

PD-ABA-426
64763

DECENTRALIZED FINANCE AND MANAGEMENT FOR DEVELOPMENT
REVISED DRAFT - May 20, 1986

A concept paper prepared for the
Office of Rural and Institutional Development
Bureau for Science and Technology
U. S. Agency for International Development

by

James T. Thomson, Associates in Rural Development,

Ed Connerley, Consultant,

and

James S. Wunsch, Indiana University

NASPAA

NATIONAL ASSOCIATION OF SCHOOLS
OF PUBLIC AFFAIRS AND ADMINISTRATION

EDWIN F. CONNERLEY

RESEARCH ASSOCIATE

NASPAA AID TECHNICAL COOPERATION PROJECT

DECENTRALIZED FINANCE AND MANAGEMENT FOR DEVELOPMENT
REVISED DRAFT

Table of Contents

	Page #
Executive Summary	i
<u>Introduction</u>	1
1. <u>The Problem of Overcentralization</u>	3
2. <u>Explaining Dilemmas: Overly-Centralized Institutions?</u>	4
3. <u>Decentralization in the Past</u>	8
4. <u>Decentralization as an Organization-Centered Process</u>	11
5. <u>Decentralization as a Problem-Centered Process</u>	12
6. <u>Sectoral Areas Amenable to Action and Applied Research</u>	15
7. <u>Analytical Frameworks: Public Goods Analysis</u>	16
a. Common Property Resources/Public Goods Problems	17
b. Excludibility	18
c. Jointness	19
d. Technological Certainty	20
e. Measurability of Outputs or Inputs	21
f. Importance of Co-production	22
g. Scale of Operation regarding Average Unit Cost	23
8. <u>Intervention Strategies: Institutional Analysis and Design</u>	24
a. Public Service Industry	24
b. Mobilizing Local Revenues	26
c. Public Sector Fiscal Reform	30
d. Spatial and Jurisdictional Analysis and Design	32
e. Interest Group Analysis	33
f. Policy Framework Analysis	35

9.	Field Service to Missions	36
10.	Applied Research and Hypotheses	40
	Appendix A: Arguments for Decentralization Arguments In Context	44
	B: Possible Project Applications: Irrigation in Pakistan	51
	C: Other Regional Possibilities	59

DECENTRALIZED FINANCE AND MANAGEMENT FOR DEVELOPMENT

Executive Summary

The central governments of aid recipient countries have, with very few exceptions, accepted near-total responsibility for stimulating and managing economic development and improvement of the quality of life for their citizens. It is now clear that many, perhaps most, of these governments have overreached their managerial and financial capacities. This tendency is particularly noticeable with respect to the operation and maintenance of large development infrastructure systems, e.g., road networks, irrigation systems, health service delivery systems, schools, potable water supplies, and public markets. Central government failures are characterized by an inability to manage infrastructure systems to generate resources sufficient for investment cost recovery and recurrent cost financing.

Many observers have commented on the tendencies of overly-centralized central governments to:

- (1) reduce opportunities for local initiatives;
- (2) pervert information flows to decision-makers;
- (3) reduce civil servants' responsiveness to citizens' desires;
- (4) imperfectly control civil service personnel; and,

- (5) distort resource allocations, favoring central units over field units.

An analysis of previous decentralization attempts points to the following common weaknesses:

- (1) failure to create incentives (economic and political), sufficient to promote constructive involvement of citizens, entrepreneurs and bureaucrats in the decentralized structures;
- (2) inadequate numbers and quality of trained human resources to administer the decentralized structures; and
- (3) inadequate revenue and expenditure authority for lower levels of the decentralized structures.

Previous decentralization efforts have frequently conceived of decentralization as an organization-centered process. In these efforts, the unit of analysis is the public administration or its offshoots (ministries, parastatals, marketing boards, etc.). The problem is making the bureaucracy "work better." Attention is therefore focused on the bureaucracy, its related structures, and their internal organization. This approach seldom concerns itself with the nature of the goods and services produced by the bureaucracy and related structures, and how this affects production possibilities. It almost never examines mechanisms to help citizen consumers articulate

preferences for particular combinations of goods and services, and modify the mix in accord with their preferences.

This paper approaches decentralization from a quite different perspective. It takes service provision and recurrent cost issues in LDCs as the starting point of the analysis. The problem then becomes one of determining how a given service provision or revenue mobilization issue might best be handled in institutional terms in order to maximize citizen consumer preference. Initially, the preferred sets of institutional arrangements are problematic; although it is clear that decentralization of present arrangements for service provision is a likely outcome in many LDC settings. The effort is directed to assessing how alternative sets of institutional arrangements will tend to channel individual and group behavior, and the implications for resolution of the target problem.

The approach taken in this paper points to two key areas where solutions to administrative inefficiency and poor performance in centralized administrative systems may be sought:

- (1) Modification of institutional arrangements (and therefore incentives), both intergovernmental and public sector/private sector, frequently by devolving central or regional government powers to the smallest local jurisdiction capable of dealing with the target problem.

- (2) Ensuring existence of the revenue (including fees) base necessary to support the new activities in the appropriate jurisdictions.

The final sections of the paper identify a proposed program of action and applied research to be accomplished under the DFMD project. It is proposed that a central theme of the DFMD project be improvement of local capacity (financial and institutional/managerial) to create and maintain development infrastructure. The need is especially well identified with respect to rural roads and irrigation systems.

