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## The fiscal impact of decentralisation: Evidence from Danish local governments

### **Abstract:**

The influence of sub-national political entities is constitutionally sheltered in federalist states. However, decentralisation of political power from central to local government has also gained foothold in unitary states, notably in the Scandinavian countries. In Scandinavia, Denmark stands out as the most decentralised country, probably even more so than most federalist states. The article addresses the fiscal consequences of this decentralisation. On the one hand, fiscal federalist theory expects decentralisation to lead to less local spending. On the other hand, mainstream decentralisation theory as well as classic economic theory predicts that this is not necessarily so: it depends on the preferences of the local population. Thus, if there are pro spending voter attitudes, decentralisation is likely to increase local spending.

The evidence from Danish local governments supports the latter interpretation of the merits of decentralisation. Local governments are not more fiscally prudent than central government, but their spending patterns are much more in line with voter than central policy maker preferences.

*Key words:* Decentralization, Central Government Grants, Local Government Fiscal Responses, Economic Incentives, Voter Preferences

### 1. Introduction

Decentralisation of the political power is constitutionally embedded in federal states. In unitary states, local governments are “creatures of the state”. This implies that the central government decides the responsibilities of local governments unilaterally. Nevertheless, decentralisation of political power has gained foothold also in many unitary states, notably in the Scandinavian countries (*Sharpe* 1988, *Page* 1991). In Scandinavia, Denmark stands out as the most decentralised country, probably even more so than most federalist countries.

The article addresses the consequences of decentralising responsibility for service delivery to local governments. According to mainstream political decentralisation theory, one of the virtues of decentralisation is the ability to tailor policies to local preferences (*Sharpe* 1970, *De Vries* 2000, *Nørgaard/Pallesen* 2003). In this respect, the political decentralisation theory is in line with classic economic reasoning. Also according to the economic “decentralisation theorem”, decentralisation increases overall welfare because of the localities’ stronger ability to accommodate local preferences (*Oates* 1972; *Tiebout* 1956). Thus, when determination of the size and composition of local service delivery is

decentralised to the localities, it could be expected that some services are expanded and others reduced, in both cases in accordance with the preferences of the local population.

On the other hand, fiscal federalist theory suggests that decentralisation puts uniform downward pressure on all kinds of local services (*Oates 1999*). Fiscal federalists assume that decentralisation increases local fiscal prudence. Specifically, it is expected that local governments that finance their expenditure either by local taxes or unconditional grants spend less than localities that are reimbursed part of their outlay by central government (*Bradford/Oates 1971*). The reasoning is that localities that bear the full burden of increasing local services themselves are fiscally more prudent than localities that are reimbursed in part by the central government.

However, theories about decentralisation are much stronger and more numerous than our empirical knowledge of the actual impact of decentralising political power to sub-national governments (*DeVries 2000*). Thus, we are not sure whether more decentralisation actually leads to stronger accommodation of voter preferences or whether local governments in reality are fiscally more prudent than central policy makers. Thus, in contrast to the much debated and investigated spending impact of various sources of local incomes increases (*Bailey/Conolly 1998, Becker 1996, Dollery/Worthington 1996, Gramlich 1997, Hamilton 1983, Hines 1995, McGuire 1975, Dougan/Kenyon 1998, Melo 2002*), the fiscal federalist expectation that local governments spend less when fiscal authority is decentralised has yet not convincingly been supported by empirical findings (*Deller/Maher/Lledo 2007*).

The empirical focus of the paper is the profound decentralisation that came as the result of the change of the grant regime in Danish local government from reimbursement of local government expenditure to unconditional lump sum grants independent of actual local government spending. For two reasons, this reform is a fertile ground for investigating the controversial impact of increased decentralisation. First, the new unconditional grants had no strings attached, and in this way the Danish case represents a rare, real world textbook example of a grant regime change and a significant and abrupt increase in the autonomy of local governments (*Chubb 1985, Deller/Maher/Lledo 2007, Gustafsson/Kjulin/Schwarz 2002*). The second reason is that the reform was gradually implemented on different policy areas and the sequential change of funding principle on the local government policy areas increases the possibility of estimating the impact of the change of grant principle on one – more or less popular – policy area vis-à-vis the expenditure development on the other policy areas with unaltered funding principles.

