Regional Conference on Local Self Governance
People's Participation and Development: Preconditions for Peace and Stability

convened by:
Makerere Institute of Social Research (Kampala)
Institute of Development Studies (Dar-es-Salaam)
Institute for International Relations (Maputo)
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Title: Financing of Local Government with Special Reference to Vertical and Horizontal Revenue Sharing

Author: Professor Bent Rold Andersen
Roskilde University
Denmark

Uganda International Conference Centre
Kampala Uganda
30th August to 4th September 1993
LOCAL SELF GOVERNANCE, PEOPLES' PARTICIPATION AND DEVELOPMENT

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Financing of Local Government with special Reference to Vertical and Horizontal Revenue Sharing.

– Bent Rold Andersen¹

What Type of Decentralization?

"Decentralization" is a label that is put on many bottles. "Decentralization may mean everything from "deconcentration", where the Central Government exerts its powers through satellites scattered around in the country; via "delegation", where the Central Government keeps control, but temporarily lends its power to subordinate units; to genuine "devolution", where the local governments have powers to make their own binding decisions which cannot be reversed by any superior authority as long as they are consistent with the law, and where they have financial means of their own that cannot be taken away from them.

In this paper I will base my considerations on "devolution". The reason for this is not that it is the most usual version of decentralization, since this is not the case. Neither in Africa nor in any other continent. Genuine devolution of powers is found only in a few of the smaller European nations; countries with peaceful recent history and a well established, long democratic traditions, such as Switzerland and the Nordic countries. In other countries, not least the former colonial powers, deconcentration and delegation are the preferred forms of decentralization.

Nevertheless, I have preferred to base my presentation on genuine devolution.

One reason for this is, that devolution is what decentralization in Uganda aims at. In several announcements, the President as well as the Government have confessed their commitment to genuine decentralization.

Another, and also very important reason for choosing devolution as my basis is that this to me seems to be most consistent with the underlying motives behind the growing interest for decentralization in the third world. Decentralization is no aim in itself. It is a natural consequence of the present stage of development, and in many countries decentralization is a precondition for further development, just as it is expressed in the preamble of this conference. Why is it so?

In earlier stages the major function of the government was that of protecting the external boundaries and the internal law and order. This called for centralization of power. But at the stage of development, which has now been achieved in most

¹ Professor, Roskilde University, Denmark. Former Minister of Social Affairs.
African countries, provision of services such as education, health, care of the old, the handicapped and the sick has become more and more a concern of the government. The reason for this is that those social formations which used to perform these tasks, the extended family and the local community, have undergone profound changes and are no longer able to take the whole responsibility for these vital functions. To a large degree Non Governmental Organizations have taken over with much success, but putting everything on their shoulders is the same as being totally dependant on donor funds and excluding the local communities from any responsibility for vital parts of their life and survival as communities. So in the long run government has to take responsibility for the stable financing and delivery of a substantial part of such services, partly by collaborating with private donors, partly by delivering the services itself.

This task, however, cannot be done properly by the central state. The necessary flexibility and adaptation to local needs and circumstances demands a local administration and local popular control with the priorities and with the administration.

Such popular control and involvement is also in line with the idea, that in many countries peoples' involvement and feeling of responsibility for their own future is a precondition for developmental take off. Decentralization can only contribute to this if it implies real devolution of substantial powers.

And finally many people have come to doubt, whether the traditional strong central state is the best way of preserving the unity of the ethничal and cultural heterogeneous nations of the third world. Practical experience has demonstrated that it has often led to bloody suppression and upheavals. May be it is time to consider the opposite method.

Thus a wish for flexible services, involvement of the common people and their participation in the process of development and the peaceful preservation of national unity call for devolution rather than deconcentration.

But what does that imply?

