
The experience of decentralization at the local level in Chile: analysis of public spending in municipality of Valdivia

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Abstract

The nature of the Chilean decentralization process has been affected by changes in the political environment. Nowadays, Chile tries to go one step further to adapt the decentralization concept in govern their state. The overall goal of decentralization policy is to give better distribution of opportunities to the regions and reduce inequality in the provision of public services and income.

The purpose of the research is to see clearly the experience from the application of decentralization in Chile particularly in Valdivia municipality. This research used public expenditure analysis for the municipality expenditure. Public expenditure analysis is the way to analyze how governments allocate and manage their financial resources. The aim of this expenditure analysis is to give recommendations for government on using and managing the financial resource efficiently and effectively to get the maximum impact in the future. This analysis is needed because resources are limited especially at the local government level, and the public spending and government activity can affect people's lives.

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1 Introducción

According to the OECD territorial report 2012, Chile's economy has been buoyant over the last two decades, with sound management of public finances. Macroeconomics and fiscal stability have been key drivers of growth in Chile's open resource-based economy. While necessary, these conditions are not sufficient to sustain positive growth rates in the medium and long term. In fact growth rates have recently slowed, mainly owing to lags in productivity, human capital, innovation and lack of economic diversification. According OECD (2012) reported the rate of poverty declined from almost 40% in 1990 to 13,7% in 2006 but it still remain very high, regional disparities in GDP per capita in Chile (CASEN, 2006). The outstanding reduction in poverty levels has not been followed by reduction in income inequalities. Those regions which have the highest GDP per capita are the mining-intensive regions like Antofagasta, Tarapaca, and Atacama. Also, the metropolitan region of Santiago because it is region that provide financial services.

Centralized source of income for the state only in a few regions and sectors has potential to destabilization in future economy at the end, will have impact on low quality of public service delivery in the entire Chile. It is shown now, with the inequality and disparity on regional income significantly. This is because the centralized system is still a domain for Chile - Santiago still the centre for decision making for regional development. Nevertheless, the central government put more attention to reduce the inequality on income and public service delivery through the implementation some concepts of decentralization such as Deconcentration, politic and some administrative decentralization. Few of the policies that has been implemented are transfer of regional planning authority from planning ministry to regional government, direct election for local executives and legislative (council). Meanwhile in the regional level, the process to establish the direct election of council members and executives is still under way (OECD, 2012)

Decentralization has an opportunity for improving income equality, better public service delivery and strengthening local development through maximizing local characteristic and potential is positive capital for Chile to strengthen the macro and micro economics.

However, the process of finding Chile's decentralization model is still a long way to go. While the search process and experiment continues to run, strong centralization in the management of government still feels so condensed in national investment and fiscal system and this has had negative effects on the performance of local development. For those municipalities who do not have a good capacity in financial resource, they do not have good opportunity to do investment for the development their jurisdictions. Based on the study of OECD (2012), almost all of their finances from national transfers are already used for the education and health sectors and this means that it is so hard for them to develop and investment on other public or economic sectors in their areas of jurisdiction.

The conditions were perceived by Valdivia is one of the municipalities in the south of Chile that has high growth cannot detach from the impacts of decentralization in this strong system of centralism. One of the indicators that could be used to portray a less decentralized Chile is the poverty index. Basedon SINIM (2013) the poverty index of Valdivia has increased from 14.8% in 2009 to 20.20% in 2012. Meanwhile the revenue and expenditure of Valdivia municipality show the increase trend from 2009-2012 (SINIM, 2013). Other studies also reported that Valdivia

income permanent (Ingresos Propios Permanentes/IPP) had increased over 27% in three years 2008, 2009 and 2010 (Consitorial consultores, 2011) cited in PLADECO 2011-2014. That condition as a background for conducting this research in Valdivia municipality. This is very interesting as a first finding when Valdivia is enjoying economic growth, larger fiscal capacity and budget surplus over the years, whilst at the same time Valdivia facing several challenges in development such as low-skilled technical human capital, weak regional mainstreaming of entrepreneurship, innovation in education (PLADECO, 2011-2014) and increase of poverty rate (SINIM, 2013).

To see clearly the impact that occurs from the application of decentralization experience in Chile particularly in Valdivia municipality, this research used public expenditure analysis for the municipality expenditure. Public expenditure analysis is the way to analyze how governments allocate and manage their financial resources (World Bank, 2010).

The aim of this expenditure analysis is to give recommendations for government on using and managing the financial resource efficiently and effectively to get the maximum impact in the future. This analysis is needed because resources are limited especially at the local government level. According to Shah (2007) public spending and government activity can affect people's lives. And Léautier (2005) cited in Shah (2007) said that public sector management and government spending help economic development and social equity especially for the poor and other disadvantaged groups such as women and the elderly. Therefore, this research will analyse public expenditure of Valdivia municipality particularly in the health and education sectors.

2 LITERATURE REVIEW

2.1 Decentralization

2.1.1 The concept of decentralization

In the last two decades, there has been a worldwide interest in decentralization of government in all parts of the world. The pursuit of decentralization is widespread. Both developed and developing countries attempt to challenge central governments' monopoly of decision-making power. In the western world, decentralization is an effective tool for reorganization of the government in order to provide public services cost effectively in the "post-welfare state" era (Bennett, 1990; Wildasin, 1997). Developing countries are turning to decentralization to escape from the traps of ineffective and inefficient governance, macroeconomic instability, and inadequate economic growth (Bird and Vaillancourt, 1999). Throughout post-communist Central and Eastern Europe, decentralization of the state is the direct result of the transition from socialist system to market economy and democracy (Bird, Ebel, and Wallich, 1995). In Latin America, the origin of decentralization is the political pressure from the people for democratization (Rojas, 1999). In Africa, decentralization has served as a path to national unity (World Bank, 1999).

There are two dimensions of the decentralization of public management system: economic and political. The standard economic dimensions of a public finance policy are macroeconomic stability, equity and efficiency (Musgrave and Musgrave, 1984). The efficiency aspect of the economic dimension is the economists' *raison d'être* for fiscal decentralization. Since individual

preferences for public goods differ, in a fiscally decentralized system individuals choose to live in a community that reflects their preference, which in return maximizes social welfare. The economic argument of efficiency stems from the fact that due to closeness to the citizens, local governments are able to meet different views and interests of people and allocate resources more efficiently than a central authority.

There are several studies that try to find a positive correlation between decentralization and government, such as Faguet, (2004) his experienced in Bolivia to find out whether decentralization has good responsive with the local needs; Bossert et al., 2003; Fisman and Gatti, 2002; Shah, 1998).