The remainder of the paper is organised as follows. Section 2 briefly outlines Danish decentralisation in a comparative perspective and the empirical design of the study. In Section 3, the empirical study of the expenditure development on the six policy areas is carried out, and finally, in the conclusion the possible generalization of the findings is discussed.

## 2. Danish decentralisation in a comparative perspective.

Decentralisation, i.e. local governments' ability to shape the public service they deliver, is likely a multidimensional concept (*Page 1991*). One dimension of decentralisation is the number of local government functions and the size of these functions. The basic idea is, of course, that decentralisation increases with the number of functions and the size of outlays of the localities. Another dimension is how these local government responsibili-

ties are financed. Local government financing tends to be a combination of locally raised taxes and central government transfers, and decentralisation is considered to increase with the degree of local government self-financing. The basic idea in this respect is that local governments are assumed to have a greater say when they spend their own money rather than receive them from central government. For the same reason, central government transfers can be divided into two broad types: Transfers with strings attached (e.g. reimbursement of specific local government expenditure) and unconditional grants with no strings attached (*King 1984, Oates 1999*). Thus, local government autonomy and level of decentralisation increase when central government transfers to the localities are of the latter rather than the former type.

Of course, if local government service provision and taxation are heavily constrained by central government regulations, local government expenditure and taxes are obviously not truly valid indicators of decentralisation. In the Danish case local governments have rather wide limits for service provision in kind on the three main areas of local government provision: pre-school child care, primary schools and care for the elderly (*Blom-Hansen 1999, Pallesen 2004*). On the income side, in order to obtain macroeconomic co-ordination, the level of local government taxation is negotiated between central government and the local government association (Kommunernes Landsforening). Thus, local governments do not always have their way 100 per cent, but it is fair to say that local taxation to a large extent is set in accordance with local preferences (*Blom-Hansen 1998*).

*Table 1:* Danish decentralisation in a comparative perspective

	Expenditure	Taxation
Local government, pct. of general government		
Denmark	69	32
Nordic countries	58	25
Unitary OECD countries	48	12
Federal OECD countries	55	31
OECD Europe	45	14
Local government, pct. of GDP		
Denmark	17	16
Nordic countries*	14	11
Unitary OECD countries*	9	5
Federal OECD countries*	10	11
OECD Europe*	9	6

Notes: \* Unweighted averages.

Data: *OECD*, National Accounts (1997), Revenue Statistics, 1965-1996, (1997).

With the reservation that local expenditure and taxation are circumscribed to varying extents, it can be seen from table 1 that the degree of decentralisation in Denmark is very high in a comparative perspective (*Blom-Hansen/Pallesen 2001*). On both of the two conventional measures of decentralisation, local governments' share of total government expenditure and taxation, Danish local governments rank highest among OECD countries. The figures not only indicate that the importance of Danish sub-national governments is greater than in the other Nordic and European unitary states, but also comparable to local governments in federal OECD countries

Central government transfers make up the difference between local government expenditure and taxation. As noted, in terms of decentralisation and local government autonomy, it makes a great difference whether central government attaches strings to

these grants. In Denmark, the type of central government transfers changed in the wake of the 1970 local government reform (*Pallesen 2004*). In general, central government financing of local government service provision changed from matching grants to a system of unconditional grants.

This is a textbook example of a change from a centralised, fully stringed transfer system to a decentralised system with full local government autonomy. Before the reform, local government had to spend on specific policy areas in order to obtain central government reimbursement. After the reform, local governments received a similar sized grant but now it was no longer earmarked for a specific policy area. Local governments were now free to spend the entire grant on other policy areas, save the money, or use the grant to reduce local taxation.

In this situation, as noted, fiscal federalists expect local governments to enjoy their new economic freedom to lower their spending on the hitherto reimbursed policy area. On the other hand, conventional political science and economic theory would expect local governments' fiscal reaction to be contingent on the voter popularity of the policy areas at stake. Whether one or the other position is right is an empirical matter. The design of the empirical investigation is the topic of the next section.

### 3. Design of the study

The change of grant regime took place gradually on different policy areas. Reimbursement of local road expenditure was to be terminated in 1973, reimbursement of public schools and local libraries ended in 1975 and 1984 respectively, and reimbursement of local government child and care for the elderly stopped in 1987. Finally, an intra local government financial reform of special social service with economic incentives similar to the change in the central government financing of local governments took place in 2002.