**Implications of Devolution.**

Involvement of the local people is the nucleus of decentralization, if the intentions mentioned shall be fulfilled. This means that the representatives of the local people must have the final word in all decisions about the services which are decentralized in the law. Only questions of lawfulness should be open to appeal to a superior legal authority. Ministers or officials from Central Government can define the limits of local decisions by general regulations, where and when the law empowers them to do so. But these limits must be broad enough to give scope for much freedom of action. As long as the local authorities respect such limits, they are allowed to be autonomous. They shall not apply for resources, their decisions shall not be subject to any accept or approval by any higher administrative or political authority. Neither should anyone be allowed to reverse the lawful decisions of the local authorities. Only if these conditions of autonomy are fulfilled, one can demand the local authorities to take the full legal and political responsibility for their decisions. Only then the voters will be able to demand every decision to be explained to them by their elected representatives. Only then there will be transparency which enables the tax payers to visualize clearly the benefits which they get in return for their sacrifices. Only then we can expect real involvement of the common people in the management of their local communities.
Such autonomy has consequences for the systems of finance that come to govern the local authorities. Freedom to make their own choices and priorities is worth nothing if the local authorities must beg for every shilling by a superior authority, or when their budgets must be approved by somebody else, or if they do not have access to sufficient funds.

The other side of autonomy, however, is that autonomy also demands that the local authorities take the financial responsibility for their decisions. Autonomous authorities should not be allowed just to pass the bill to somebody else. In order to achieve this, a financial system is necessary, which is transparent enough to demonstrate clearly the links between decisions on expenditures and decisions related to finances.

**Local Taxation for Local Purposes.**

The most obvious way of providing local governments with resources, is to put some sources of taxation at the disposal of local governments.

This way of establishing a basis for financing the local government's services has many advantages, above all that of providing maximum transparency and popular control over the tax money. The tax-payers have the possibility of knowing exactly, what their taxes are being used for. Literally, financing by local taxation will enable them to see with their own eyes the schools, the roads, the hospitals, which they got in return for their taxes. It is easy to explain to them what will be the consequences of lowering the tax pressure or of increasing service demands. The locally elected councillors are directly responsible to their voters, they are unable to lay blame on the bad will or foolishness of higher authorities; more remote from the voters. The voters can, through local debates or referenda, be directly involved in setting priorities for the distribution of expenditures among the various local purposes. These clear, visible ties between public income and expenditures provide an ideal background for the development of democratic attitudes and behaviour.

For various reasons, local taxation, however, has limitations as a source of income for local authorities in most third world countries:

1. For technical reasons, some taxes are not suitable for local taxation. This applies in particular to all kinds of indirect taxation: e.g. employers' contributions, customs, duties and tariffs, Value Added Tax etc. - i.e. some of the most profitable taxes. Theses taxes tap the production at the spots, where the money is most visible and therefore most difficult to escape.

2. In developing countries, most of the local economy, especially in rural districts, is informal, i.e. the production comes only sporadically to the surface, to a point where the money becomes visible (and therefore taxable) to the authorities. Generally, in an informal economy, the efficiency of taxation depends very much upon the local "social control", i.e. the extent to which the local population reacts negatively upon tax evasion. Such social control can only develop in an environment of transparency and public support for the public sector. We have - in our many meetings with local councillors - again and again been told, that the potentialities for local taxation exist, but they that will materialize only when the benefits of tax-paying become clearly visible to the local popula-
This will only happen if the units of local governments are relatively small.

3. Some of the taxes, which are most suited to local taxation – i.e. market dues, export tariffs, licenses are counterproductive if they are raised beyond certain levels.

4. Local taxation may have adverse distributional effects. There is normally a close negative correlation between the economic wealth of a locality and the need for public services.

For all these reasons it is hard to imagine a situation in any near future, where the local authorities in typical third world countries, like Uganda, will be able to finance their projected services by local taxation alone.

Transfers from Central to Local Government.

In a decentralized system with genuine autonomy at lower levels, the Central Government abjures exerting control over the lower authorities by means of intervening in their concrete decisions. This, however, does not mean that Central Government renounces any control at all. Of course, no Central Government can give up the power to regulate activities at lower levels in order to obtain harmonization of strategies and – not least – to economize in the use of the nation's scarce resources. But it has to make use of instruments other than that of intervening directly in the lower councils' specific decisions and arrangements.

