Policy Note

# On the Legal Classification of Local Government Functions*

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## I. The Delegation of Powers to Subnational Governments in Unitary States

In unitary states, the national legislature determines the functions and finances of all subnational governments. These determinations are subject to constitutional limitations and judicial review, but within these constraints, the national legislature is free to revise, adjust, and reapportion the powers of local governments as it sees fit. In this sense, then, all local government powers in unitary state have been "delegated" to them by the national legislature.[1]

In unitary states with weak local governments regimes, the framework legislation that defines their general powers typically states that these powers are always "subject to the law." This type of standard legal phraseology is largely redundant and is typically used to underscore the sovereignty of the national parliament. In other words, these types of clauses are used to ensure that no matter how the general powers of local governments are defined in framework legislation, the parliament is free to specify in other laws and regulations the actual content of these powers whenever and however it pleases.

Unitary states with stronger local government regimes, however, typically group local government powers into two or three categories that indicate different degrees of local government autonomy. These categories are usually defined in framework legislation and are designed to ensure that when passing other laws and regulations, the national governments respects –in a reasonably consistent way—the different types of powers it has delegated (in the broadest sense) to local governments. In other words, this effort to group the powers of local governments into two or three categories is designed to place constraints on parliament when passing other laws and regulations, even if it is understood that in the last instance parliament remains free to rewrite the framework itself.

Unfortunately, there is no standard system for classifying the powers of local governments, and both the naming of the categories and their content differs across countries. Nonetheless, most classification systems follow a similar scale and a similar logic. The scale runs from powers that local governments can exercise more or less at their own discretion, to powers that they can exercise only under close national oversight and control. The logic that they typically share is that the amount of autonomous power that local governments have in a given domain is directly connected to how these domains are expected to be financed.

Thus, in most unitary states, local government have their fullest powers over functions that they are expected to finance out of taxes and fees that they raise themselves, and they have the least independent decision making power over functions that remain financed by the national government through categorical grants. In this sense the logic of the scale follows the British saying, "He who pays the piper, calls the tune."

[1] This is not true in federal states, where the functions and finances of 1st tier subnational governments –cities, towns, and communes—are typically determined by regional or provincial parliaments, and not the national legislature. The constitutions of some federal states do require state or regional governments to assign some minimum powers to 1st tier local governments and/or to treat them according to some common principles.

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This logic clearly establishes two categories at either end of the spectrum. On one end of the spectrum, most countries grant local governments what are called "own" – or sometimes "exclusive" or "original" -- powers over functions that they are expected to finance primarily out of taxes they raise themselves. Here, their powers are extensive, and the national government's ability to regulate them is typically limited to ensuring that local governments arrive at their decisions concerning these functions in accordance with the laws governing the division of powers within them, and the rules governing how budgets are formed, passed and executed.

Moreover, while the national government may require that the services provided under the heading of own powers meet national safety or environmental standards, local governments are typically left to determine how much of the service they want to supply, and at what quality. For example, building and maintaining local roads, bridges and parks are classic local government own functions. For all of them, there are safety and environmental standards. Nonetheless, local governments are free to provide as many or as few local roads, bridges and parks as they want, and can do so long as safety and environmental standards are met.

Similarly, at least in countries with temperate climates and relatively abundant sources of water, water supply and sewage treatment is also typically considered a local government own function. Here too, local governments are required to ensure that safety and environmental standards are met by both private and public entities. But they are free to provide as much public water supply and sewage treatment as they want to pay for.

On the other end of the spectrum, most countries also grant local governments what are called "delegated" –or sometimes "entrusted" or "assigned"-- powers over functions or tasks that the national government has decided are important, and which need to be funded, but which it thinks are better administered by local governments. Here, local government powers are quite limited, with the national government specifying not just the purpose of the funds that are being provided to them through categorical grants, but the procedure and manner of their use.