The sequence of change improves the possibility to evaluate the impact of the reform by comparing the expenditure development in the changed area with other policy areas. The change of grant regime in one policy area – while the funding principle in all other local government areas remains unchanged – increases the likelihood that the change of grant system is actually the root cause of changes in the expenditure development in the affected policy area.

In one of the affected policy areas, public schools, local governments have a legal obligation to take in all students in the relevant age group. A strong increase in the number of applicants puts upward pressure on school expenditure. Irrespective of a change in the funding regime, it is difficult for these municipalities to avoid an increase in total cost in this situation. In general, changes in the population served by the local government may bias the evaluation of the reform. In order to avoid this bias, expenditure per student is also included in the investigation of the impact of the reform.

In two other affected policy areas, pre-school care for children and care for the elderly, local governments have more options to respond to incentives to reduce spending. First, on these two policy areas local governments have some discretion regarding the intake of clients. National law only vaguely describes the local governments' obligation to provide "the needed amount of services", and to some extent local governments decide the coverage of their services.

Second, user fees partly finance both care for the elderly and day care for children. Within broad central government guidelines local governments decide the level of user co-payment. Third, local governments have a broader repertoire of services on these two policy areas. There are two fully substitutable kinds of day care for children: (less expensive) local government sponsored and supervised day care in private homes and (more expensive) day care institutions run by the local governments. Care for the elderly is even more diversified, however, with two major types of services: (less expensive) home care for the elderly and (more expensive) institutionalised services. These services are, at least to some extent, also substitutable. Thus, on care for the elderly and day care for children local governments have more options to reduce spending by increasing user fees and substituting more expensive with less expensive kinds of services. In advance, it seems more likely that the fiscal federalist proposition should gain foothold on these policies.

However, other political-economic factors may also account for an eventual change in the expenditure development in the wake of the change of grant regime (Boyne 1996). Thus, in this context, it may be hypothesized that the high needs or wealth of the localities may moderate, or even nullify, the impact of the change of grant regime.<sup>1</sup>

## 4. Empirical analysis of the change in financing support of local governments

### 4.1. Local road maintenance

The first major change of the central government's financial support to the local governments takes place in 1972/73 when reimbursement of local road maintenance ends.

*Table 2:* The impact of the abolishment of reimbursement of local government road maintenance expenditure (real 1970-expenditure) in 1972/73. Aggregate of all 275 local governments

	1970/71	1971/72	1972/73	1973/74
Road maintenance expenditure (mill. DKK)	863	878	758	848
Increase in expenditure (pct.)		1.7	-13.7	11.9

Source: Statistics Denmark.

The reduction of total local road maintenance expenditure the year the reform takes effect indicates that the change of grant regime has an impact. Road maintenance expenditure increases again the year after the reform but it remains below the pre-reform level. Unfortunately, local road expenditure is only reported as the aggregate total of all local government road maintenance expenditure. For this reason, it is not possible to check whether road expenditure is significantly reduced at the disaggregate local level when other confounding factors can explain the expenditure change. However, the aggregate figures support fiscal federalist expectations.

## 4.2. Public Schools

The second major change of local government financing takes places in the field of public education where 65 per cent of local government expenditure to teachers' salaries used to be refunded by the central government. This open-ended reimbursement system changes in 1975/76.

*Table 3:* The impact of the abolishment of reimbursement of local government expenditure to teacher salaries (real 1970-expenditure) in 1975/76. Aggregate of all 275 local governments

	1973/74	1974/75	1975/76	1977
Teacher salaries (mill. DKK)	2146	2329	2600	2926
Increase in teacher salaries (pct.)		8.6	11.6	12.5
Teacher salary per student (DKK)	2875	3077	3433	3883
Increase in teacher salary per student (pct.)		7.0	11.6	13.1

Source: Statistics Denmark.

In contrast to the development in road maintenance expenditure, the change of grant regime in public schools does not support the fiscal federalist proposition. Teacher salaries continue to increase after the reimbursement system stops in 1975/76 and the rate of increase in expenditure is even higher after the reform than before. Taking the number of students into account does not change this overall conclusion. The increase in total teacher salary and salary per student is very similar.