The proposed applied research program would respond to the following question:

What institutional and fiscal structures will most encourage effective local initiation, management and recurrent cost financing of specified development functions and donor or government-financed infrastructure projects?

Seven specific hypotheses related to the above question are presented in the paper.

In an appendix, the paper briefly reviews several presumed advantages of decentralization in LDCs. Among these advantages are improved efficiencies due to:

- (1) better information for decision-makers;
- (2) reduction of the cost of local institutional entrepreneurship;
- (3) citizen consumer co-production of goods and services; and
- (4) revenue earmarking.

It argues that the benefits of decentralization will transcend questions of efficiency. That is, that decentralization will produce important benefits in terms of enhanced national unity and democratic government in appropriate contexts. Finally, it notes several comments which should be kept in mind in choosing among decentralization strategies and other approaches.

1
DECENTRALIZED FINANCE AND MANAGEMENT FOR DEVELOPMENT

REVISED DRAFT - May 20, 1986

Introduction

This concept paper is prompted by AID's concern with the serious negative consequences of over-centralization in many Third World political, economic, administrative and revenue systems. It also grows from AID's interest in involving less developed country (LDC) beneficiaries in the planning, execution, financing, maintenance and control of activities launched with USAID support. It reflects U.S. policy in promoting private sector activities where appropriate. It builds on a foundation of positive program results achieved in some of AID's more successful prior efforts in decentralization, and attempts to learn and benefit from some of the less successful ones as well.

Several Asian countries and USAIDs have implemented provincial and/or municipal development projects over the last several decades. Others have pressed ahead in bringing greater control over public sector fiscal flows with divestiture, and other experiments aimed at transferring public sector functions to the private sector.

These sustained decentralization efforts, when accompanied by relative political stability, have measurably increased local capacity for project planning and management, contributed towards cost containment at the public sector center, and assisted in reviving moribund economies - Korea, the Philippines and Indonesia illustrate generally successful efforts. Countries as diverse as Bangladesh, Burkina Faso, Nepal and Peru are currently paying great attention to decentralization policies and possibilities. Nigeria, following the upheavals of the civil war, and in spite of continued problems

pre concluded

balancing the countervailing pressures from ethnic, regional, and occupational interests, stays steadfast in its commitment to a federal solution to its developmental and political problems.

However, most USAID recipient countries currently employ strategies based on central state administration of economies and development activities. It is now clear that many of these states have overreached their capacity to mobilize and manage resources effectively. The time is ripe to examine alternatives.

We begin this paper with Section 1, which notes the two problems at the heart of this project: precipitous deterioration of capital infrastructure and poor quality government services; and discusses in some detail AID experience with these problems. Section 2 reviews ten hypotheses which present these dilemmas as consequences of overly-centralized government institutions and procedures. Section 3 comments briefly on decentralization initiatives and suggests why many have failed. Section 4 and Section 5 contrast two analyses of decentralization, first as an organization-centered process and then as problem or clientele-centered process. Section 6 lists the sectoral areas for which this project may be relevant. Section 7 describes the kinds of analytic frameworks which will be used by project personnel in dealing with decentralized finance and management problems. Section 8 outlines the type of interventions, and Section 9 outlines the applied research which will be carried out under the project, and the hypotheses which will guide

that research. Finally, Appendix A reviews numerous pro-decentralization arguments and also discusses them in the LDCs real-world context.

1. The Problem of Overcentralization

Third World residents, government officials, donor agency personnel and experts have repeatedly noted serious failures in central government attempts to manage economic development possibilities and quality of life at the local level. Infrastructure deterioration is one important aspect. Time and again, throughout the developing world, host country and foreign assistance funds have been allocated to build physical infrastructure. But, experience shows that large numbers of these facilities are not maintained. Roads, bridges, irrigation projects, water supply systems, public buildings, public market facilities and similar installations deteriorate or break down. Wear and tear must of course be expected under any pattern of use. What is distressing is the frequency with which wear and tear escalates into serious erosion of service quality, chronic breakdown, or even complete abandonment.

Similar problems have been identified in projects and sectors focusing on delivery of services. Judged from the perspective of both experts and users, human health operations, state-organized veterinary medicine activities, child and adult education, quasi-cooperatives and similar service organizations have often failed to provide adequate levels of service to users. Consequences have been severe for those who bear the costs of failure:

continuing poverty, ill health, and human potential unrealized. Similar issues apply to environmental management. Many would argue that mismanagement of natural resources and consequent degradation of the environment are two of the most serious problems now facing most developing countries. These issues are particularly pressing throughout Africa, and in sub-regions of Asia, Latin America and the Caribbean.

2. Explaining Problems: Overly-Centralized Institutions?

Many LDC governments have performed inadequately in trying to promote economic development. Most of these have relied on highly centralized agencies to dominate the internal politics and control the economies of their countries. Critics have linked over-centralization to inadequate performance through a number of hypotheses. These may be summed up as follows:

- a. Centralized institutions reduce opportunities for initiative at the local level by establishing inflexible performance requirements and procedures which fail to take account of local-level realities.

