the county council), the Gothenburg region (indirectly elected), Gothenburg (the municipality), and the neighbourhood council (also indirectly elected)¹. How will popular will be realised in what is far from a transparent system?”

The public sector is organised in several levels in all countries except the very smallest ones. The tasks assumed by the public sector in a modern state are many and multi-faceted, and there is no reason to assume that all these tasks are managed rationally at one and the same level. In general terms thus, a multi-level format appears rational. On the other hand, a quick look shows that the division of powers and the distribution of tasks varies substantially even among countries that are similar in many other respects. This indicates that there is no particular division of powers that represents the highest degree of rationality. Different countries have different political and administrative traditions reflecting different priorities, and this is how it should be. Nonetheless, there may be substantial room for improvement. The six levels that the inhabitants of Gothenburg have to live with is not the result of a careful design of the public-sector hierarchy. There may be something to learn from other countries, and there is a possibility of genuine innovation.

1.1 State versus local – a classical problem

Already the presence of two levels in the public sector creates problems. The debate on relations between state and local powers is, not surprisingly, an old one. Countries differ in at least three dimensions: administrative, functional, and financial². In *administrative* respects countries differ by the status that they assign to the local level. Some countries mention municipalities in the constitution (South Africa, Sweden), whereas others do not (the United States, Norway). How easy it is to create or merge municipalities? Is financial autonomy guaranteed by the constitution? Sweden represents an intermediate position in these respects. Chapter 1 of the Swedish constitution establishes that democratic governance is assured *inter alia* via local autonomy. Further, the constitution mentions municipalities and county councils and establishes their right to levy taxes in order to finance their activities. The formation or merging of municipalities is not mentioned however, but is decided by the Government.

The oldest administrative units, the village and the “härad” (approximately the hundred), are pre-Christian. Following the establishment of Christianity, the parish became the basic unit of several functions beside the religious-administrative, for

¹ Nilsson (red.) (2002).

² See Davidsson (forthcoming) with further references.

instance poor relief and – much later – basic education. The hundred was as natural a candidate for basic unit at the time of the municipal reform in 1862, but the parish was chosen in exchange for the support of the clergy for the dismantling of the estates-based parliament³. After the wave of mergers that was finalised in the mid-1970's, Sweden was in fact back at roughly the territorial division that would have obtained had the hundred instead been chosen as the basic administrative unit.

Also in *functional* respects there are important differences between countries. In some countries, municipalities are entitled to manage only what has been explicitly assigned to them by the state, whereas Sweden and other countries have a more generous definition of the legitimate municipal sphere. The requirement is that the activities be of general interest and that there is link to the area or the members of the municipality. Activities managed by the state, by other municipalities or by county councils are also excluded.

That the state assigns certain tasks to the local level is, as we have seen, an old tradition. Poor relief, a partial responsibility for the military infrastructure, smallpox prophylactics, and basic education are early examples of such functions.

When it comes to *financing* finally, the picture is no less varied. A number of countries do guarantee the local power of taxation in the constitution. Other solutions are based upon tax base sharing, transfers from the state to the local level, fees and other revenues. The Nordic countries are characterised by a relatively degree of local financial autonomy, but even within this group there are variations. In order to judge the degree of autonomy it is of course necessary to take into consideration how much of local activities are in fact prescribed by the state, and to what extent such activities are partly or wholly financed by the state.

Even in the simple case of two levels, there is a third party that complicates the analysis – the citizen. Arguments for or against local autonomy at the very least have to account for the consequences for the citizen of the various alternatives considered. And – as will be clear from the discussion to follow – what is “closest to the citizen” in the sense of being handled at the local level is not necessarily what is best for her.

1.2 Arguments for and against local autonomy

Arguments for and against local autonomy are linked both to ideas about the essence of democracy and to more material aspects on governance such as economic efficiency. One argument for strong local autonomy is that it is claimed to give more *freedom* to the citizens. The individual is in this case the point of departure, and every restriction on individual freedom of actions stemming from memberships in social groups encroaches upon the freedom of the individual. An individual in isolation cannot accomplish much without interacting with others, however, so it is not group membership as such but rather its mandatory character that is seen as essential. The small-sized municipality would in this perspective be easier to live with than the national state.

³ Stjernquist (2000).