Decentralization often assumes that it leads to better resource allocation and a more productive, and possibly smaller, public sector (Oates, 1972, 1999; Shah, 1998). The 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 decentralization 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). Yet others have argued that decentralization 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). In China, fiscal decentralization increased efficiency of resource allocation by strengthening local incentives for local problem solving. (Lin and Liu, 2000)

According Oates (1972) decentralized governments will be better informed about local conditions and better able to satisfy citizen preferences. Seabright (1996) and Tabellini (2000) make the same case based on citizens being better informed about the activities of local governments and therefore better placed to reward or punish local politicians according to their performance. Weingast (1995) and Montinola, Yingyi, and Weingest (1995) argue that fiscal decentralization means that economic agents have the ability to leave more corrupt regions, which would tend to improve governance. Inman and Rubinfeld (1997) and de Mello (2000) argue that fiscal decentralization strengthens social capital and encourages political participation. Also, the World Bank (2004) suggests that the resulting competition between centers of authority reduces the risk that governments will expropriate wealth.

The few relevant empirical studies have had rather mixed results. Cross-country studies in this vein include De Mello and Barenstein (2001), who report that a range of governance indicators improve as the share of subnational government spending in total spending increases; Fisman and Gatti (2002). who find that revenue and expenditure decentralization reduce corruption; Enikolopov and Zhuravskaya (2007), who report that governance indicators improve when fiscal decentralization is combined with strong national parties; and Kyria and Roca-Sagale's (2011) cited in OECD (2012) who find that fiscal decentralization has a positive impact on the quality of government in Organisation for Economic Co-operation and Development (OECD) countries, though these effects are mitigated in the presence of regional elections and multilevel government.

Nevertheless, decentralization not always have good response and opinion. Other economists have argued that fiscal decentralization can undermine governance. Bardhan and Mookherjee

(2000), Tanzi (1995), and Prud'homme (1995) argue that the local officials are more susceptible to capture by local economic interests. Prud'homme (1995) and Tabellini (2000) further suggest that the harmful effects may result because local government activities are less intensely monitored than central government activities. Hommes (1995), the World Bank (1999), and Fukasaku and de Mello (1999) argue that fiscal decentralization may lead to poor accountability and governance if expenditures and revenue mobilization functions are not clearly assigned across different levels of government.

Prud'homme, (1995) and Tanzi, (1995) thought decentralization can create many difficulties for managing macroeconomic policy, especially in terms of ensuring fiscal coordination and implementing stabilization policies. 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. A second worry is that sub-national governments would have an incentive to spend excessively on public consumption rather than on public investment, which would lead to suboptimal levels of expenditure (OECD, 2012).

All of the arguments above are true because they are supported by research evidence. Nevertheless the idea to make better quality of people as a basis to find what types and what level of decentralization can be applied in this country. Therefore, analyze the implementation existing system would be important to find the right formulation

2.1.2 The areas of decentralization

According Olsen (2007), there are basically three types of decentralization within the public sector:

First is political decentralization. It is about the transfer of political power and decision making authority to sub national levels such as elected village councils, district/municipal councils, province councils, regional councils and state level bodies. Where such transfer is made to a local level of public authority that is autonomous and fully independent from the devolving authority, devolution takes place.

Second is fiscal decentralization which involves a level of resource reallocation to local government which would allow it to function properly and fund allocated service delivery responsibility, with arrangements for resource allocation usually negotiated between local and central authorities. The fiscal decentralization policy would normally also address such issues as assignment of local taxes and revenue sharing through local taxation and user and market fees.

Third is administrative decentralization which involves the transfer of decision making authority, resources and responsibilities for the delivery of selected public services from the central government to other lower levels of government, agencies, and field offices of central government line agencies. The most radical form of administrative decentralization is devolution, with local government having full responsibility for hiring/firing of staff and assigning authority/responsibility for carrying out tasks. Deconcentration is the transfer of authority and responsibility from one level of the central government to another, with the local unit accountable to the central government ministry or agency which has been decentralized. Delegation, on the other hand, is the redistribution of authority and responsibility to local units or agencies of

government that are not always necessarily branches, or local offices of the delegating authority, with the bulk of accountability still vertically directed upwards towards the delegating central unit.

As decentralization, delegation, and deconcentration have been mentioned above, it is useful to briefly look at the most common definitions of these terms.

Deconcentration is often considered as a controlled form of decentralization and is used most frequently in unitary states. Deconcentration redistributes decision making authority and financial and management responsibilities among different levels of the central government. It can merely shift responsibilities from central government officials in the capital city to those working in regions, provinces or districts, or it can create strong field administration or local administrative capacity under the supervision of central government ministries.

Delegation is a more extensive form of decentralization. Through delegation, central governments transfer responsibility for decision making and administration of public functions to semi autonomous organizations not wholly controlled by the central government, but ultimately accountable to it. Governments delegate responsibilities when they create public enterprises or corporations, housing authorities, transportation authorities, special service districts, semi autonomous school districts, regional development corporations, or special project implementation units. Usually these organizations have a great deal of discretion in decision making. They may be exempt from constraints on regular civil service personnel and may be able to charge users directly for services.

Devolution is often considered the most radical form of decentralization. When governments devolve functions, they transfer authority for decision making, finance, and management to quasi autonomous units of local government with corporate status. Devolution usually transfers responsibilities for services to municipalities/district councils that elect their own mayors and councils, raise their own revenues (at least partly) and have independent authority to make investment decisions. In a devolved system, local governments have clear and legally recognized geographical boundaries over which they exercise authority and within which they perform public functions. It is this type of decentralizations that underlies most cases of political decentralization.

2.2 Public Expenditure Management in Decentralization Context

Governments collect revenues through taxes, fees and charges, royalties on natural resources, and the sale of goods and services. They also receive income from investments and often from borrowing. These revenues are used to make transfer payments to individuals and businesses, pay interest on accumulated debt, and finance general expenditures. Both spending and revenue-raising activities of governments tend to alter the relative economic position of individuals and families often by design, because income redistribution is one of the main functions of government activity.

According to Rugerri (2005), estimating expenditure incidence requires three major steps. The first step deals with issues such as selecting: the time period, the analytical framework, the unit of analysis, and the appropriate income measure. The second step involves allocating government

expenditures to the selected family unit. The final step deals with selecting and applying indexes of redistribution.

This research is trying to examine the expenditure incidence in Valdivia municipality. As a theoretical framework in this research, the terminology expenditure is used as introduced by ruggeri (2005)

2.2.1 What is included in government expenditures?

According to Shah (2007) government activity affects the economic dimensions of people's lives through a variety of channels: public spending, taxation, borrowing, monetary policy, foreign policy, competition policy, regulatory activities, and ownership or control of business enterprises. By concentrating on public spending, analysis of government expenditure incidence focuses on only one of the channels through which government activity affects the relative well-being of individuals and families. The coverage of even this component in expenditure incidence studies is often incomplete. The government uses four major vehicles for delivering its spending programs: (a) direct spending through its departments and agencies as recorded in budgetary transactions, (b) direct spending through funds that are not included in the budget, (c) indirect spending through the business enterprises it owns or controls, and (d) spending programs delivered through the tax system, commonly known as tax expenditures. Only the first two items are usually included in expenditure incidence analysis, partly because those are the items that define the government sector in official statistical publications. For example, in the National Accounts published by the Organization for Economic Cooperation and Development (OECD, 1998: 643) the government sector is defined as,

“all departments, offices, organizations and other bodies which are agencies or instruments of the central, state or local public authorities, whether accounted for, or financed in, ordinary or extraordinary budgets or extra budgetary funds. Included are nonprofit institutions which while not an integral part of a government are wholly, or mainly, financed and controlled by the public authorities or primarily serve government bodies; all social security arrangements for large sections of the population imposed, controlled or financed by a government; and government enterprises which mainly produce goods and services for government itself or primarily sell goods and services to the public on a small scale. Excluded are other government enterprises and public corporations”.