On the other hand, the Central Government cannot simply pass the obligations to execute certain tasks and to deliver certain services to lower authorities without providing them with means and resources to carry out these responsibilities. That would only cause chaos and irresponsibility at the lower levels.

This means that some arrangements have to be established for transfers of resources from the Central Government to the Local Governments.

There are three very different techniques which are used for that purpose in various countries:

Transfers based on Approved Budgets.

One method, which is often used in systems which are not devolutioned but deconcentrated, is to base the transfers on approved budgets of the local governments. Under this system, each local government must produce each year a budget covering the expenditures which it considers necessary to perform the decentralized tasks, minus the expected revenue of local taxes. These budgets have to be approved by the Central Government and will consequently be under central control, even in details. Such estimates, however, will depend on the standards which each local government sets up for its services. Based on the assumption that the Ministry of Finance will probably often cut in the local budgets, but never raise the estimates of budget, the local governments will be encouraged to do tactical budgeting by expanding their estimates beyond their actual needs. Similarly they will attempt to maximize the grants either by underestimating the revenues of the local taxes or by not collecting them efficiently. This in turn will compel the Ministry of Finance to do what the local governments have already been expecting: Namely to cut the budgets. In which way? A proportional reduction will reward those local authorities which have
budgeted for the highest standards for their services, and will punish those authorities which have set more modest or realistic standards. In the long run this will result in even more "tactic budgeting" and lead to quite unrealistic expenditure estimates in the local governments, thereby severely disturbing the possibility of conducting a realistic macroeconomic policy. Therefore the Ministry of Finance will sooner or later be obliged to leave the principle of proportionate reductions. Instead it has to make its own assessment of the acceptability of the estimates of each local unit - or alternatively to set up general guidelines for the standard of the services throughout the country. Whether the Ministry chooses one or the other of these alternatives, the result will be in serious conflict with the autonomy of the local councils to make their own priorities among the various fields of expenditures. So to base the transfers on approved budgets will not be consistent with any real devolution of powers to the local authorities.

Reimbursements of Expenditures.

Using reimbursements has been one of the most common methods of transferring resources from Central to local governments. There are many reasons why it has been so popular. At first glance, it seems very fair and simple: As the tasks are transferred to the local governments, it appears natural to many people, that the central government should continue to pay a proportion of these expenditures in each local unit. Moreover, from a superficial point of view, it appears to be fair that those councils which fulfil their duties and thus actually spend the money for the decentralized services, get more in reimbursements than those councils which do not fulfil their new duties.

In recent times, however, those countries which used to make the most extensive use of proportional reimbursements, are increasingly abandoning this method in favour of block grants. The reason is that more and more negative side-effects have become apparent. Above all it has proved difficult to harmonize a system of reimbursements of local expenditures with overall financial control, unless direct control - which is incompatible with devolution - of the administration of the services is introduced. Under a system of reimbursements the total sum of local expenditures determine the total transfer from the central to the local governments, regardless of the national financial situation. This is enough to erode every attempt of pursuing a responsible macroeconomic policy. Moreover, reimbursement of expenditures encourages spending. Under financial constraints this makes a difficult task even more difficult for those responsible for the national budget.

Another problem is the adverse distributional effects of such reimbursements. Contrary to the belief of many people, reimbursements favour the rich local governments at the expense of the poor ones. This is due to the fact that the level of expenditures in a local unit does not only reflect the need, but also the amount of money available for spending. Reimbursements tend to favour the rich local units at the expense of the poor ones. The higher the reimbursement percent, the more will the wealthy units be favoured.

If reimbursements are nevertheless used, it must be stressed that the percentages need not be the same for all kinds of services. On the contrary! Perhaps the most valid arguments for reimbursements in at genuinely decentralized system is that in that way the Central Government can to some degree impose its own priorities on the decisions of the lower administrative units without intervening in the individual decisions. By giving high reimbursements on those expenditures which it favours, the Central Government makes spending on these services more attractive to the lower units that other expenditures. This point of view is
especially relevant if the Central Government wants to introduce a compulsory minimum standards on specific services, for instance a minimum number of home nurses per 1000 inhabitants in all local units. In that case the logical solution is to give 100 percent reimbursements of the expenditures on the services up to the defined minimum, and a lower or none reimbursement on the extra services which are provided above the minimum standard.