A closely related argument is that the municipality can be the basis of a *community* of a different kind than the national state can offer. Ideological arguments of this kind have been used extensively in the debate between liberal and communitarian thinkers⁴. The strength of this argument to some degree depends on what groups it is considered reasonable for a group to interact with. The conditions for a communitarian feeling are obviously not the same in a small agglomeration of a few thousand inhabitants as in the city of Stockholm with 750 000.

Arguments for local autonomy aiming at political institutions tend to concentrate on *closeness* and *participation*. Geographical proximity to decision-makers is then assumed to be translatable into a deeper form of political nearness. That a higher degree of local autonomy leads to higher levels of participation can be correct in the sense that more political posts are assigned to individuals in general elections. The size of the basic administrative unit is obviously an important parameter in this context; in Europe, the average number of citizens per elected official varies from just over 100 (Czech Republic) to more than 5 000 (Greece). But more vital to the function of democracy than whether 1 or 3 per thousand of the population are elected officials is the interaction between these officials and the population as a whole.

Efficiency arguments for local autonomy have also been put forward. Efficiency is a concept with many dimensions. Efficiency in the *macroeconomic* sense would allegedly be reflected in a smaller public sector; the idea is that a number of mechanisms tend to make the public sector larger than what citizens really desire, and that the restraining mechanisms would be stronger the smaller the size of the political unit⁵. No matter whether the first part of the argument is correct or not, it is fairly easy to verify that there is no empirical support for the latter part; there is simply no clear correlation between the degree of local autonomy and the total public expenditure level⁶. By way of illustration, the Nordic countries combine a relatively high degree of local autonomy with a comparatively large public sector.

But efficiency can also be interpreted in the sense that public service production better *reflect citizen preferences* if decisions are made at the local level. The idea is that the municipalities offer bundles of public services and that citizens can move to the municipality that best corresponds to their demands⁷. The empirical support for this hypothesis is not particularly strong⁸; moving implies high direct costs and can also lead to social costs in the form of lost social networks. A factor of some importance is also that lower tax levels tend to capitalise in the form of higher estate prices, which tends to increase friction. Nonetheless, Dahlberg and Fredriksson⁹ have found some empirical support for the idea that mobility in local or regional labour markets is affected by the

⁴ Mulhall and Swift (1992).

⁵ Stigler (1957), Brennan and Buchanan (1980).

⁶ For some different views on the subject, see contributions by Söderström and by Moesen and Van Rompuy in Prud'homme (ed.) (1991).

⁷ Tiebout (1956).

⁸ Rubinfeld (1986).

⁹ Dahlberg and Fredriksson (2001).

supply of public services and tax rates, whereas the mobility between regions shows no such effects.

An argument that connects to both closeness and efficiency is that local autonomy permits more of *experimentation* and therefore leads to a more rapid adaptation to new environmental conditions or changed preferences among the citizens. At least in theory, the conditions for variation are greater among decision-makers who see the local electorate as their principal than among regional or local managers within a national administrative structure. But it is an empirical question to what extent this potential variation actually materialises, and if so whether it is compatible with the idea of equal treatment.

Another argument related to efficiency is that local decision-makers know local conditions of production better. This was in fact one of the main arguments presented for the transition from ear-marked to general state transfers in the early 1990's. Again, there seems to exist little empirical support for this argument. The transition from ear-marked to general state subsidies in principle liberates resources that could be used for tax reductions, but this sort of transition often turns out to have less noticeable effects than theory prescribes and the resources tend to stick in the municipal sector (the so-called "fly-paper effect")¹⁰.

Adaptation to local conditions is of course possible also within national administrations such as the National Road Administration, provided that local managers are given appropriate freedom of action. Whether such adaptation actually occurs is an open question, given that conditions of loyalty differ between national and local administrations.

Arguments against extensive local autonomy can be summoned areas as arguments in favour. Basic *human rights* of the kind that are enumerated in the constitution must be guaranteed by the national level. The protection of minorities can then (but need not) become stronger. In order to protect single individuals from abuse or assaults the state is prepared to intervene even into the nuclear family. On the other hand, history provides numerous examples of attacks on minorities that have been led from the national level, so it is difficult to draw any clear-cut conclusions in this respect.

Among these basic rights most people would be prepared to include access to services such as basic education and health care, services for which the state must accordingly guarantee minimal access. This requires either full state responsibility for the production or delegation of responsibilities combined with inspections and a right to intervene against deviations from the national norm.