- b. Centralized institutions drive up the political cost of starting local activities and so discourage service users from seeking out ways to improve services. Centralized regimes withdraw or withhold decision authority from the local level and reduce the number of points where decisions can be made. Simple decisions which concern only a limited local area must then be made at a higher level with a consequent increase in transactions costs. Those who want the decision must, in effect, join the queue, unless they have the political clout "to elbow their way to the front of the line." If they lack clout and other groups are more influential, the wait may be a prolonged one.
- c. Centralized institutions pervert information flows. Subordinates avoid communicating bad news to those who influence their career chances. Decision makers in the higher reaches of the bureaucracy thus tend to make policy on the basis of distorted information (a virulent form of imperfect information).
- d. Centralized institutions reduce civil servants' interest in developing services which users value. Civil servants tend, in such systems, to look up the hierarchy, rather than out to service users. Because bureaucrats depend on their superiors, not users, for job security and promotion, users have difficulty influencing them and modifying central policies to meet user concerns as these develop in the local context.

- e. Paradoxically, because their management systems are often weak, centralized institutions also experience serious personnel control problems. The phenomenon of goal displacement symptomizes this situation. Political elites at the top of the bureaucracy will manipulate programs for patronage purposes. When they can get away with it, subordinates also pursue patronage goals or their own interests in implementing policies, rather than the goals formally specified by superiors. Among other areas, such manipulation occurs in revenue administration systems. These then become both inefficient and inequitable in raising revenues.
- f. Officials in centralized institutions often distort resource allocations to favor central units, under their direct control, at the expense of local jurisdictions and lower echelons in their own agencies. This behavior is characteristic of many centrally-administered projects in LDCs.
- g. Officials and employees in centralized institutions develop an intense vested interest in perpetuating their organization regardless of their efficiency and effectiveness in contributing to development. Wages paid to central civil service personnel and parastatal enterprises in LDCs average 4.4:1, several times the

median income. But in developed countries (OECD), the ratio averages 1.7:1. Thus, in the LDCs, loss of official position or job often equates to a personal economic catastrophe.¹

- h. Such organizations' miserable performance, their officials vulnerability to removal for political reasons, the state's legal control over the enterprise, and the absence of control by the public, creates a nexus of incentives for public sector corruption and continued inefficient performances.
- i. Central ministries overextension (as the burgeoning budgets demonstrate), leads to inadequate control over investment commitments and fiscal flows internal to the public sector. Few states have created administrative capacities equal to the massive financial role which they have arrogated for themselves.

¹ It is worth noting that the number of public sector employees in LDCs is not dramatically higher per capita than in OECD countries. However, their cost is a far higher proportion of non-agricultural employment (OECD = 24%; LDC = 44%) and the bulk of the employees are employed by central governments and centralized in a few urban areas. (Heller and Tait, "Government Employment: Some International Companions" in Finance and Development, September, 1983 pp. 47).

- j. The overwhelmingly statist and centralist emphasis has often precluded serious consideration of alternative institutional arrangements for the delivery of public sector goods and services, particularly options which draw in private sector actors. In consequence, a universe of possibilities remains largely unexplored.

3. Decentralization in the Past

For at least three decades, critics have proposed decentralization as a solution to these problems. Various approaches to decentralized development have been suggested. Most promise better performance through greater citizen involvement in choice of government personnel and influence on policies, as well as in conception and execution of development projects. Thus far, progress on decentralization programs designed to increase citizen participation has been sporadic and limited. For example periodic gains have been made in municipal finance in Latin America, but in many countries gains have been eroded under pressures from authoritarian regimes and economic hard times. Most African countries have been preoccupied with building or maintaining central regimes; serious work on decentralization has generally languished. Overall, achievements have been modest, with the exception of some long-term efforts in Asia (Nepal, Indonesia and Thailand among others). But even in the Asian countries, progress towards effective decentralization has fluctuated as a function of dominant government policy concerns.

"Decentralization" efforts in the past have often failed, and failed for entirely comprehensible reasons. In most cases no comprehensive analysis was made of either the appropriateness of decentralization for the service or good desired, the specific financial, personnel or legal prerequisites of the decentralization effort involved, or its political feasibility. To name but a very few examples, the Ghanaian - USAID Agricultural Management Training Project engaged in a well-designed and well-implemented program of field personnel training to assist decentralization of the Ministry of Agriculture in Ghana. But MOA's reluctance to change any logistical, planning or personnel procedures and regulations meant field results were minimal. Panchayat Raj in India, an oft cited decentralization failure, foundered on its tendency to load an overwhelming number of contradictory tasks on an undertrained rural development officer whose efforts collapsed under the load. The attempt of the Philippine Small Scale Irrigation Project to decentralize management, maintenance and financial responsibilities to local associations worked fairly well, until Ministry of Finance concerns over rapid amortization bankrupted many of the associations. Ironically, one successful decentralization project, the Provincial Development Assistance Project (PDAP) achieved its successes as an unintended consequence of project strategy, when PDAP rural staffs (funded by the project) put aside the technocratic management approach taught them by USAID, and became the staff of provincial governors. In several cases, such governors developed numerous local development projects. Some became important challengers to the Marcos regime. The PDAP staff was critical to the governors' ability to extend and expand their capacity to define and implement provincially based and financed

correct.
political
involvement

development projects.² Numerous projects have effectively decentralized by pursuing the "project management unit" approach. In the short run, this has led sometimes to improved project performance, but its inattention to the broad institutional context has meant projects were rarely sustainable once USAID left the scene.