**Block Grants.**

Reimbursement of actual expenditures as well as transfers on the basis of approved budgets are examples of **conditioned** transfers. The money is only transferred to the local governments on the condition that they are spent on expenditures which the Central Government approves. They limit the freedom of the local authorities to spend the money according to their own priorities, based on their judgment of the local needs. So they differ from transfers given as **unconditioned grants**, also called "block grants". These are given as periodical lump sums to the local authorities to be used as they find most useful.

This of course does not mean that there are no restrictions at all. The local authorities are bound by the law. They can only spend the money on legal purposes. But they can choose freely among a plethora of legal options.

Block grants take their point of departure from the total amount which has to be transferred from Central Government to the local governments. There is no scientific basis for determining the total amount to be distributed as block grants. This has to be the result of a political balancing of factors against each other: The available financial resources of the nation versus the standard of services which are desirable in the local units. May be we can make the assumption that, at least at the beginning of decentralization, the transfer of tasks and responsibilities does not intend to reduce the quality or quantity of the services as compared with their standard when previously administered by the Central Government. Given this assumption we can define the initial minimum transfers to be given as block grants as the total sum previously used before decentralization by the line ministries and institutions of the Central Government for the services which are transferred. Of course a higher total sum can be decided, at the initial stage of decentralization as well as later on, reflecting a desire for increasing standards of services and/or improved economic possibilities.

Once this amount has been determined, it has to be distributed among the local authorities according to some objective criteria which reflect the need for services and the financial strength of each local authority. When the need for transfers of each local unit is reflected in the objective criteria in the formula for block grant, each local government does not have to document its need for transfers by making expenditure estimates.

Thus the size of the transfer via block grant is given externally for each council. Therefore the budgeting procedure at local level will not start by making estimates of expenditures, but by making estimates of incomes, based on expected revenues of local income sources and the externally given block grant. The total amount thus available then has to be distributed among the various areas of expenditure. This will present itself as a matter of priorities, and there will be no scope for tactical budgeting. Financing local expenditures by local tax revenues and block grants based on objective criteria stimulates economic accountability and responsibility of the local councils and administrations by making the scarcity of
the resources visible and by making the task of economizing with these scarce resources imperative.

To the extent resources are transferred as block grants, there will be no earmarking of the money. It is put at the free disposal of the local council to be used according to the priorities of the local Resistance Council. Thus, in contrast to expenditure sharing, block grants create no conflict between local autonomy and macroeconomic policy.

**Criteria for Block Grants.**

So we have to determine how the block grants should be distributed among the local authorities. One rather tempting idea would be to use the size of the population as the sole criterion, i.e. to give equal amounts for local use for each citizen. Contrary to the intentions, however, this would not render all local units equal. Some of the local units have greater needs than others because of, for instance a scattered population, a high number of school children, high morbidity rates, etc. So equal block grants per inhabitants would allow a lower standard of services in some units than in others. In the same way some local authorities have better taxing powers than others if their populations are wealthier. Here again equal grants would leave them with unequal standards.

To these problems some discussants have responded that we might simply use the amount of services available or the actual expenditures as criteria. But this is just another way of reimbursing part of their expenditures and thus to open up for tactical budgeting, and to favour the wealthy local governments at the expense of the poorer ones.

What we need is some criteria which on the one hand reflect the need for services and the local taxing power, without at the same time being responsive to the actual or former spending of the local authorities (or the local distribution of the previous expenditures of the Central Government). To give an example: The need for school services depends very much on the number of children at school age. Thus this number is an exact indicator of the need for schools and therefore an appropriate criterion for block grants. As a contrast: The actual number of actual school children is an inappropriate criterion, since it does not include those children who have not got a place in a school. This criterion therefore favours those local councils that have established schools for everybody at the expense of those local communities who have only partially covered the need. The point is that the number of schools children as criterion does not distinguish whether an insufficient coverage is caused by the council giving low priorities to schools or to lack of money.