Expenditure incidence analysis also omits the spending programs that are delivered through the tax system. Treating these indirect expenditures as part of the tax system does not affect the overall incidence of the government budget, but doing so does alter the relative contribution of spending and taxation. For example, if those tax expenditures are distributed in a regressive manner that is, if they benefit high-income families relatively more than low income families their inclusion in tax incidence analysis will reduce the estimated progressivity of the tax system and increase the progressivity of public expenditures.

Three main sources of information on public expenditures can be used to estimate their redistribution impact (the Canadian terminology will be used as an example): public accounts, the system of national accounts, and the financial management system. The public accounts are financial statements produced by each level of government to provide a record of their fiscal

transactions during a given fiscal year. They provide a wealth of details but are not well suited for incidence analysis because they do not always follow the same accounting practices. Standardization of accounting procedures is used in the financial management system. In these sets of accounts, financial information for all levels of government in a given fiscal year is presented on a consistent basis, which allows for consolidation of data and for comparisons between different levels of government

According to Rugerri (2005), these accounts have two additional advantages: they provide a breakdown of government expenditures by function and incorporate a broad definition of government by including agencies that perform governmental functions. Standardization of accounts is also used in the national accounts, which provide public expenditure data on a calendar year basis. Unlike the financial management system, however, the system of national accounts presents largely aggregated data and does not provide a detailed classification of government expenditures. Therefore, it can be used in studies analyzing the incidence of government spending as a whole, but it is not suitable for measuring the redistribution effect of selected government spending programs.

2.3 Decentralization Process in Chile

The nature of Chilean decentralization over time was affected by changes in the political environment. During the democratic governments of Frei (1964-1970) and Allende (1970-1973) there were elected municipal councils and various neighborhood groups. These groups served as the base of popular participation in national affairs and often were organized around local and regional issues. Allende for example, used local groups to advance social programs, especially the neighborhood food distribution program. While democratic structures were in existence at the municipal level under both Frei and Allende, the resource base of the municipalities was weak.

Pinochet (1974-1990) abolished all such democratic structures and replaced them with a military hierarchy in which centrally appointed intendentes were responsible for regions, governors headed provinces, and alcaldes (mayors) were responsible for municipalities. All appointees were named directly by the President and were loyal to the national government first, and their area second. This effectively brought all municipalities under direct national control. All the intendentes and governors (and most of the mayors) came out of the military, and the clear aim of the new structure was to transmit commands from above most efficiently. The provision of public services in Chile under Pinochet was intended to operate like a private market, with strong central control. Municipal level tasks were privatized wherever possible and the streamlining of all levels of government became a primary goal. Municipal governments thus acted like 'service delivery agents,' providing local public service on a cost-effective basis, without having local governing power. This form of decentralization created a direct line of hierarchical control from Pinochet down throughout the nation, consistent with his political and macroeconomic agendas.

Pinochet gave this new structure of government greater powers and resources, especially through the 1980s. The most important changes were the delegation of responsibility for primary and secondary education and primary health care to the municipalities, for which funds were transferred on a per capita basis. In addition, extra resources were provided to the municipalities

through the property tax (via the Common Municipal Fund (FCM)), additional license income, and the transfer of investment resources through the Regional Development Fund (FNDR). The resources owned by the municipalities thus increased significantly over the 1980s, although they remained a very small proportion of total government revenue (around 6%). The municipalities were, moreover, subject to strict central government guidelines and restrictions in terms of finance, were not permitted to run deficits, to have discretionary local tax control, or to take a significant role in local economic development. There were some redistributive features in the system of finance for both the municipalities and the regions. Among the municipalities this was achieved by the operation of the Fondo Comun Municipal (FCM) and the Regional Development Fund. The Pinochet government also made considerable efforts to professionalize the staff of municipalities via increased training and objective hiring standards.

The major change in decentralization achieved by the current democratic regime has been to institute elections for municipal councils and mayors (the first elections occurring in 1992) and to give the municipalities' additional finance. But the extent to which municipalities are free to raise additional funds is quite limited, and tax base inequalities raise distributional problems. There are additional proposals under consideration to strengthen and democratize the regional level of government. While the intendentes will continue to be appointed by the President, new regional councils will be elected by the municipal councils.

The provincial level of government has been largely an irrelevance over the years. It has been retained in the recent reforms with an appointed Governor and an advisory council. However, it has neither significant powers nor any source of finance. Its influence is limited by the personality of its Governor and the proposals it makes to the regional government. It occasionally assists the regional government in administrative tasks or (rarely) coordinates municipal actions.

During the Pinochet rule, strict military style control and an ideological desire to reduce the size of the state (through both decentralization and privatization) were the major motives for the somewhat odd combination of central control at the national level and decentralizing structures through the municipalities. At the same time, there were efforts by foreign aid donors and NGOs to bypass the Pinochet structures, leading to a variety of specific funds. More recently, the democratization of government has led to a debate on the size, shape and resources of different levels of government which has focused on (a) the desirable level of political control at different levels; (b) the desire to provide a firm foundation for sustained democracy; and (c) the desirability of increased decentralization from the point of view of efficiency, equity, participation and accountability.

Historically, the municipalities have long had their own source of funds, varying from licenses to the sale of goods and services. This funding base brought in extremely little revenue and was regressively distributed, with wealthier municipalities having much more per capita resources than poorer ones. In 1977-79, the municipal share of total government revenues was just 2.5%. The Pinochet regime provided new revenue sources and changed the distribution of revenue among municipalities. Municipal governments, however, remained highly dependent on central government revenues. According ILPES (1992), cited in Ranis and Steward 1994) Some of Pinochet's innovations included:

i. From 1979 all revenue from the property tax was allocated to the municipalities (which had previously received only a fraction). To a certain extent this displaced the "aporte fiscal," a central government transfer to the municipalities which was sharply reduced in value, then phased out completely by 1986. This additional revenue from the property tax cum FCM was much greater than the aporte fiscal and accounted for 34% of revenue from the municipalities' own taxes and licenses in 1990, the biggest single source of revenue. This tax, however, was not under local control as both the tax rate and assessments were set by the central government.

ii. In the previous system, both "own" revenue and finance from the central government varied with the wealth of the municipalities. Thus in 1974, the most wealthy 10% of the municipalities received 70% of the total income. A system of redistribution among municipalities was introduced through the FCM. It was financed by 60% of the property tax, 50% of the vehicle tax in all municipalities, and a proportion of receipts from a tax on business in three high income municipalities. The FCM was distributed in accordance with a formula, including a flat rate per municipality, the number of inhabitants per municipality, the number of exemptions from the property tax (a poverty indicator since a flat rate value of property determines exemption), and a proportion according to the shortfall of municipality income from average municipality income. The remaining 10% of the FCM was conditionally allocated to municipalities with emergency deficits. This fund has been an effective means of redistributing revenue from communities with a strong tax base and targeting those with a weak tax base.