From 1973/74, it is possible to get reliable data for the individual local government and to assess the expenditure development in each of the 275 localities. Table 4a and 4b (below) show the result of the regression analysis of the total local expenditure and expenditure per student for all localities. The grant reform is included in the analysis as a dummy variable (years before reform=0, years after reform=1). Number of students and local government wealth are included as control variables. To tap the impact of specific local factors, a dummy for each of the 275 localities is also included in the regression analysis.

*Table 4a:* Regression analysis of the impact of the abolishment of reimbursement of local government expenditure to teacher salaries (real 1970-expenditure) in 1975/76. Total expenditure

	Unstandard. coefficient	Std. error	Beta coefficient	t-value	significance
Grant reform	33569.8	5945.5	.090	5.646	.000
Local wealth	-978.4	444.1	-.284	-2.203	.028
No. of students	.939	23.43	.017	.040	.968

Notes: Explained variance (adjusted): .94. Values for local government dummies not shown.

Source: Statistics Denmark.

*Table 4b:* Regression analysis of the impact of the abolishment of reimbursement of local government expenditure to teacher salaries (real 1970-expenditure) in 1975/76. Expenditure per student

	Unstandard. coefficient	Std. error	Beta coefficient	t-value	significance
Grant reform	6.251	1.038	.160	6.024	.000
Local wealth	.06	.078	.188	.877	.381
No. of students	-.010	.004	-1.633	-2.346	.020

Notes: Explained variance (adjusted): .83. Values for local government dummies not shown

Source: Statistics Denmark.

The regression analysis of total expenditure and expenditure per student echoes the aggregate results: The grant reform does have a significant impact on total expenditure and expenditure per student, but contrary to fiscal federalist expectations, the impact is positive.

### 4.3. Local libraries

Like local roads, libraries are one of the minor local government responsibilities. The automatic central government reimbursement of 20 per cent of local government expenditure on libraries ends in 1984.

*Table 5a:* The impact of the abolishment of reimbursement of local government expenditure to libraries (real 1979-expenditure) in 1984. Aggregate of all 275 local governments

	1982	1983	1984	1985
Expenditure on libraries (mill. DKK)	1073	1053	1024	1041
Increase in expenditure (pct.)		-2	-3	+2

Source: Statistics Denmark.

Even though expenditure is reduced already in 1983, the reduction of local government expenditure on libraries the year the reform takes effect indicates an impact of the change of grant regime. Library expenditure increases again the year after but remains below the pre-reform level. In sum, the development in the aggregate library expenditure conforms to fiscal federalist expectations.

*Table 5b:* Regression analysis of the impact of the abolishment of reimbursement of local government expenditure to libraries (real 1979-expenditure) in 1984. Total expenditure

	Unstandard. coefficient	Std. error	Beta coefficient	t-value	significance
Grant reform	-359.8	64.09	-.033	-5.564	.000
Local wealth	3.002	1.116	.053	2.690	.008

Notes: Explained variance (adjusted): .99. Values for local government dummies not shown

Source: Statistics Denmark.



The regression analysis also shows that the grant reform had a significant, negative impact on local government spending.

#### 4.4. Pre-school Child Care

In 1987 the 50 per cent central government reimbursement of local government pre-school care expenditure stops. As noted above, in this case local governments have more options to dampen the expenditure development. Local government is allowed to charge users up to 30 per cent of total local government spending on day care, and many local governments have the possibility to respond to the change of grant system by increasing user charges. Also, because child care in kindergarten is more expensive per child than local government sponsored day care in private homes, local government may also respond to the grant reform by increasing the relative share of day care places in private homes and lower the share of places in kindergartens to reduce total expenditure and expenditure per child.

In sum, the impact of the grant reform may have an impact on total child care expenditure and net total expenditure (subtracted user fee) or expenditure per child and net expenditure per child (subtracted user fee).