These examples and others suggest that several problems have hindered decentralization projects in the past:

- 1) Many have not created the kinds of political incentives necessary to promote citizen involvement in defining and carrying out government activities at local levels. These programs also fail to design incentives for officials who support decentralization efforts.
- 2) Many decentralization programs fail because they do not provide adequate training for officials in newly autonomous local regimes.
- 3) The programs usually do not provide adequate means to finance government or collective activities at decentralized, local levels.

² One such governor, Edourado Javier was a key opponent of Marcos, and was murdered in February, 1986 in the post-election furor. Some analysts have suggested his leadership and martyrdom was a critical turning point in the Aquino accession to power. In substantial measure, Javier created his base through resources provided him by PDAP. For further analysis, see the Evaluation Report: Provincial Development Assistance Project, 1980, USAID/Philippines.

- 4) They have often worked to "dump" unwanted, difficult, or politically unpopular tasks on an undermanned, underfunded and underauthorized unit (or even a single actor).
- 5) Real control over critical inputs, be they skilled personnel, key commodities, information, or the actions of key, complementary agencies, have remained at the center.

4. Decentralization as an Organization-Centered Process

Past shortcomings in decentralization efforts were caused in part by theories of decentralization which were organization-centered. The focus of analysis in these theories is the unit of public administration, or its offshoots (ministries, parastatals, marketing boards, etc.). The problem is making the bureaucracy "work better".

As the focus of analysis is broad and rather indiscriminating, remedies have tended to be equally broad and indiscriminate: general reforms for "bureaucracy". Reform efforts have tended to overlook the variety of problems and tasks bureaucracies face, and the need to tailor structural reform to the nature of the task. They have also tended to overlook the need to analyze bureaucracies in a broader context: what changes in patterns of political power, fiscal systems, personnel policy, authority to raise revenue and pass ordinances must be coupled with decentralized responsibilities to make them work?

Remedies proposed for bottlenecks at the center, lack of initiative in government bureaucracies, and other commonly identified ills of overly-centralized systems have been such generalized perceptions as: (1) shifting work load from central to regional or field agencies - deconcentration - and sometimes (2) shifting policy authority from the center to more local levels - delegation - but only within the broad limits of the existing administrative system. (3) Devolution - a third form of decentralization involving transfer of real decision-making power to local jurisdictions - is generally not considered. In some cases, authority transfers are intended to encourage "guided" popular participation in local arenas; however, the absence of a broader transfer based on comprehensive analysis has meant that administrative and political controls have been so tight that autonomous decision-making at the local level is virtually impossible. Changes of this sort do not materially improve incentives for effective participation in the provision/production of public goods and management of common or collective resources. For local users, costs continue to outweigh benefits, if continuing low levels of citizen participation are any indication; for local officials the picture has been similar, with few resources and incentives offered them to stimulate and sustain decentralized initiatives.

5. Decentralization as a Problem-Centered Process

A second conceptual framework approaches the centralization/ decentralization debate from a quite different perspective. It takes

effective service provision and recurrent cost issues in LDC's as the starting point of the analysis, and focuses on determining how a given service provision or revenue mobilization issue might best be handled in institutional terms. Initially, the preferred sets of institutional arrangements are problematic. Effort is directed at assessing how alternative sets of institutional arrangements will channel citizen and official personnel behavior toward better results, and the implications for resolution of the problem. In practice, the analysis moves through four steps:

- (1) Determination of the nature of the goods and/or services to be provided, and the good or service for which increased revenue is needed, e.g., road maintenance, adult education, veterinary medicine, local water supply, etc., particularly, whether they are private, public or common pool goods or services.
- (2) If the particular issue is appropriate for government, at what level(s) of government is it best handled?
- (3) If a decentralized solution is appropriate, how should relations concerning the problem be organized among government jurisdictions at the local and supra-local levels?
- (4) How might relations be structured between citizens and governments at each level in order to promote the most productive/efficient form of provision or revenue development, including assessing the authority and resources required of other levels of government by the level delivering the service.

This approach stresses reliance, whenever possible, on existing management and revenue potential within local-level communities to provide collective goods. Where investigation reveals such potential does not exist at present, institutional analysis and design can provide guidance on creating it.

This theoretical framework points up two key areas where solutions to administrative inefficiency and poor performance in centralized administrative systems may be sought:

1. Modification of institutional arrangements (and, therefore, the incentives to officials and citizens), both intergovernmental and public sector-private sector, sometimes by devolving central or regional government powers to the smallest existing, or new, local jurisdiction capable of dealing with the target problem; sometimes by privatizing the provision of public goods hitherto provided by state ministry personnel; and sometimes by revising the central rules which authorize and prohibit certain actions by local units, by private individuals, and by firms.
2. Ensuring existence of the revenue (including fee) base necessary to support the new activities in the appropriate jurisdictions, developing an institutional structure to raise and manage this revenue and modifying the systems of fiscal management in operation to support these activities.

6. Sectoral Areas Amenable to Action and Applied Research

The set of sectoral foci currently under consideration is listed below. This list will be revised in light of subsequent comment. Items will be dropped if they do not fit with existing or planned projects. Others will be added as a function of mission and government interest. Activities finally selected for project attention will be chosen in part to reflect multi-mission interest, in order to create opportunities for comparative applied research.