iii. Funds to finance basic education, health and social assistance were transferred with the transfer of responsibility for these services during the 1980s. The funds for social assistance exactly matched the expenditures. In education, a flat rate subsidy per pupil was paid, but the real value of these subsidies fell quite sharply over the 1980s. Health payments were made in accordance with specified services provided. Major municipal deficits emerged due to the reduced real value of the education subsidy and the accompanying privatization which removed pupils (and their subsidies) from the municipal schools while costs did not fall proportionately. In health, the main problem was a ceiling imposed on total expenditures in 1983, while health services expanded and the real value of government finance again fell. The 'flat' payments to cover health and education expenditures were meant to provide local government with an incentive to control costs. However, these reimbursements did not, in the aggregate, cover actual costs. This caused an acute financial squeeze on the municipalities, who had to use some of their "own" funds reallocated from other investment and operating areas to finance health and education. Some municipalities also ran deficits, although in principle these were prohibited. Ways of financing deficits included using a portion of the FCM reserved for emergencies and petitioning for special funds established by the Pinochet Government. Since 1990, there have been occasional overtures to the Finance Ministry, which has funded deficits in a few cases but has simultaneously applied "IMF conditionality" to the municipalities to discourage repetitions.

iv. The Pinochet regime also initiated a flow of funds for investment, the most important being the Regional Development Fund (established in 1975) amounting to 15% of the public sector investment budget (largely financed by the IDB). This fund finances new investment projects in health, education and minor infrastructure, such as rural roads, and is distributed in response to project submissions by the municipalities and regions. The projects are subject to an

appraisal by the planning ministry. Small projects can be evaluated and approved at the regional level, but projects above about U.S. \$200,000 must be analyzed by the center. Redistributive criteria, including the population size and the inverse of per capita income of the area, in principle determine the regional distribution of the funds, but they are not always applied in practice. 90% of the Fund is allocated to five areas: basic education, basic health, sanitation, rural roads, and small urban roads. The remainder is discretionary and can be spent on a wide range of projects

v. Other investment funds for use by municipalities with varying degrees of local control were set aside for neighborhood improvement, urban improvement, communal equipment, sanitation, pavements, and sports. Each program is designed to cover a particular type of activity or need. The Regional Fund is probably most responsive to municipal submissions, although both regional and central government play a critical role. For some of the funds, the role of the municipality is quite marginal: for example, in the neighborhood improvement fund, the role of the municipality is confined to identifying poor areas, with priorities set at the regional level. Municipalities typically are only responsible for execution of the projects

According to World bank (1992) cited in Ranis and Steward (1994) in their publication mentioned, proposed changes in the financing system include a revaluation of the property tax (including an increase in the exemption level), discretion to the municipalities to alter the rate of the property tax between 1.1% to 1.6% (with municipalities charging less than 1.6% having their FCM reduced proportionately), removal of a ceiling on the business tax, and small changes in the formula for distribution of the FCM (the most important being the inclusion of the percentage of uneducated mothers and child malnutrition as criteria). It is expected that these changes will increase municipal own revenue by 20- 30%, giving more to larger/more developed municipalities.

According to steward and Ranis (1994), a new scheme initiated at the regional level, known as ISAR, allows the transfer of a small proportion (up to 5%) of the investments of sectoral ministries to the regional governments at their request. Program transferred under the ISAR mechanism include rural and urban roads and pavements, neighborhood schemes and potable water as well as various projects of the Social Investment Fund (FOSIS). The Regional Fund (FNDR) is to increase by 25% above the increase in total public sector investment each year over four years, with some of the additional funds to be spent by the regional governments rather than the municipalities. Thus the proposals give more investment resources to the region, but none of them are totally under regional control; the regional governments still lack any source of current expenditure.

As mentioned in the OECD territorial report (2012) the municipalities are heavily dependent on outside money, especially for investment finance. "Own" revenue, including taxes and FCM, accounts for 57% of the total budget revenue of the municipalities. But the municipalities only finance an estimated 16% of the investment in their area, an amount which just exceeds the contribution of the various external funds. Both are dwarfed by the expenditures of the central ministries, which account for nearly 70% of the investment in the regions. One future consideration which may alter the central government/municipal fiscal transfer relationship concerns the FCM.

Overall, Chile faces a large local revenue dilemma, as per-capita municipal revenues vary by a factor of more than 100 to 1 among the cities alone (the variance is even higher when rural municipalities are included). This implies that merely assigning discretionary tax control to municipal governments will not alleviate the built-up fiscal pressures and will only increase the variance in municipal welfare. Correcting the inequalities inherent in local tax bases by some system of transfer from the central government must be a major part of any decentralization effort granting more power to the municipal governments.

As a summary, according to Stewart and Ranis (1994) there was minimal decentralization during the Frei/Allende administrations, shown by the few functions and very limited resources available to the municipalities. The small amount there was can be described as constrained devolution. The municipalities were autonomous units with elected governments, responsible to the local electorates and not to the central government. However, they were heavily constrained by limitations on their tax powers and functions. The Pinochet period showed a major increase in decentralization, as indicated by the new functions and resources assigned to the municipalities and regions. This decentralization was strictly deconcentration and delegation, as abolishing the elected authorities at municipal levels eliminated all elements of devolution.

According to Ministerio del Interior (2001) in OECD territorial report (2012) the general objective of decentralization in Chile as “to contribute to the development of the country, by promoting institutional reforms to recognize the right of the regional and local citizen to decide and plan their territorial affairs, especially those concerning economic, social and cultural development”.