*Table 6a:* The impact of the abolishment of reimbursement of local government child care expenditure (real 1982-expenditure) in 1987. Aggregate of all 275 local governments

	1985	1986	1987	1988
Total gross expenditure (mill. DKK)	6512	6774	7136	7396
Increase in total gross expenditure (pct.)		4.0	5.4	3.6
Total expenditure, net of charges (mill. DKK)	4727	4894	5154	5294
Increase in net expenditure (pct.)		3.5	5.3	2.7
Total gross expenditure per child	27,923	28,427	29,002	29,529
Increase in total gross expenditure, per child (pct.)		1.8	2.0	1.8
Net expenditure per child	20,270	20,539	20,946	21,135
Increase in net expenditure per child (pct.)		1.3	2.0	0.9

Source: Statistics Denmark.

Overall, the change of the grant system does not slow down local government day care spending in neither gross nor net expenditure. Only to a limited extent do local governments choose to increase user charges more than the general increase in day care expenditure in the wake of the funding reform, and post-reform growth in net expenditure (total expenditure and expenditure per child) is only slightly lower than the increases in gross expenditure (total expenditure and expenditure per child).

In sum, local governments' expenditure behaviour does not follow fiscal federalist expectations. Expenditure increases even though local governments had opportunities to lower their expenditure by substituting more expensive with less expensive services and increasing user fees.

*Table 6b:* Regression analysis of the impact of the abolishment of reimbursement of local government child care expenditure (real 1982-expenditure) in 1987. Total expenditure (net)

	<b>Unstandard. coefficient</b>	<b>Std. error</b>	<b>Beta coefficient</b>	<b>t-value</b>	<b>significance</b>
Grant reform	58.83	277.52	.001	.212	.882
Local wealth	3.909	3.425	.012	1.141	.255
No. of children	39.64	3.734	.942	10.616	.000

Notes: Explained variance (adjusted): .99. Values for local government dummies not shown

Source: Statistics Denmark.

*Table 6c:* Regression analysis of the impact of the abolishment of reimbursement of local government child care expenditure (real 1982-expenditure) in 1987. Total expenditure per child (net)

	<b>Unstandard. coefficient</b>	<b>Std. error</b>	<b>Beta coefficient</b>	<b>t-value</b>	<b>significance</b>
Grant reform	.993	.169	.045	5.888	.000
Local wealth	.002	.002	.025	1.006	.315
No. of children	-.006	.002	-.598	-2.815	.005

Notes: Explained variance (adjusted): .98. Values for local government dummies not shown.

Source: Statistics Denmark.

The regression analyses of the total net expenditure and the net expenditure per child (the two expenditure measures most likely to support the fiscal federalist position) do not change this conclusion. In neither case does the grant reform of the two cases have the impact expected by fiscal federalists. Measured as total expenditure per child, the reform even tends to increase local government expenditure.

#### 4.5. Care for the elderly

The grant reforms of child care and care for the elderly are simultaneous. The two policy areas have other traits in common. Charging the users is an option in both cases and local governments have some flexibility to substitute between an expensive institutionalised service and less expensive home care on both policy areas.

In many ways, the local governments' expenditure responses to the grant reform are similar in the two policy areas. Care for the elderly gross expenditure also increases after the change of grant system, both measured as total expenditure and expenditure per elderly.

*Table 7a:* The impacts of the abolishment of reimbursement of local government elder care expenditure (real 1970-expenditure) in 1987. Aggregate of all 275 local governments

	1985	1986	1987	1988
Total gross expenditure (mill. DKK)	8448	8522	8956	9001
Increase in total gross expenditure (pct.)		0.1	5.1	0.1
Net expenditure (mill. DKK)	7777	7832	7620	7672
Increase in net expenditure (pct.)		0,1	-2,7	0,1
Gross expenditure per client	45,603	44,971	46,490	45,503
Increase in gross exp. per client (pct.)		-1.4	3.3	-2.2
Net expenditure per client	41,971	41,133	39,556	38,784
Increase in net exp. per client (pct.)		-2.0	-3.8	-2.0

Source: Statistics Denmark.

In contrast, local governments increase user charges more on care for the elderly than on day care for children. The increase in user charges reduces net expenditure. Thus, unlike gross expenditure, net expenditure declines the year after the introduction of the reform, both measured as total net expenditure and net expenditure per client.

However, the regression analysis of total net expenditure and net expenditure per elder (once again the two expenditure measures most likely to support the fiscal federalist position) shows that the grant reform does not have the impact expected by fiscal federalists in either case. Quite to the contrary, when the wealth of the localities and the number of elderly are taken in to account, local government expenditure has increased after the grant reform.