In many countries which use block grants, and which have well established data systems, specified down to local levels, the selection of criteria as well as the determination of weights assigned to them will often be decided on the basis of thorough statistical correlation analysis. This is hardly possible in any third world country. The choice of criteria as well as weighting must therefore inevitably rest upon common judgment as to what are the factors that determine need for services in a third world context. Such choice cannot avoid being rather

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7 This, of course, is also the case, when "need" is measured in terms of the difference between the national average expenditure per inhabitant and the corresponding figure for the local unit.
arbitrary. But simplicity of the formula should have preference over a seeming precision, which is anyway illusory.

In Uganda the most important services which will be transferred to the local authorities are: Primary and secondary education, preventive and curative health services and local feeder roads. So we need some objective criteria which reflect the local need for these services. The group of consultants of which I am a member, has proposed the following criteria:

1. The number of children at school age within each community; to indicate the need for primary and secondary education.

2. The rate of mortality within the local jurisdiction; to indicate the need for health measures. This is chosen instead of the most obvious indicator which is the rate of mortality. It will be difficult to provide reliable data on both, but certainly much easier for the rate of mortality than for the rate of morbidity.

3. The number of acres of area in the community per inhabitant; to indicate the need for all kinds of infrastructure, including feeder roads and regional roads.

We have proposed that these three criteria be given equal weights, because we have no basis for discriminating among them.

So we propose these three criteria to indicate the varying need for the most important public services. But to be fair to all districts we also need an indicator of the taxing power of the local authority. Here we suggest the total production of all goods and services in the district per capita, in other words the GDP per capita. The relationship between this indicator and the size of the block grant, however, should be constructed in such a way that, the higher the GDP per capita, the lower the block grant. Therefore the criterion which we have suggested is: The reciprocal of the GDP per capita in the local government area.

 Arbitrarily we have proposed that the need for services should have 60 percent weight in the formula for block grants and the taxing power 40 percent. The final criteria and their weights appear from the table below:

<table>
<thead>
<tr>
<th>Objective Criteria and Weights for the Sharing of Block Grants.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Number of Children at School Age in Percent of Total Population</td>
</tr>
<tr>
<td>2. Rate of Mortality</td>
</tr>
<tr>
<td>3. Number of Acres per Inhabitant</td>
</tr>
<tr>
<td>4. Reciprocal of total Production per Capita</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>
It should be emphasized that by means of these weights and criteria we do not calculate the shares of the local authorities, but the share per inhabitant in each local unit.3

This way of calculating the block grants serves several purposes: 1) to transfer money in such a way that tactical budgeting is excluded and regard is taken to macroeconomic considerations, 2) to relate the size of the block grant to each local government to its specific need for services, and 3) to equalize unequal economic opportunities among the local communities. All these considerations are vital to the success of the decentralization.

**Private Donations.**

As I mentioned in the beginning, private donations, primarily from NGOs, are playing a big role in the delivery of services in many third world countries. In many places NGOs are more important service providers than the public sector. Under such circumstances it could be maintained that it makes little difference whether that small part of the services, which is publicly financed, is delivered by the state or by the local governments. The answer to this is that decentralization is a precondition for an increasing involvement the local population in the delivery and financing of the services they consume.

But if this is accepted, shouldn't then the local and regional differences in the amount of NGO financed services somehow be reflected in the size of the block grants to the individual local governments? Certainly these differences in private donations cause local differences in the standard of services; just as differences in taxing power cause inequalities in the standard of services. Why should local differences in taxing power influence the size of the block grants, whereas differences in private donations should not?

However, the point is that the private donors normally want to earmark their donations to specific purposes and often also to specific locations. If their donations are set off against the block grants, then these donations will come to benefit the economy of the Central Government or be spread evenly to all the local authorities in the country. Quite contrary to the intentions of the donors.

Under such conditions we can expect the private donations to disappear, if they are set off against the block grants causing a drastic decline in the level of services in many local areas without improving the level of services in other areas. Whether we like it or not, educational and health services will continue for many years to be dependent upon continued support from NGOs.