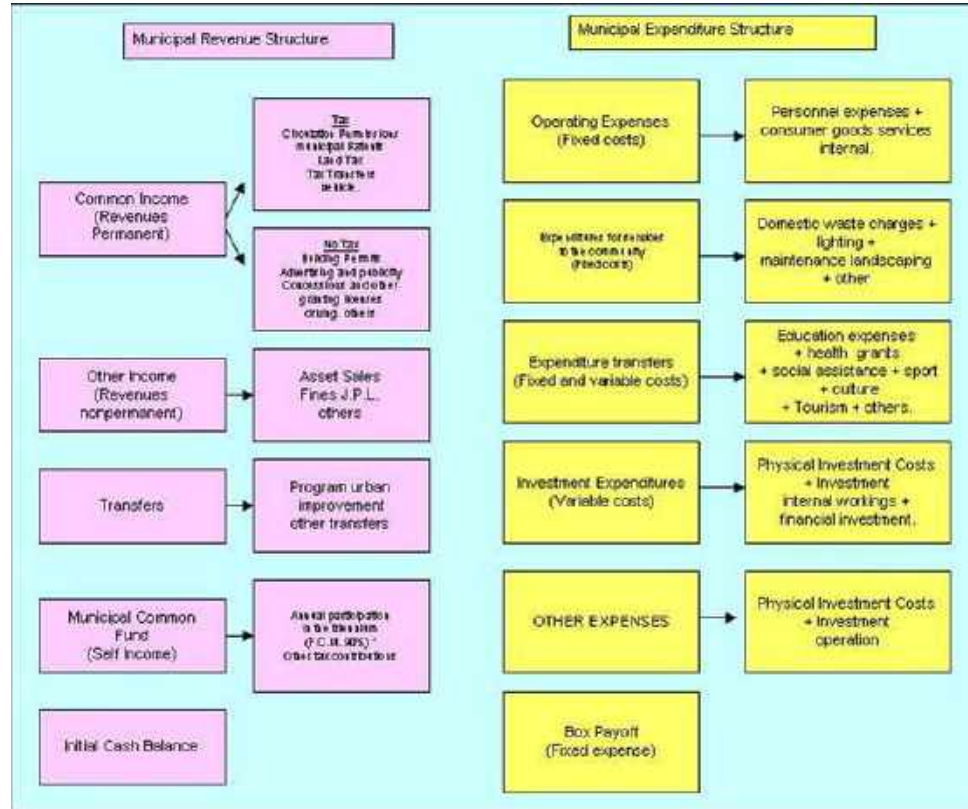
The overall goal of that objective is to give better distribution of opportunity to regions and reduce inequality of public service provision and income. For that reason, the government formulated the three principal objectives: Stronger democracy and greater participation, more efficient public management and improved regional competitiveness (OECD, 2012).

3 RESULTS AND DISCUSSION

3.1 Valdivia Municipality Budget Structure

The budget structure of Valdivia municipality as figure below consists of revenue and expenditure items. The revenues are distinguished into common permanent revenue; non-permanent revenue; transfers; Municipal Common Fund, and Initial cash balance. The expenditure items are divided into operating expenses (fixed cost); Expense for service to the community (fixed cost); Expense transfers (fixed and variable costs); Investment expense (variable cost); Other expenses, and Box payoff (fixed cost).

Figure 1: Valdivia Municipal Budget Structure



Source: PLADECO Valdivia Municipality 2011-2014

Common income in the revenue side was divided again into tax and non-tax. Those are included in the tax group are: circulation permissions, municipal patents, land tax, transfer tax and vehicle. The non-tax group is also divided into building permits, advertising / publicity, concessions, and other such as granting of driving license.

In the item of other income (permanent revenue) the revenue sources consist of asset sales and fines JPL (Juzgado Policia Local)

In the item of transfers, the source of income based on urban improvement program or other transfers.

In the item FCM, the sources from annual participation in the triennium (FCM 90%) and other tax contribution.

In the item of operating expenses (fixed cost), the city government spending consists of personal expenses and internal consumer goods and services.

Meanwhile, expenses for service to the community are used for domestic waste charges, lighting and landscaping maintenance.

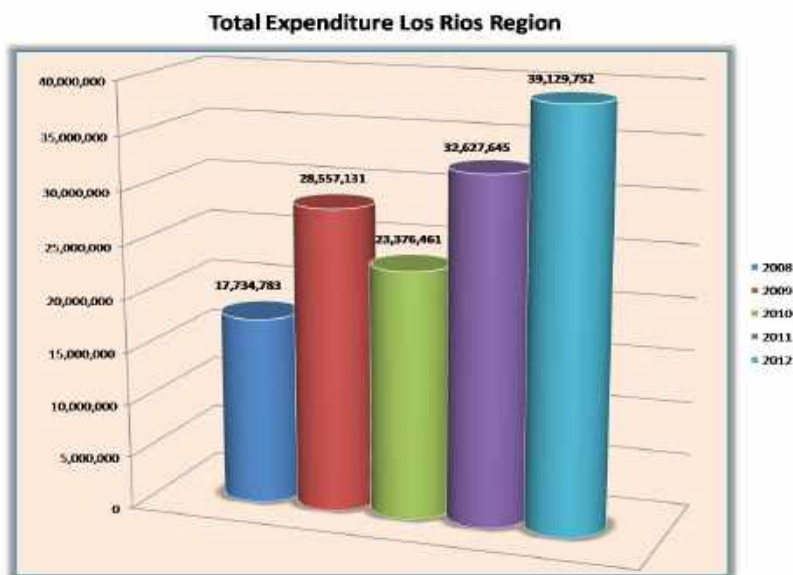
Transfer expense consists of education expenses, health grants, social assistance, sports, culture, and tourism.

Expenses that are included in the item of investment expense are the cost of physical investment, working internal investment and financial investment.

The other expense include investment is the physical cost, and investment operations.

3.2 Regional public spending in Región de Los Ríos

Figure 2: Total Expenditure Los Rios Region

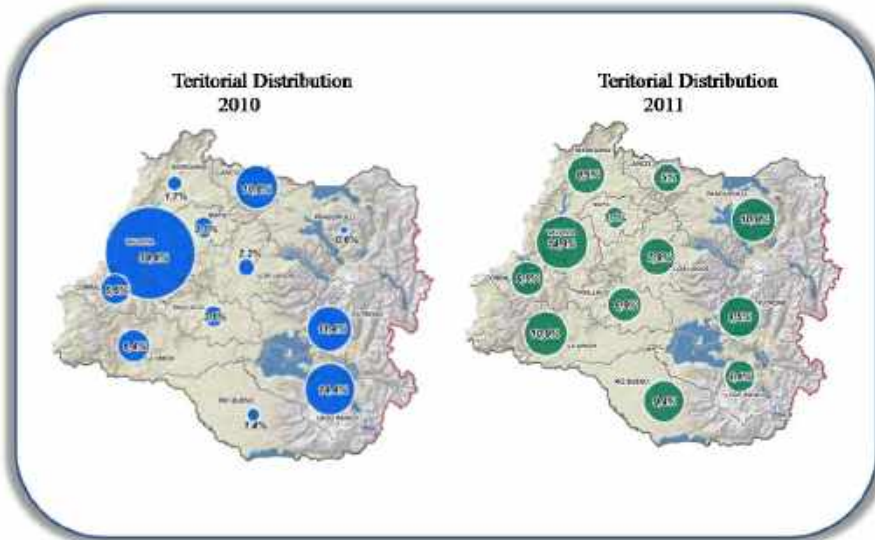


Source: SINIM, 2013

The figure above shows that the trend of regional budget is increased from M\$ 17.734.783 in M\$ 2008 to 28.557.131 in 2009. But in 2010 the regional budget fell down to M\$ 23.376, 461 and then continuously increase up to M\$ 39.129.752 in 2012.