*Table 7b:* Regression analysis of the impact of the abolishment of reimbursement of local government elder care expenditure (real 1982-expenditure) in 1987. Total Expenditure (net)

	Unstandard. coefficient	Std. error	Beta coefficient	t-value	significance
Grant reform	14062.3	1720.71	.014	8.172	.000
Local wealth	28.60	25.19	.007	1.135	.257
No. of elderly	-22.97	14.26	-.035	-1.611	.108

Notes: Explained variance (adjusted): .99. Values for local government dummies not shown

Source: Statistics Denmark.

*Table 7c:* Regression analysis of the impact of the abolishment of reimbursement of local government elder care expenditure (real 1982-expenditure) in 1987. Total Expenditure per client (net).

	Unstandard. coefficient	Std. error	Beta coefficient	t-value	significance
Grant reform	70.64	19.46	.036	3.630	.000
Local wealth	-.009	.285	-.001	-.033	.974
No. of elderly	-1.369	.161	-1.109	-8.488	.000

Notes: Explained variance (adjusted): .98. Values for local government dummies not shown

Source: Statistics Denmark.

#### 4.6. Specialized social services

The final reform to be considered is the 2002 change in financing of specialized social services (notably out-of-home placement of children and youngsters). Before the reform, financing of these services was a fifty-fifty local-regional arrangement. In effect, like the cases of central government reimbursement of local roads, schools, day care and elder care, the localities only paid part of the bill when they sent clients to the regional facilities. Like the grant reforms of the central government funding of the localities, the change of funding system of the specialized social services implied that the localities (up to a certain limit) had to pay the full cost of these services. Thus, also in this case, the reform gave the localities an economic incentive to reduce the number of outplacements or substitute more expensive regional provided services (foster homes) with less expensive locally sponsored services (family foster care in private homes) in order to reduce local government spending. There are no local spending figures that allow us to compare expenditure before and after the reform. However, it is possible to estimate the impact of the reform by evaluating the development in the number of outplacements and the service composition (e.g. the use of family foster care in private home).

*Table 8a:* The impact of the reform of the funding of specialized social services in 2002. Aggregate of all 275 local governments.

	2000	2001	2002	2003
No. of outplacements (total)	13,641	14,171	14,363	13,970
Increase in outplacements (pct.)		3.9	1.4	-2.7
Outplacement frequency (pct. of 0-18 years)	1.13	1.16	1.16	1.12
No. of outplacements in family foster care	6,163	6,492	6,522	6,398
Increase in outplacements in family foster care (pct.)		5.3	0.0	-1.9
Relative share of family foster care (pct.)	45.2	45.8	45.4	45.8

Source: Statistics Denmark.

Table 8a shows that there is a moderate impact of the funding reform. The number of outplacements (and the outplacement frequency) slightly decreases in the second year after the reform. On the other hand, the localities' use of the relatively cheaper family foster care is stable. The regression analysis shows that in terms of outplacement frequency the impact of the grant reform has the "right" direction while the reform has no significant impact on the use of the relatively cheaper family foster care when other factors are taken into account (the social index is a composite measure that taps into the graveness of the localities' social problems).

*Table 8b:* Regression analysis of the impact of the funding of specialized services in 2002. Outplacement frequency

	Unstandard. coefficient	Std. error	Beta coefficient	t-value	significance
Grant reform	-.009	.007	-.033	1.270	.204
Local wealth	.000	.000	.111	2.402	.017
Social index	.178	.073	.360	2.443	.015

Notes: Explained variance (adjusted): .85. Values for local government dummies not shown

Source: Statistics Denmark.

*Table 8c:* Regression analysis of the impact of the funding of specialized services in 2002. Relative use of family foster care

	Unstandard. coefficient	Std. error	Beta coefficient	t-value	significance
Grant reform	-.009	.013	-.027	1.270	.516
Local wealth	.000	.000	.071	.974	.331
Social index	-.115	.143	-.186	.799	.424

Notes: Explained variance (adjusted): .62. Values for local government dummies not shown.

Source: Statistics Denmark.