Local donations should have no influence on the size of the block grants given from the Central Government to individual local authorities.

Regarding the donations given from foreign donors to the Central Government for specific purposes, I come to the same conclusion. This is self evident as regards those donations which are given for specific purposes that have nothing to do with local services.

A few donations, however, have to do with local projects which alternatively could be financed by the local authorities. Examples of this may be irrigation projects,

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3 In the attached appendix it is demonstrated by an example how the actual calculations can be done.
the construction of important local or regional roads, hospitals or health clinics, even schools, etc. Such projects only differ from the previously mentioned services which are run by NGOs by being regulated by contracts with the central government. But the major point remains that the donors want the money to be given to specific purposes at specific localities and that they would dry out if they were set off against block grants or other flows of money to the local authority.

But this should not make us forget the fact that local self determination, involvement and sustainability will only be won to the extent local services are locally paid.

Bent Rold Andersen
REGISTER
Administrative Units (5)
Approved Budgets (4-6)
Autonomy (2-5), (7)
Care of the Old (2)
Children at School Age (7), (8)
Colonial Powers (1)
Conditioned Transfers (6)
Construction (10)
Contributions (3)
Correlation Analysis (7)
Deconcentration (1), (2)
Delegation (1)
Devolution (1), (2), (5)
Distributional Effects (4), (5)
Duties (3), (5)
Earmarking (7)
Education (2), (8)
Efficiency (3)
Estimates of Expenditures (6)
Estimates of Incomes (6)
Export Tariffs (4)
Extended Family (2)
External Boundaries (1)
Feeder Roads (8)
Financial Constraints (5)
Formula for Block Grants (8)
GDP per Capita (8)
Handicapped (2)
Health (2), (8-10)
Health Clinics (10)
Hospitals (3), (10)
Inequalities (9)
Informal Economy (3)
Involvement (2), (9), (10)
Irrigation Projects (9)
Law and order (1)
Lawfulness (2)
Local Authorities (2-9)
Local Community (2)
Local Councillors (3)
Local Differences (9)
Local Governments (1), (3), (4), (5-7), (9)
Local Taxation (3), (4)
Local Units (5-7)
Macroeconomic Policy (5), (7)
Market Dues (4)
Minimum Standards (6)
Ministry of Finance (4), (5)
NGOs (9), (10)
Non Governmental Organizations (2)
Objective Criteria (6), (8)
Preamble (1)
Priorities (2), (3), (5-7)
Private Donations (9)
Private Donors (2), (9)
Proportional Reimbursements (5)
Rate of Morbidity (8)
Rate of Mortality (8)
Referenda (3)
Regional Roads (8), (10)
Reimbursements (5), (6)
Schools (3), (7), (10)
Services (2-10)
Sick (2)
Size of the population (7)
Social Control (3)
Standards (4-7)
Switzerland (1)
Tactical budgeting (4), (6), (7), (9)
Tariffs (3), (4)
Tax Evasion (3)
Tax Payers (2)
the Nordic countries (1)
Total Production (8)
Transfers from Central to Local Government (4)
Transparency (2), (3)
Uganda (1), (4), (8)
Unconditioned Grants (6)
Value Added Tax (3)
Weights (7-9)
LOCAL SELF GOVERNANCE, PEOPLES' PARTICIPATION AND DEVELOPMENT
Preconditions for Peace and Stability
Kampala, Uganda 30 August - 4 September 1993

Financing of Local Government with special Reference to Vertical and Horizontal Revenue Sharing.

Appendix

Calculation of Block Grants, an Example.

The Basis of the Case.

The case is based on the assumption, that there is a certain lump sum to be distributed among a number of districts, which - for the sake of simplicity - is restricted to 5. This simplification, however, does not affect the formula used. The size of the lump sum is considered given, for example as the result of a tax sharing procedure or a yearly decision in connection with the national financial budget.