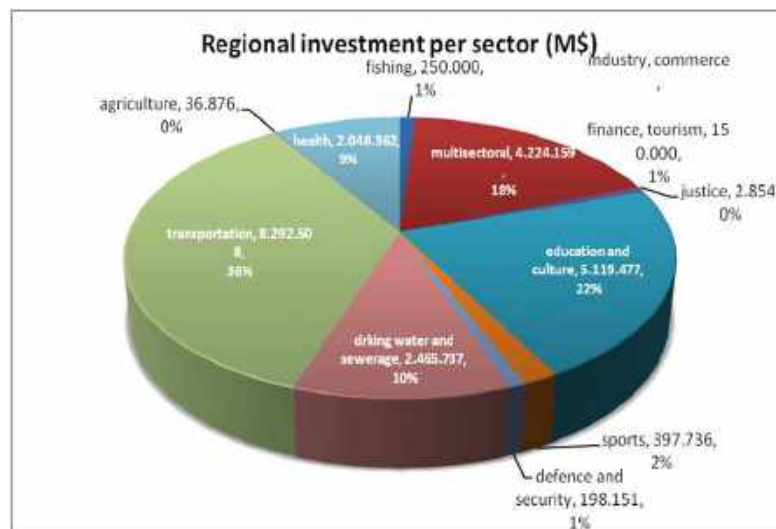
The increasing trend is explained by the fact that Los Rios is the new region in Chile, therefore there are several new initiatives and programs from the national level projected and implemented in this new region.

Figure 3: Territorial Distribution in Los Rios Region



Source: Subdere, 2012

Figure 4: Regional Investment by Sector



Source: Subdere (2012)

From the distribution of regional expenditure showed above, Valdivia is the biggest recipient among all the municipalities even though the portion has decreased from 39,4% in 2010 to 14,9% in 2011.

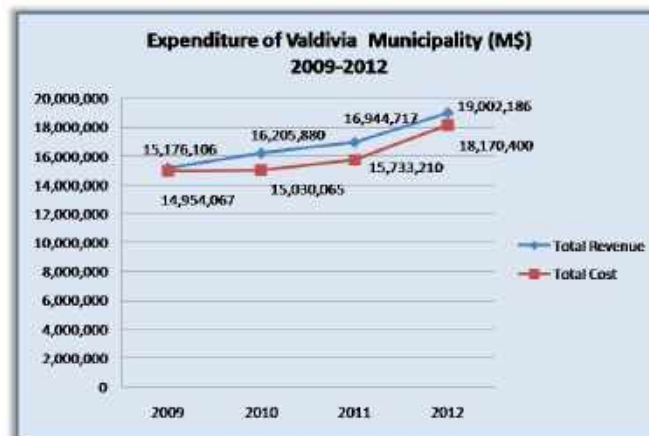
Since Valdivia has the biggest population among all the municipalities, therefore the scale of public service programs such as infrastructure, health and education had big attention from sector ministries.

Figure above shows that the highest sector portion receiving regional investment is the transport sector which received 36% (8.292.508) from the total budget, and then followed by education and the cultural sector which received 22% (5.119.477) and the health sector had 9% (2.048.362).

3.3 Revenue Structure of Valdivia Municipality

As mentioned above in the structure of municipality budget. Regularly Valdivia Municipality have to report the accountability on finance used to the public, which known as *quenta publica*, and internally to national controller. Contain of the report is the detail of revenue and expenditure distribution of municipality.

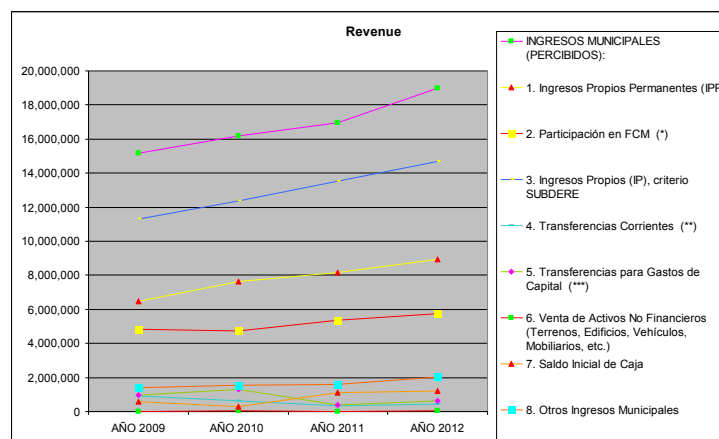
Figure 5: Total Expenditure of Valdivia Municipality 2009-2012



Source: SINIM, 2012'

The statistics above show an increasing trend in the revenue and expenditure of Valdivia from 2009 to 2012. The same data also shows the fiscal surplus of fiscal of Valdivia Municipality from year to year.

Figure 6: Revenue of Valdivia Municipality in 2009-2012



Source: SINIM, 2013

Table 1: Revenue of Valdivia Municipality in 2009-2012

Income:	2009 M\$	2010 M\$	2011 M\$	2012 M\$	Average contribution %	Average Increase %
	15,176,106	16,205,880	16,944,717	19,002,186		7%
1. Permanent Income (IPP):	6,465,788	7,654,021	8,169,669	8,940,402	26%	46%
2. Municipal Comuna Fund (FCM)	4,840,730	4,712,194	5,351,582	5,736,896	17%	40%
3. Transfer Income (Subdere)	11,306,518	12,366,215	13,521,251	14,677,298	43%	43%
4. Current transfer	937,438	617,126	340,774	454,132	2%	16%
5. Transfer for capital expenditure	962,883	1,321,949	410,220	610,635	3%	21%
6. Sale non financial asset	9,400	47,795	0	41,474	0%	
7. Initial Cash Balance	570,167	304,312	1,095,538	1,183,769	3%	69%
8. Other Income Municipalities	1,389,700	1,548,483	1,576,934	2,034,878	5%	49%

Source: PLADECO, 2011-2014

Based on the data for the year 2009-2012, the three largest income source for Valdivia are, Income transfer (subdere) which contributed an average of 43%, the second largest income is Permanents income(IPP) contributing 26%, and the next is a FCM with an average contribution of 17%.

The two sources of income with the lowest contributions respectively are Sale non financial asset 0% and 1% other transfers

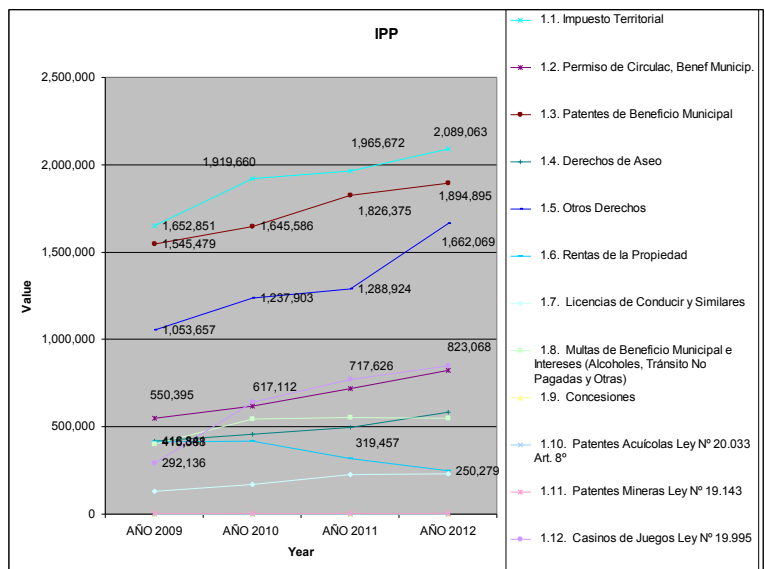
The figure above also shows the trend of increasing revenues from a variety of items for Valdivia municipality from year to year.