Current sectoral areas of interest include:

- a. secondary and feeder road maintenance; path and farm-to-market road construction, as well as maintenance;
- b. education (primary, adult literacy; perhaps secondary education as well);
- c. human health services provision;
- d. resource management, e.g., woodstock, pastures, watershed and fisheries management, soil and water conservation operations;
- e. small- and medium-sized irrigation systems operation and maintenance;
- f. veterinary health services provision; and,
- g. water supply operations at the village and inter-village level.

Two vital cross-cutting issues are:

- a. privatization via mechanisms (e.g. contracting out, franchising) which provide public goods and services via private sector entrepreneurs; and,
- b. fiscal systems reform: efforts to improve local government finances, and to strengthen the means to contain central spending to allow "space" for local institutional growth.

One possible central theme for the DFMD project arising from the above sectoral foci is local capacity (both financial and managerial) to operate and maintain development infrastructure, such as rural roads or irrigation. A second focus might be on assisting the design and strengthening of institutions to manage natural resources.

7. Analytical Frameworks

Several analytical frameworks can be used to structure diagnosis of these problems. These frameworks lead to specific suggestions which can help guide design of decentralized solutions to these problems. Some of the frameworks outlined below have been subjected to extensive empirical testing and are solidly grounded, though they will undoubtedly be refined through further theoretical and field applications. Others are more experimental in nature, but promising enough to warrant attention. Those of greatest interest

are described below. Illustrations of possible S&T DFMD project services are noted. These are methods to help us understand the "production" and "revenue" problems unique to producing goods and services host governments and missions have chosen as priorities. It is through exploring these questions, and others which will no doubt emerge as the project develops, that we are guided in our choice of interventions — in analyzing and designing institutions appropriate to the task.

A. Common Property Resources

Many of the sectoral areas listed on p. 16 concern common property resources, that is, resources such as a road, a pasture or a watershed which a group holds in common but uses individually. The framework outlined below provides a tool to analyze these resource management problems and to design appropriate institutional arrangements through which they can be managed. When user demand exceeds available use units (transportation, forage, topsoil) these resources must be managed or they will be destroyed.

Many efforts over the past several decades have assumed that common property resources must be managed from the top down by an agency outside the user group. But recent research in a large number of LDC's suggests local resource user groups often develop ingenious and effective arrangements and incentives to ensure sustained-yield productivity. Such user-managed systems can be strengthened by appropriate legislation or hastened into oblivion by ill-adapted rule systems.

A DFMD consulting team would analyze resource management problems from a user perspective. Team members would gather data on technical characteristics of the resource and the means available for managing it, the supply-demand relationships, the formal and informal institutions which do or could manage the resource. Once this range of data has been collected, it will be possible to think through institutional arrangements — including those above local levels — which will enable users to reinforce existing management practices or experiment with new ones and, by incremental adjustments, devise a workable management scheme.

B. Excludibility

To what extent can a producer or provider of a good or service exclude some from its consumption? When the producer of a good is able to do so, then the private market may be the best mechanism to produce the good concerned. In this circumstance, producers can deny consumers the good until consumers have paid for the unit of consumption they desire. A properly operating free market may be expected under these circumstances to provide optimal flows of resources at efficiency prices. When, however, goods are not excludible, then entrepreneurs cannot recoup their investments in resources, capital or labor through the market because of the problem of free-riding. The market will fail to provide the good, and governmental provision may be necessary in order to require all who consume the good to share in its production costs. As discussed below however, government need not necessarily also

act as producer of the good; private enterprise can produce the good on a contract basis, while government acts to collect revenues to pay for the good, maximizing competition and usually improving economic efficiency. Much infrastructure in the LDCs is characterized by non-excludibility, and its management and maintenance has thus been difficult. Alternatively, some services may be characterized by excludibility, and are strong candidates for privatization.

C. Jointness of Consumption:

In some situations, goods and services are consumed "jointly" by varying numbers of people: under these conditions, additional consumers do not detract from the supply of the good nor raise its production cost, and there is great temptation to provide such goods and services to very large numbers of people to obtain economies of scale. National defense is a good example of such a good; others might be a regional flood control project, irrigation systems maintenance and management, agricultural research on better seed varieties, or improved curricula for schools. It is very important, however, in maximizing efficient and effective production, that these goods be produced at levels which correspond to their clientele's needs and preferences. Thus seed variety production needs to be organized with reference to regional climatic conditions, school curricula to relevant cultural needs and perspectives, and flood control to relevant physical areas. This is particularly clear when "co-production" is involved (when clients must actively work with producers to achieve outcomes), for if culturally, practically or otherwise offensive or irrelevant joint goods are

produced, one can expect at least withdrawal from co-production if not overt resistance and hostility. In either case, production flags and costs rise. Thus, joint goods are excellent candidates for careful evaluation on the feasibility of decentralization to correspond to local public preferences and conditions. This is particularly the case when some joint "goods" are regarded as "bads" by others. For example, downstream pollution is a public "bad" characterized by joint consumption. Here, decentralization may need to be balanced by intergovernmental agreements and regional or national authorities to ensure that such "bads" are jointly consumed only by those who choose to live with them, for whatever reasons they might have for doing so.

D. Technological Certainty

When optimal (or even feasible) technologies for production of desired goods or services are not known or are uncertain, then decentralization to local governments or private markets may be a beneficial strategy. This avoids premature over-investment in a single, problematic strategy, and encourages a diversity of experiments which may bring forth more effective technologies, refine them, and allow their comparative evaluation. Most service delivery systems have uncertain technologies, making them vulnerable to "fads" which can seriously set back production if uncritically and too widely accepted.