Classic examples of "delegated powers" include the conduct of elections, the provision of hot meals to low income pupils, or the management and operation of facilities that serve people from multiple jurisdictions –like student dormitories, orphanages, and homes for the elderly. Indeed, in these latter two cases, the national government both determines who is eligible for the service and at least in theory, commits to covering the service's full costs, including the costs of extending it to new beneficiaries.[2]

## II. The Ministry of Regional Development's "Vested" and "Transferred" Powers

If the categories at both ends of the spectrum were the only categories that local government responsibilities fell into, life would be relatively simple. But unfortunately, this is not the case.

[2] The national government is, of course, also free to provide local government with categorical grants to pay in full or part for infrastructure investments that help local governments execute their own functions.

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Instead, in most countries many "primarily local" responsibilities are financed by a combination of local revenues and national government grants and transfers, while many "primarily national" government responsibilities are financed by a combination of national government grants and local government revenues. For this reason, these functions are usually called "shared" functions".

Indeed, it is this fuzzy middle ground that the Ministry of Regional Development of Ukraine is hoping to sort out by introducing into the Law on Local Governments two types of delegated powers which it has called "vested" and "transferred" powers. According to the Ministry, vested powers are "state guaranteed services" whose financing is secured by shared national taxes, including equalization grants, and "whose manner and procedure of provision" is set by the national government but whose quality standards are not. Meanwhile, transferred powers are "state guaranteed services" whose financing is secured by direct grants to local government budgets, and "whose manner and procedure of provision" *as well as whose* quality standards are defined by the national government.

In the documentation we have, it is not clear what the Ministry really means by quality standards. But it does provide secondary education as an example of a "transferred power", meaning one in which the state sets quality standards; and pre-school and extracurricular education as examples of "vested powers", meaning powers in which the state does not set quality standards. What this suggests is that the most important "quality standard" at issue concerns whether are not local governments have to provide the service to all concerned citizens (e.g. all children of secondary school age), or whether they are free to adjust the level of service to what they think the needs of their particular communities are and what they think they can afford to pay (e.g. preschool education for those preschool age children that want to go to preschool AND which the local government chooses provide preschool education for).[3]

In the following we argue that this attempt to solve the problem posed by functions that in reality are financed by a combination of state and local revenues is misguided, confusing and fiscally dangerous. Instead, we argue that what the Ministry is calling vested powers really should be moved into the category of local government own powers, and what the Ministry is calling transferred powers should be called shared powers or functions. Finally, the category of delegated powers should be retained but reserved for functions or tasks that are financed through narrow categorical grants designed to support in their entirety the function or task at issue (including grants for investments or for specific purchases like school equipment or school buses).

## III. Shared national taxes are freely disposable revenues which cannot and should not be legally earmarked for specific functions.

The 2014 reforms of the intergovernmental finance system were designed to help clarify the relative financial responsibilities of the national government and local governments by replacing an equalization system that in theory equalized local government revenues for all functions, with

[3] The distinction may also refer to the outcome measurement of service provision, with external tests provided to graduates of secondary schools (ZNO), while no such tests are provided for preschools.

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a system in which the national government agreed to finance the wage costs of hospitals and secondary schools through categorical (block) grants, and a more limited equalization system designed to provide freely disposable revenues to poorer local governments whose PIT shares yielded significantly less revenue than national per capita average.

Both before and after the 2014 reforms, PIT shares have legally been considered freely disposable local government revenues and not categorical or block grants. As such, PIT shares are designed not to finance specific state mandated services –'guaranteed' or otherwise. Instead, they –and the equalization grants associated with them-- are being provided to local governments because the national government recognizes that local governments cannot raise sufficient revenues from local taxes, fees and charges to cover the costs of the functions they have implicitly or explicitly been assigned as own functions. Or put another way, local governments are free to spend their PIT shares on whatever they like, precisely because it is assumed that they know best which of their own function they want or need to support most.

In both fiscal and substantive terms, the most important function at issue here is preschool education. And while there are certainly excellent reasons to want to ensure that all preschool age children can attend preschool if their parents want them to, this is certainly not the case in Ukraine today. As far as we know, there is no law that requires local governments to provide preschool education to children whose parents want to send them to preschool. Worse, if such a legal provision existed, today it would be a fiction because very substantial percentages of preschool age children do not attend preschool (c. 30-40% in urban areas; 50-60% in rural areas), and at least in most cities there are long waiting lists to get into them.