IPP experienced an average increase of 46%, FCM by 40%, IP SUBDERE by 43%, TC by 16%, cost transfer of capital by 21%, Balance cash by 69%, Other income municipality by 49% and in 2010 there was an increase in income that very large percentage of heading No. sale non financial assets by 508% but in 2011, this item did not contribute income at all. Then in 2012 it contributed 41.474 million pesos. However, the overall percentage of the amount is very small.

A significant percentage increase occurred in the source of income derived from the cash balance at 69%.

3.3.1 Common Income (Revenue Permanent)

Figure 7: Permanent Income (IPP)



Source: SINIM,2013

Based on data collected for the years 2009-2012, the largest of Valdivia Municipal permanent income was from Impuesto territorial (land tax), patentes municipal (license fee) and otros beneficios de Derechos (other benefit).

In general, all sources of income on permanent income items showed an increasing trend from year to year.

Only the item permission of aquaculture (Ley de patentes acuicolas) revenue decreased in 2011 (319.457 M) and 2012 (250.279).

Other Items of revenue sources that have the potential to continue to increase is business permit of municipal and others income.

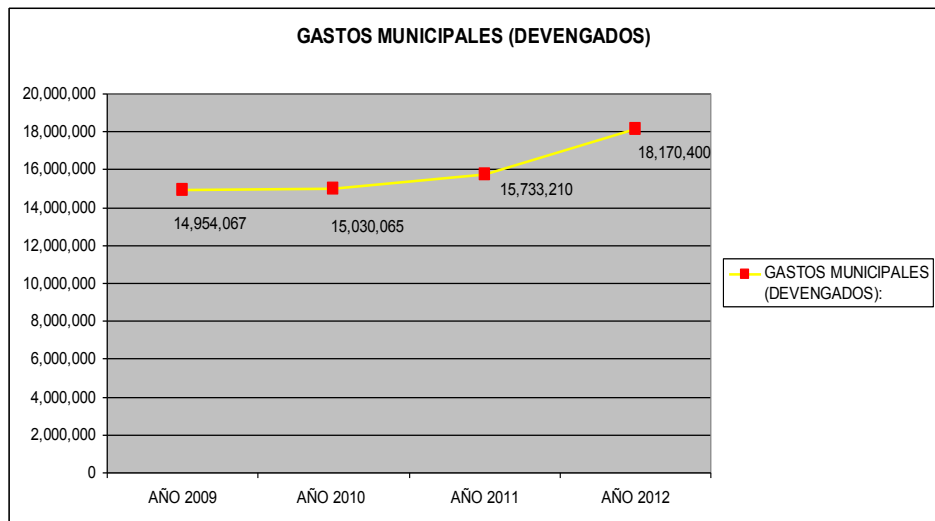
Event though the contribution from land tax is highest for the Municipality, actually the research find it should be have more contribution from this side. Base on the interviewed with the government official was found the information about a business company who had high income will pay the same number of land tax with the company who only low income (both of them has a same size on land use). Municipality only get from income share of land tax, but not from the profit of company who operate the business in Valdivia municipality

3.4 Municipal Expenditure

Valdivia municipality as the city is considered the city continues to grow, it shows also a trend of increase in spending. The figure below illustrates the structure of Valdivia municipality spending for the years 2009-2012.

3.4.1 General Municipal Expenditure

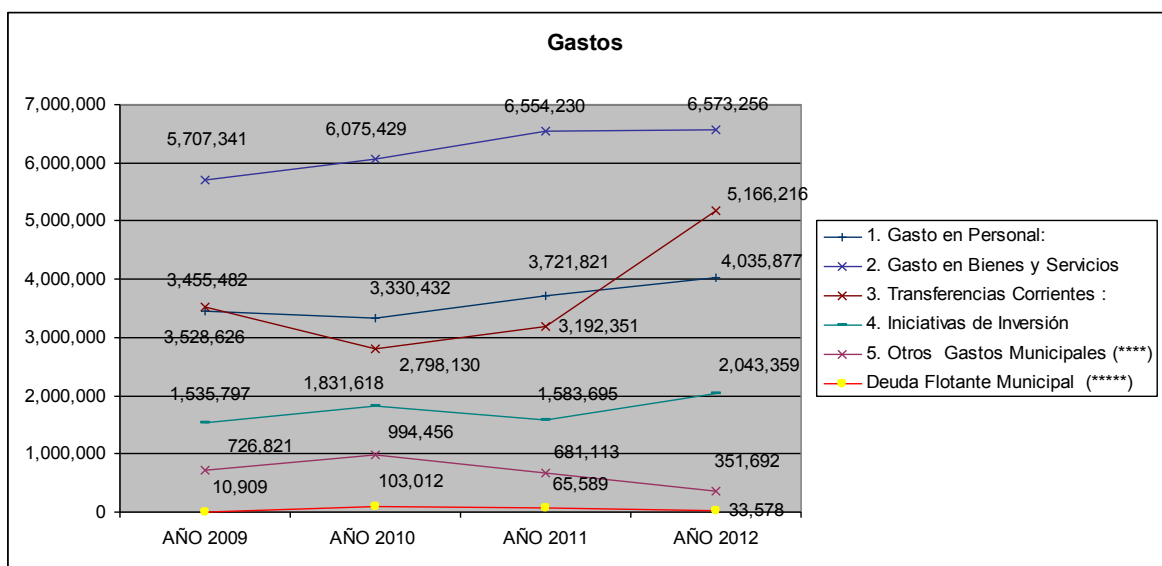
Figure 8: Expenditure of Valdivia Municipality for the years 2009-2012



Source: SINIM,2013

Based on the figure above, the tendency of Valdivia municipality spending is increase from year to year. In 2009, expenditure amounted to M\$ 14,954,067 which increased to 15,020,065 in 2010, 15,733,210 in 2011 and 18,170,400 in 2012. One of the occurrences of this increase was caused by the rising cost of the program transfer to the municipality from the national government.

Figure 9: The Expense structure of Valdivia Municipality in 2009-2012



Source: SINIM, 2013

Based on the figure above, it shows some of the items of expenditure which has a tendency to increase: *gastos en personal* (personal cost), and *bienes y gastos services* (cost for product and

service purchase), *iniciativas de inversion* (Capital investment) and *transferencias Corrientes* (Transfer from sectoral or agency public to Municipality)

Transferia corientas has occurs a sharp increase in 2012, from 3,192,261 in 2011 to 5,166,216 in 2012.