E. Measurability of Outputs or Inputs

Some goods and services, the amount wanted, and their specific characteristics can be clearly defined; similarly, the nature of the outputs, their conformity to specifications, their timeliness, volume and effectiveness can be clearly measured. Improved seed development may be one such good, as might be transporting a given volume of agricultural commodities between certain points on a certain schedule.

However, some services such as "local development", "health services" or education can be less clearly specified a priori, and are often debatable in measuring output.

For example, is a successful public health field service one which records high incidence of disease and public health problems, because that indicates great energy and activity on its part? Or are such data indicative of poor performance, because they indicate there are serious field problems? The issue can be interpreted either way.

When there is little ambiguity in specifying desired outputs, and measuring their attainment, privatizing public services to the local, regional or national level may be an effective strategy to reduce public sector size and avoid some of the diseconomies of hierarchy. When ambiguity is a problem, though, the difficulty of specifying contract terms, evaluating contract compliance, and the desirability of

facilitating quick feedback between consumers and producers suggests that governmental units may continue to be the best provider and producer. However, a complete analysis of optimal strategy would also depend on level of jointness, size of the relevant local community, as discussed above, and scale of operation related to average cost (discussed below). Thus, governmental decentralization may or may not be a good approach to avoid some of the problems of hierarchy discussed in this paper's body, and one makes that choice through such analytics.

F. Importance of Co-production

When service goals require citizens to actively work to "co-produce" desired ends (such as is often the case in public health, agricultural extension and education), close cooperation between professional and citizen is imperative. Smaller units to organize and supervise such services may be an advantage in their economical and effective production, as they can be more closely tailored to consumer desires and local needs. More informed contact between professional and official is associated with smaller units of production as well, and might be expected to encourage coproduction. Depending on such questions as jointness and excludibility, or certainty in technology and measurability, either governmental or private mechanisms might be chosen to produce such goods. In either case, goods and services characterized by co-production are excellent candidates for decentralization of one variety or another.

Co-production in areas such as health, education, policing, and some renewable resource management problems can involve several tactics. These might range from citizen informal assistance with road maintenance, to upkeep of tertiary irrigation canals by organized user maintenance groups, to policing of village forest areas or control of over-grazing on pastures. Parental involvement in primary education will be critical, as it will in provision of family health services.

G. Scale of Operation regarding Average Unit Cost

When substantial economies of scale are attainable, production of the good at the national level may be desirable. If such a good is characterized by excludibility, then perhaps this production is best left to the private sector; when non-excludibility and jointness of production also obtain, then government at a regional or national level may be the best provider of the good. Production, however, may still be possible in the private sector, under contract or franchise to the relevant governmental level. As should be clear to the reader by now, there is no simple set of "protocols" which deterministically guide these decisions. The various issues we have raised may all point in one direction, be it public, private, or, national, regional or local. More often, they will indicate there are mixed values and costs in any strategy. Their value is that they help clarify what those costs and values may, and thus help inform policy choices and successful implementation.

8. Intervention Strategies and Mission Services: Institutional Analysis and Design

Having worked through the strategic issues raised by the analytical frameworks , this project would use the guidance these questions offer to analyze and design institutions to improve infrastructure maintenance, service delivery, and increase local sector revenues. Any of several institutional strategies might be suggested by these analytics:

A. Public Service Industry

This appears promising for some types of service delivery problems. It relies on the ability to separate provision (i.e., financing) of a public good or service from its production (i.e. activities involved in making the good or service available to consumers). This creates the opportunity to use quasi-market competition to encourage efficiency in production of public goods and services, and can be applied at any level of government.

While the Agency has addressed the question of State-Owned Enterprises from several perspectives, cost containment of central Ministry operations has been largely neglected. Public service industries can be one mechanism to address this set of problems. For example, private sector producers of goods or services would include local engineering firms willing to design and supervise construction of schools or health clinics; construction firms willing to build those structures; farmers willing to maintain, under contract, dirt, gravel or laterite surface

roads through timely pothole repairs; local medical practitioners, etc. Precisely the same logic and alternatives apply at the national as well as the local level, and project experiences may prove useful to design interventions at each.

A DFMD team might be fielded to provide design support for development projects to delegate control over services to local jurisdictions, or at the national level to assist in developing strategies and options for overall fiscal management or central cost containment. Upon host country request, a team might provide advice on design of responsive decentralized institutions in a particular country context or, as a test case, for some component subdivision. Teams might likewise undertake development of comparative research projects. In scope, research could be either cross-regional within a single country, or cross-national. Topics could include monitoring and evaluating performance and impacts of institutional arrangements designed (with or without local input) to promote specified outcomes, e.g., better operations and maintenance of irrigation systems of local highway construction and maintenance agencies, and of various approaches to privatizing national enterprises.

A DFMD team could provide advice, in situations where public agencies have had difficulty providing adequate levels of service through in-house production schemes, on the range of activities best contracted out for production. Factors to consider here include the range of firms currently active, conditions governing entry into the market by other firms, ability of the jurisdiction to produce the service itself,

capacity to contract with other jurisdictions which may be producing the service, etc. The team could also advise mission and host country personnel on conditions which have to be met in the private sector before entrepreneurs will consider contracting an attractive option. These include, among others, availability of appropriately-trained personnel, and such issues as legal rule systems which inhibit orderly private markets.