As such, preschool education is de facto if not de jure a local government own function and calling it "state guaranteed delegated (vested) function" clarifies nothing if levels of service provision are left up to local governments. Indeed, calling it a "state guaranteed delegated function" creates liabilities for the national budget: If preschool education is considered a state guaranteed function both local governments who cannot afford to provide the service, as well as parents who are not being offered the service would presumably have legal grounds to claim that the national government must fund it for everyone.

Worse, the national government would have hard time responding to these claims by arguing that preschool education is a state guaranteed function but it is up to local governments to use their shared taxes to fund it, if: a) the entirety of these shared taxes –or the equalization grants associated with them—could be shown to be insufficient for universal preschool coverage; and b) these shared taxes and equalization grants are also legally designed to support other "state mandated vested functions."

So again, and as painful as it may be to recognize, existing fiscal realities and coverage levels argue strongly for considering preschool education a local government own function whose safety and educational standards can be set by the national government, but whose coverage levels are left to local governments. This does not mean that efforts to expand coverage and to promote

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universal preschool education should be abandoned. Instead, they should be carried out through the strategic use of categorical grants to local governments and/or to parents who can afford to provide or purchase the service.

## IV. Secondary Education and Health Care should be categorized as a "Shared Functions" because local governments own schools and hospitals and make substantial financial contributions to both sectors from their general revenues.

The 2014 reforms introduced what are known in other countries as block grants for Secondary Education and Health Care. Block grants are grants that can only be spent on specific function, but which within that function local governments have considerable discretionary powers. In and of themselves these discretionary powers argue for considering both Secondary Education and Health Care as what other countries often call shared, concurrent, or non-exclusive functions.

In education, reforms introduced since 2014 strengthen the argument for considering education to be shared function. These reforms have made it clear that the Education Grant is designed to cover the pedagogical costs of schooling (teachers' wages) while local governments are supposed to cover all other school operating costs, including the wage costs of non-pedagogical employees. As such, and looked at as whole, Secondary Education is now best understood as a "state guaranteed function" whose costs are shared between national and local governments.

But there are other reasons to consider Secondary Education as a shared function. First, even if local governments are required to spend the education grant only on teachers wages, in practice they have retained a fair amount of discretion about what kind of teachers they employ and in which schools they should teach. Forming and adjusting the network of secondary schools is an exclusive prerogative of local governments. And second, at least some local governments use some of their freely disposable revenues not just to pay for the non-pedagogical costs of schooling but to employ more teachers than the education grant is designed to support. Some cities, for example, finance additional positions of deputy directors, above the norms required by legislation. In short, the function should be considered shared because local governments pay for the non-pedagogical costs of schools, exercise significant control over school networks, and because some of them also pay for more teachers than are being funded by the national government.

The situation with Health Care is somewhat different. After the creation of the Health Care Grant in 2014, the national government decided to move towards a single payer health care system. Under this system, the basic operating costs of both public hospitals and private clinics, as well as primary health care physicians will be financed directly from the national government through contracts based on some combination fee for service, enrolled patients, and/or persons living in specific catchment areas.

To finance these costs, the national government will eventually have to radically reduce or completely eliminate the Health Care Grant, meaning that unlike in education local governments will no longer receive substantial block grant funds to support the operating costs of the sector.

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Moreover, and as we understand it, to encourage a level playing field between public and private providers, local governments will also eventually be prohibited from providing hospitals with funds for wages, even if these funds come out of their freely disposable revenues.

As such, it is fair to say that the role of local governments in the sector can be expected to significantly decline. But this role will not be eliminated. As we understand it, the national government does not expect to renationalize public hospitals, which will remain in the ownership of local governments. As the owners of public health care facilities local governments will continue to be expected to pay for their non-wage operating costs of the facilities they own, as well to finance some of their needs for new equipment. They will also presumably remain lenders of last resort if the facilities they own incur debts that they cannot repay. Finally, and perhaps most importantly, local governments will be responsible for restructuring and closing some of the facilities they own so as to reduce the oversupply of hospital beds in their jurisdictions, and to prepare public hospitals to compete with private clinics.