## 5. Discussion: Is there a pattern in the localities' response to the grant reforms?

In general, the impact of the increase in local government fiscal autonomy due to the change of grant regime from matching grants to lump sum grants is not in line with the expectations of fiscal federalist theory. Largely, only in three of the affected policy areas – local roads, libraries, and specialised social services – does increased decentralisation result in more fiscally prudent local government behaviour.

In the other three policy areas – public schools, day care and care for the elderly – local governments do not reduce expenditure in response to the reform. On the contrary, expenditure tends to increase more after the reform than before.

*Table 9:* Voter attitudes to public spending on various policy areas, PDI (per cent difference) in the 1980s and 1990s

Voter preferences	PDI 1980s (All)	PDI 1980s (left wingers)	PDI 1980s (right wingers)	PDI 1990s (All)	PDI 1990s (Users)	PDI 1990s (user charges, users)
Pensions to the elderly	60	62	48			
Home care	n.a.			45	67	0
Nursing homes	n.a.			33		
Day care for children	26	33	-9	22	53	-44
Schools	26	28	8	15	43	
Libraries				-12	-6	41
Culture	-31	-31	-41	-23	-15	20
Roads	-35	-33	-27			

Notes: PDI: Per cent difference between voters wishing increased expenditure minus voters wishing lower expenditure (share of voters).

Sources: *Kristensen* (1982), *Winter/Mouritzen* (2001).

With the reservation that voter attitudes towards the various spending items are not entirely consistent measured over the years, the empirical evidence strongly indicates that local services, notably for the elderly, but also day care for children and local schools, enjoy high voter support, while the voters are less willing to spend money on libraries and roads (table 9). Thus, the local governments' expenditure response to the change of the grant regime is in neat accordance with the voter popularity of the different local government responsibilities. Thus, local governments seem to ignore the economic incentive of the change of grant regime in the popular policy areas, whereas the incentive to reduce spending is put to work in less popular local government domains.

Moreover, the different local government policies on user fees for day care and care for the elderly also make sense when voter attitudes towards user fees are considered. As seen from table 9, increased spending in both areas is very popular among the voters and especially users of the services. Nevertheless, elder care users and parents with children in day care hold very different views on user fees. The elderly accept user fees to a much higher extent than parents with children in day care. Thus, the at first sight odd local reaction to increase user fees more on the most popular care for the elderly area than on the less popular day care services for children indicates that local governments have a well developed sensitivity to voter sentiments. At least, local politicians can expect less criticism for raising user fees on care for the elderly than on day care for children.

## 6. Conclusion

Denmark is probably one the most decentralised Western countries. Local governments' share of taxation and public expenditure is second to few. Central government transfers that fill the gap between local taxation and local expenditure have successively been changed to unconditional grants, providing local governments with even more fiscal autonomy. This setting is a fertile ground for investigating the impact of increased local government autonomy. And the lesson is clear: Decentralisation does not foster fiscal prudence but improves responsiveness to voter attitudes. Thus, spending is not reduced on more popular policy areas – public schools, child care and elder care – while less popular areas – local roads, libraries and specialised social services – are cut back. Classic political and economic theories' high expectations about local governments' ability to accommodate voter preferences have gained empirical support.

Whether the Danish findings can be generalized to other political-economic settings remains an open question. Similar examples of decentralisation are less clear cut in other political settings (see *Deller/Maher/Lledo* 2007). Still, the different impact of similar types of reforms on the various policy sectors has been reported elsewhere (*Deller/Maher* 2005; *Oulasvirta* 1997). Thus also in other countries where fiscal authority has been decentralised is spending on popular policy areas (e.g. health care services in Finland and police and fire protection in the US) more privileged than services like parks and recreation, culture and social services for weak and marginalized groups. In this way, there seems to be a broader picture of decentralisation portraying voter incentives as more important to local policy makers than economic incentives.

## Note

- 1 Local political priorities are another factor that may run counter to the incentives inherent in the change of grant regime. Left wing localities run by social democrats are considered to be more inclined to sustain local government spending than localities governed by less spending minded right wing politicians (*Imbeau/Petrý/Lamari* 2001). However, due to the design of the study with dummies for all localities (see below) it is not possible to include a measure for the political orientation of the localities (which is constant throughout the investigated four year period).

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