It is further assumed, that the proposal for block grant criteria, which were proposed by the NCG-Consultants¹, is used as the basis for the sharing of the lump sum:

Table 1. Objective Criteria and Weights for the Sharing of Block Grants.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Number of Children at School Age in 20%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Percent of Total Population</td>
</tr>
<tr>
<td>2. Rate of Mortality 20%</td>
<td></td>
</tr>
<tr>
<td>3. Number of Acres per Inhabitant 20%</td>
<td></td>
</tr>
<tr>
<td>4. Reciprocal of total Production per Capita 40%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total 100%</td>
</tr>
</tbody>
</table>

It should be emphasized that by means of these weights and criteria we do not calculate the shares of the districts, but the share per inhabitant in each district.

First Step in Calculation: Establish the Data!

The first step is to collect the data on the objective criteria for each district and to organize these. We assume this has been done; the outcome being shown in Table 2:

Table 2. Data on objective Criteria for each District.

<table>
<thead>
<tr>
<th>Data</th>
<th>District Number</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Number Inhab. In thousands</td>
<td>200</td>
</tr>
<tr>
<td>Number of sq. km.</td>
<td>4000</td>
</tr>
<tr>
<td>Number of sq. km. per inhabit</td>
<td>0.02</td>
</tr>
<tr>
<td>Production, $ per inhabit</td>
<td>300</td>
</tr>
<tr>
<td>Reciprocal, prod. per inhabit</td>
<td>0.003333</td>
</tr>
<tr>
<td>Number, children at school age, in</td>
<td>50</td>
</tr>
<tr>
<td>thousands</td>
<td></td>
</tr>
<tr>
<td>Children at school age, percent of</td>
<td>25</td>
</tr>
<tr>
<td>inhabit</td>
<td></td>
</tr>
<tr>
<td>Rate of mortality in p.m.</td>
<td>20</td>
</tr>
</tbody>
</table>

From this table important structures of each district, which are relevant to their need for transfers, will appear.

To give an example: District no 1, is relatively small, which of course reduces its need for transfers. On the other hand, it is relatively densely populated, which ceteris paribus increases its need for costly infrastructures. In addition to this, it has a relatively low production per capita, i.e. it has a poor population and therefore only limited taxing potentialities, which increases its need for transfers. However, its need is limited because of the relatively low number of school children, but its has a high rate of mortality, which indicates a great need for health services and thereby a need for transfers. How shall these contradictory factors
Third Step: Calculating Points for each District by Multiplying each Criterion with the Weight attached.

The bottom line of the above table 3 indicates the relative need for transfers per inhabitant of each district provided each of the criteria had an equal weight. But the weights are not equal. Therefore in Table 4 we multiply each of the index values in table 3 by the weight of the criterion in question. Thereby we attach a value – a "number of points" – to each district and criterion, indicating the weighted need for transfers per inhabitant:

Table 4. Number of Points of each District by multiplying Index Values by Criteria Weights.

<table>
<thead>
<tr>
<th>Number of Points</th>
<th>District Number</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Number of sq. km. per inhab</td>
<td>20</td>
</tr>
<tr>
<td>Reciprocal, GDP per inhab.</td>
<td>40</td>
</tr>
<tr>
<td>Children at school age, percent of inhab</td>
<td>20</td>
</tr>
<tr>
<td>Rate of mortality in p.m.</td>
<td>20</td>
</tr>
<tr>
<td>Sum= points per inhab.</td>
<td>100</td>
</tr>
<tr>
<td>Points Total</td>
<td>20000</td>
</tr>
<tr>
<td>The Percentage Share</td>
<td>11</td>
</tr>
</tbody>
</table>

All the points are summed up for each district in the row "Sum = Points per inhabitant". By multiplying these figures by the number of inhabitants in each districts we arrive at the total number of points for each district, which is an indicator of its total need for transfers. Thus the number of points per inhabitant is 100 for District 1, which, multiplied by 200 (thousands) inhabitants makes 20,000 points. The total number of points for all districts makes 184,121. The number of points of District 1 (20,000) makes 11 percent of the total number of points for all districts (184,121). Thus District 1 has a claim of 11% of the total lump sum for block grants. The bottom line of Table 4 shows the percentage share of each of the five Districts; and the total lump sum allocated for Block Grant will therefore be distributed in those proportions.