B. Mobilizing Local Revenues

Decentralized revenue mobilization issues have been examined in detail by the ST/RD Local Revenue Administration Project (LRAP) implemented by Syracuse University under a Cooperative Agreement. Project personnel have focused on a number of obstacles to decentralized financing across a range of activities. They have also developed strategies for dealing with these obstacles, and illuminated the relationship between local and central revenue systems.

The analytical framework employed in this project helps make strategic level decisions on local revenue: ought revenue to be provided on a fee-for-service basis, through sector-specific taxation, through general revenues; and ought these to be collected at a local, regional, or national basis.

If some sort of local or regional approach is found to make sense, then further analytics help tailor interventions ought to be pursued to fine tune the appropriate strategy.

For example, recent research through the Syracuse LRAP has suggested three questions ought to be probed:

- (i) Is the service area small enough, the social group homogenous enough, and the good/service provided distinct and measurable enough that local residents can perceive any connection between increased revenues and expanded services? Similarly, even if residents are more homogenous, might a mixed "bag" of services be defined which a coalition of local residents could agree to?
- (ii) Are there distinct administrative bottlenecks in services or in the operation of a revenue system which need to be improved in order for available revenues to be raised?
- (iii) Does local revenue growth beyond current levels depend on expanded economic growth for the area concerned?

Given the answers to these and no doubt other questions which will develop as field-work progresses, one might pursue such interventions as:

- (i) designing new administrative units for the maintenance, management and as the revenue base to correspond to such questions as jointness, excludibility, interdependence (spill overs and scale economics) among and within communities, community agreement, measurability of outputs, etc.;
- (ii) using central subsidies as a tool to pair with local revenue to encourage local responsibility, especially when the benefits of specific goods extend beyond the locality or local consensus on which goods are preferred, is not complete;
- (iii) easing and opening administrative bottlenecks through centrally-based technical assistance, subsidies, seconded personnel, etc.; and,
- (iv) developing central codes and oversight capacity (inspectors general, judicial systems, and concerned private institutions such as media, business, etc.) to help assure fairness and consistency with broad national goals.

Evidence from a variety of sources reflects significant growth in central budgets (both for state-owned enterprises and central ministries) without clear or comparable growth in their effectiveness. World Bank analyses, for instance, point to serious budgetary losses by parastatal and state-owned organizations which "soak-up" vast amounts of

capital, earned generally by the poorest and most undercapitalized sector: agriculture. In effect, just as state-owned enterprises are proving unable to pay their own way and lead national development, they are eroding the only major productive sector left in many of these economies and, robbing resources from the already poorest members of the societies.

Public sector costs have also grown large in most central ministries. While some of the inferences to be drawn are still unclear, what is certain is that public sector costs in general have grown to rather high proportions of national production in recent years throughout most of the Third World. In such countries, as Congo, Jamaica, Yemen and Zambia, the share of GNP spent by the public sector reaches such figures as 54.6%, 44.9%, 41.8%, and 39.8%. (Comparable figures for developed countries including their large social welfare systems, such as Japan, Switzerland, Canada and West Germany, are 19%, 18.3%, 23.3% and 31%). Whether such high percentages of public sector expenditure are bringing proportionate rewards to LDC economies is dubious, to say the least. Empirical research on the effectiveness of such field services as agricultural extension and the performance of centrally managed projects suggest serious inefficiencies in the use of these resources. What is certain is that every schilling, peso, franc or rupee extracted from farmers and small entrepreneurs to fund poorly administered and expensive central state structure is one less for them to invest in economic expansion or consumption. Recent research in Africa shows that the return to rural areas of national budget has been as low as 5% on the tax burden the rural areas carry (Bates, Markets and States in Tropical Africa, 1981).

C. Public Sector Fiscal Reform

With these figures in mind, it can be seen how the fiscal and employment dimensions of the public sector burden are factors critical to understanding overcentralization: they devour revenues needed for local development at the same time they vacuum wealth from the rural areas for central costs.

The project will draw together expertise from economics, public finance, and the policy sciences to begin to build our understanding of the following applied issue-areas:

1. What means may be applied to reduce fiscal drains imposed by public bureaucracies and inadequate fiscal management? Governments may require strengthened mechanisms for the management and control of public finances, including fiscal matters linking central ministries with SOEs. Systematic analysis might be conducted also on capital investment, and budgetary decision making.

Fiscal restraint will probably also require means to better constrain public sector employment, assess the unit costs of public services, and provide adequate incentives to retain scarce managerial and technical talent.

2. Improved central revenue systems are also critical to providing "space" for decentralized initiatives.

Systematic review of the structure and elasticity of tax codes, disincentives for business, and administrative effectiveness in collection and enforcement ought to be explored. Also, systems to more effectively link central to decentralized revenue systems, including mechanisms to transfer monies and account for their use are necessary to sustain decentralized institutions.

3. Privatization options discussed above (Public Service Industries) will also require contextual analysis.

Various instruments exist: contracting out, management contracting, franchising, leasing, deregulation, formalized agreements between parastatal managers and central ministries. Each of these require appropriate systems to budget, allocate, transfer and account for funds. It is important that these issues be addressed, and as feasible, experiments be initiated involving instruments selected from this. Evaluative practices, strategies of action, and institutional designs will need to be refined to fit developing country conditions.