In short, and at least for the foreseeable future, local governments will continue to play very important regulatory roles in the sector, and though their financial role will surely shrink, it is unlikely to completely disappear. For these reasons, we think classifying Health Care as shared function make sense, even if the basis for doing so is different than in Education.

## V. Classifying some functions as "Shared Powers" is messy and requires the development of strong institutional mechanisms for intergovernmental dialogue and coordination. But it is better than pretending they do not exist.

Over the last fifty years both social problems, and the social welfare services that countries put in place to address them have grown more and more costly and complex. The rising cost of these services almost inevitably requires national governments to contribute substantially to their financing. And the rising complexity of these services almost inevitably requires granting implementing agencies substantial front-line autonomy to adjust, adapt and revise programs and services to meet the specific demographic and socio-economic conditions of different localities.

Taken together, these forces have led to the substantial increase in what many countries have come to call shared, non-exclusive or concurrent functions (powers), meaning functions in which both national and subnational governments play important and often overlapping roles. The very fact that these functions are shared makes their management and coordination difficult. Further complicating things is the fact that these sorts of functions are typically shared in very different ways across different sectors and services, so that the rules governing how labor retraining or vocational education should be financed and regulated, differ substantially from how elderly care or disaster relief and remediation should be financed and regulated.

These sorts of services are thus not only complex, but complex in ways that make it virtually impossible to define a single set of rules that could easily by used to govern the intergovernmental fiscal and regulatory relationships that many social services now seem to inevitably carry with

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them. Instead, each shared function typically requires the development of sector specific rules to define the financial and regulatory obligations of multiple levels of government. Moreover, as problems, background conditions and fiscal possibilities shift, these rules often must be rewritten and renegotiated.

In short, these sorts of functions are not only increasingly common, but messy. So much so that experts in public administration and finance increasingly refer to them as the "the curse of concurrent functions," cursed both because they are inevitable and because they are hard to govern well. But if shared or concurrent functions are increasingly regarded as a curse, then much of the contemporary literature on the subject argues that the one thing worse than having them, is creating legal regimes that pretend that they do not exist.

Contemporary literature on public finance and administration now recognizes that there are now many local government functions that cannot easily be defined as own powers, or powers narrowly delegated to them be the national government. Instead, many –perhaps even most-- public sector functions have to be shared between levels of government, and rather than wishing them away by not giving them a name, time and energy is better spent by recognizing their existence, and then building the institutional forums and mechanisms that allow multiple levels of government to continually adjust and renegotiate their respective regulatory and financial rights and obligations[4].

Successful governance of shared functions requires both strong local government associations and the readiness of the national government and all its agencies to seriously engage with them. It also requires making data on both public finances and services available to these associations, as well as to think tanks and universities so that evidence-based analysis of what is and is not working can be used to shape policy. And finally, it requires passing laws that require intergovernmental discussion and deliberation before legislation impacting the finances and functions of local governments can be passed by parliament.

Indeed, here Ukraine would do well to look closely at Poland's Joint Commission for Intergovernmental Affairs. This body is composed of representatives of all local government associations and all national government ministries. It has a variety of permanent and ad hoc committees that meet on a regular basis, and its operating costs are paid for by the national government. Most importantly no piece of legislation that might materially impact either the finances or functions of local governments can be submitted to parliament without a non-binding resolution of the Commission. As such, the Commission does not encroach on the sovereign powers of the national parliament. Instead, what it makes possible – indeed what is required by law -- the continual discussion of and deliberation over all the rules, regulations and financial flows that make the governance of complex functions possible in a contemporary, multilevel welfare state like Ukraine.

[4] For a good discussion of these issue see Nico Steytler, "The powers of local government in decentralised systems of government: managing the'curse of common competencies'" The Comparative and International Law Journal of Southern Africa, Vol. 38, No. 2(July, 2005), pp. 271-284