The goal of *equalising* conditions of living may also come into conflict with far-reaching local autonomy. If public services to a great extent are defined and financed locally, there is of course also a substantial risk that the supply in certain areas will not meet nationally defined standards. This can be countered via different types of

¹⁰ Oulasvirta (1997). An example where conditions do have effects on behaviour is described in Bergström, Dahlberg and Johansson (1998).

equalisation systems. The level of ambition and the design of these systems depend on the choice of tax bases, general transfers and other factors.

Against the communitarian ideology stands the idea that the nation is the traditional unit that can serve as a basis for political identity, and that ties of solidarity consequently should be defined at the national rather than the local level. A certain cultural homogeneity across the nation would then be beneficial.

Efficiency arguments can also be mustered against local autonomy. Extensive financial freedom threatens the capacity of the national government to maintain macro-economic stability¹¹. Stabilisation in the event of economic shocks can also be difficult to accomplish at the local or regional level.

The existence of *economies of scale* in administration, public purchase etc. is an argument against too small units of administration. This was one of the main arguments for the mergers of the 1960's and the 1970's. The growth of public-sector engagement required economic and administrative competences considered to be beyond the reach of a small municipality.

Similar arguments are valid for the function of economic control. Many – perhaps most – issues are simply too complicated for the average citizen to have the necessary competence and time to assume the role of controller. Professional audit, qualified economic journalism etc. are necessary ingredients in the control process and are more easily supplied in large municipalities or at the national level.

1.3 Organisation of the book

Against the background of the many trade-off problems characterising state-local relationships, it should come as no surprise that there is substantial variation between countries, and that hybrid solutions are common within one and the same country. Such hybrids are often marred by internal contradictions and often lead to friction between the levels. The overall aim of the present book is to investigate whether there is room for changes that may contribute reducing this kind of friction – for example by improving accountability, by changing the design of horizontal mechanisms of equalisation, or by strengthening the budget process.

The economic theory of multi-level democracy, the theory of fiscal federalism, has been developed primarily with formally federal states in mind¹². The main application is by consequence a federal structure, in between a unitary state and a confederation. In relation to a fully unitary state, this represents some degree of decentralisation of political power. Starting instead from a group of autonomous states, the term of “federalism” will by contrast refer to a process of centralisation; this is how it is currently used in the discussion about the future development of the European Union.

The Nordic countries are of course not federal states, but they exhibit relatively far-reaching local autonomy by international comparison. The institutional problems that

¹¹ Ter-Minassian and Craig (1997).

¹² See classical text such as Musgrave (1959) and Oates (1972); further, Oates (1999) and Boadway (2001).

appear in such structures remind of what one finds in traditional federal states, which makes it natural to investigate to what extent existing methods and results from the theory of fiscal federalism are applicable in this context.

The report is published within the framework of the SNS Constitutional Project, and the perspective is basically constitutional. The question underlying the different analyses is *if*, and if so *how*, the relationship between the state and the local level should be regulated in the constitution in other ways than at present.

In chapter 2, Robin Boadway and Eva Johansson survey the division of powers between the state and the local level in an economic perspective. Which tasks are appropriately handled at the local level, and which are more naturally managed by the state? What are the consequences for the distribution of financial powers and the need for equalisation of economic resource bases?

Chapter 3, written by Jürgen von Hagen and Matz Dahlberg, concentrates on the financial freedom of action at the local level. In what does the freedom of municipalities interact with the state's responsibility for maintaining financial stability? Is there a risk that municipalities behave irresponsibly, knowing that the state will in the last instance take care of acute financial problems in the future? Experiences from abroad indicate that this might be the case.

In the following chapter Howard Chernick analyses the ambitious Swedish system of equalisation. Ever since its introduction in the early 1990's, the system has been criticised for various reasons – for violating the constitution, for reducing or eliminating incentives to economic growth, for stimulating over-consumption of public services, etc. Chernick analyses some of these issues against the background of experiences from other countries.

In chapter 5, Clayton Gillette analyses the state-local relationship from a legal perspective. The chapter uses American experiences to illuminate how conflicts concerning the use of state transfers and local autonomy in other respects can be handled.

The three following chapters widen the perspective from the state-local perspective. Olof Petersson treats some of the complications that follow with EU membership for the classical discourse on democratic governance and local autonomy. Dennis Mueller and Emil Uddhammar widen the perspective even further to include the trade-off between public and private. They argue not only for a redistribution of tasks between the state and the local level but also for a much stronger role for private financing of public services via fees.

The final chapter collects some of the observations from the previous, and further presents a handful of theses on the problems of multi-level democracies, stressing the main concerns from a constitutional perspective.

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