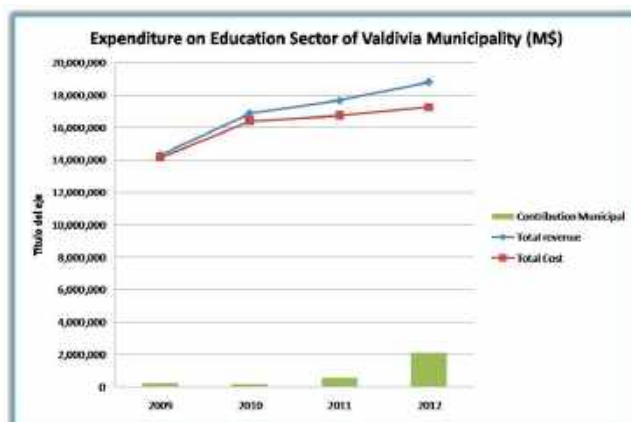
While on the item *otros gastos* (other costs) municipals and *deuda flotante* (Float Debt Municipality) municipal decreased.

3.4.2 Expenditure by Sector

This study was focus on the education and health sector expenditures. In the education sector expenditure can be seen as the figure 29 below

3.4.2.1 Expenditure for Education

Figure 10: The Structure of Expenditure in Valdivia Municipality (2009-2012)



Source: SINIM, 2013

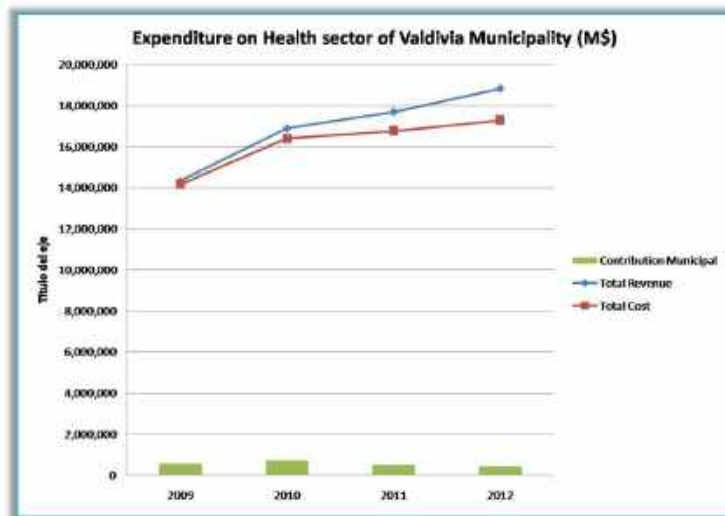
In general, the expenditure on the education sector has tended to increase. It also follows the trend to increase for the municipality contribution to the education sector.

Total establishment school in Valdivia until 2012 is 45 schools. Which are including primary and secondary schools. This number is highest compare other Municipalities in Los Rios Region. The student who schools in Valdivia is not only people from Valdivia, but also from municipalities around Valdivia. It is happen because they thought Valdivia schools are better from their original place. But only people who have more finance income can bring their children to get school in Valdivia municipalities.

Municipality government through *Programa de Mejoramiento Urbano* (PMU) has several activities to improve the quality of education in Valdivia. These programs financed by Ministry of Education. Municipality only has function as implementation and administering these program that decided by Ministry of Education.

3.4.2.2 Expenditure for Health Sector

Figure 11: The structure of Health Expenditure Sector in Valdivia Municipality



Source: SINIM,2013

The figure above shows the increasing trend of health sector budget in Valdivia municipality. The biggest portion of financing on the health sector is Ministry of Health and Valdivia municipality has a small contribution. After 2010, the contribution of Valdivia municipality tends to decreased. It is happen because the Valdivia municipality put more allocation to other sector such as tourist and personal expenditure.

The largest percentage of planning and budgeting programs for health and education derived from sector ministries and regional government. In education sector are; 81.68% in 2009, 84.86% in 2010, 63.91% in 2011 and 62.65% in 2012. Meanwhile the health sector: 77% in 2009, 75% in 2010, 85% in 2011 and 81% in 2012.

4 CONCLUSION AND RECOMMENDATION

Principle results and findings from this research are summarized in this chapter as follow below.

- Decentralization in Chile has not reached the level of the fiscal management autonomy, known as fiscal decentralization, because the fiscal system is still centralized in the national government. This situation has affects such as: it weakens the capacity of local governments on planning and budgeting based on local needs, making a high dependence on national and regional governments, causing uncertainty for planning and budgeting at the level of the municipality, because the municipality governments do not know how much the budget will be received from the national and regional governments for the next year. The low level of public participation in the program implementation and monitoring, because of the doubt in the planning process that has been done - people assume that their input is not properly used by regional and government national

- Source of government revenue derived from territorial tax is not proportionate because the municipal government is currently receiving a share of the division of tax from land tax and non-tax scale of business profits resulting from the use of the land. But to make an adjustment to the tax, local government does not have the authority. The authority to issue a new tax is in national government level.
- Main financing resources for development program of Municipality is from FNDR. Regional government and Sector Ministry will decide the program for municipality. Input from municipality is not relevant for those institutions.
- Valdivia municipality government has a low financial capacity in determining budgeting programs in health and education. It can be seen from the percentage contribution of the health sector amounted to: 23% in 2009, 25% in 2010, 15% in 2011 and 19% in 2012. While the health sector amounted to: 19% in 2009, 16% in 2010, 37% in 2011 and 38% in 2012. The low contribution of the sector's has potential impact on the content of the existing program is far from the real needs of the community. It is happen due to the planning process undertaken by sector ministries and regional governments which has limitation to absorb the aspiration of local communities.
- Due to the strong decision making by sector ministries and regional governments, the planning document (PLADECO) which is made by the municipal government potentially has not significant financial support, because the existing system and regulation requires municipal planning documents must refer to existing planning and budgeting which has developed by sector ministries and regional government
- Low level of community participation in the process of development planning and budgeting in the education and health sector due to the people perception on Valdivia municipality government that does not have the capacity in executing the program, the program execution authority is in the hands of regional governments and sector ministries
- A program for health and education which is planned and formulated in the national and regional level does not reflect the needs of Valdivia peoples. It can be seen from the planning and budgeting programs system at regional and sector ministries which is top down. The process of aspiration absorption that happen so far in local level through sector units in the existing regional governance is not optimal.
- Giving proper authorities to the municipality level in terms of local development planning and fiscal decentralization. Those are for municipalities to have the opportunity develop programs based on local community needs and stimulate municipal governments to explore their local potential's to support the local development. For that the amendment of national regulations on governing the municipality level and budget law needs to be adjusted.
- Adjustments on planning and budgeting systems in order to put more orientation to balance the bottom up and top down processes. Program planning in the sector and regional governments should be more coherent to the local document planning (PLADECO) rather than using regional planning and national planning as references for local development planning. For this it needs that:
 1. The development planning system should more consider a balance button up and top down approaches ,

2. Update the administrative and structural multilevel relation in: Municipality with regional, province and national governments.
3. Increase the level of decentralization by giving more delegation in municipality government level. To plan and manage basic public services such as education, health and environment. And followed with autonomy of finance authority (specially in basic public services such as education, health and environment)

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