D. Spatial and Jurisdictional Analysis and Design

Spatial and jurisdictional analysis and design, as an intervention strategy provides a method of designing effective devolution of responsibilities to local jurisdictions, under specific circumstances, for providing services or goods. It stresses, among other things, the following elements:

1. the importance of congruence between the size (geographic boundaries) and interdependence (upstream-downstream irrigation problems, watershed, community values in education) of the problem to be dealt with and the size of the jurisdiction which is to deal with it;
2. the advantages and disadvantages of general purpose jurisdictions vs. special districts as institutions to manage service provision infrastructure operation and maintenance, and raising revenue.
3. the importance, in terms of controlling abuses of political power and providing for resolution of disputes between different jurisdictions, of coupling the devolution of political power to autonomous local jurisdictions with extension of the independent judicial capability. Devolution means that central administrations will limit their ability to supervise and direct the conduct of

officials in local jurisdictions; auditing and an independent judiciary provide ways for central officials to ensure that local jurisdictions meet their general obligations, and that they act within the limits of the law;

4. the kinds of mechanisms available in different political and economic systems to encourage local official responsiveness to citizen/consumer concerns and preferences;

This framework would be useful both at the field project level, and in policy dialogue situations, e.g., in the Philippines where a new regime is seeking to restructure political relationships with the declared aim of strengthening participatory democracy.

E. Interest Group Analysis

Decentralization programs have been marked by only modest past success. In formulating diverse programs, donor and host country officials have had to operate without an organized or detailed understanding of how factors which significantly influence the possibilities of reform — e.g., leadership perceptions and unity, interest group behavior, internal bureaucratic pressures — are to be acknowledged and integrated into reform programs. In the absence of such analyses, policy makers have relied almost exclusively upon economic rationale. Failures in implementation, accordingly, have resulted.

This component of the project will aim to build knowledge of how certain factors, particularly organized interest groups and bureaucratic actors, constrain (or enlarge) the margin for reform. Important variables can function as either constraints or opportunities. Above all, the orientation is to be pragmatic: it should result in a better grasp of what combination of variables strengthen both the commitment of leaders and their bureaucratic capacity to bring about decentralization reforms, such that sustainable change is made possible.

The following categories of factors might be investigated to determine the bearing they have upon the margin for reform

- a. the international context
- b. domestic interest groups
- c. intra-bureaucratic conflict
- d. problem definition by strategic decision makers
- e. the macro-economic policy environment.

The potential costs, as well as benefits, of allowing local jurisdictions autonomy, and pursuing privatization in terms of the possibility of conflicts with central planning goals, abuse of minorities, etc., might be addressed through this intervention.

F. Policy Analysis

Several intervention strategies will require changes in host government policy to be successful. Policy regarding the private sector has worked to hinder market processes, to impede entrepreneurs entry into and exist from various sectors of the economy, to make property rights ambiguous, to slow private transactions through heavy regulation and licensing requirements, etc. In the public sector, severe limitations on the authority of local governments to hire personnel, raise revenue, and pass advances have similarly stifled organizational opportunities. Similarly local communitites which historically raised revenue and labor, and made rules which protected common resources and sustained small-scale infrastructure, have been weakened, damaged or destroyed by central policy.

Analysis needs to be done on the specific implications of national policy for enhancing decentralized alternatives. In some cases such analysis when combined with "interest group analysis" might well suggest that, in all practicality, no decentralized intervention is likly to succeed. In others, it may recommend specific and host-government-acceptable policy reforms. In either case, the project expects to strengthen the ability of missions to make informed decisions at both strategic and factual levels regarding decentralization.

9. Field Services to Missions

The Decentralized Finance and Management Project will offer various services to field missions. They are:

A. helping missions conceptualize DFMD problems and work out approaches to them;

B. helping missions design and develop DFMD projects;

C. monitoring and evaluation of on-going DFMD projects, to provide a flow of information upon which to base periodic project reorientation decisions;

D. provision of TDY technical assistance on DFMD issues to on-going mission projects and in support of policy dialogue;

E. recruitment and placement of long-term DFMD technical assistance for mission projects;

F. comparative cross-national applied research on DFMD issues common to several USAID projects;

G. training and professional networking for host country personnel involved with DFMD problem solving and research;

*What should be collected
What matters should
not be employed
to be employed
reorientation
mission projects
identify
across countries
relevance*

H. systematic dissemination, through seminars, workshops and publications, of lessons learned from field experience and applied research; and,

I. interest group analysis, estimating the political viability of various DFMD projects or related projects;

Some of these services, sometimes all of them, will be relevant in a particular country interested in exploring decentralized finance and management questions. Backstopping on problem conceptualization may be useful in situations where mission personnel identify DFMD opportunities, or sense obstacles to progress in an area, but lack time and background to define issues more concretely. Short-term help with project design, development, monitoring and evaluation is necessary when policy decisions must be translated into interventions and then progressively adjusted and modified to achieve policy and project objectives. The services of TDY specialists thoroughly familiar with DFMD problems and potential solutions can provide urgently needed support in policy dialogue settings. Applied research to gather data, analyze it and present it in forms useful for policy discussions with government officials is indispensable when the problem is quite clear,

but its dimensions are not. If policy makers are not fully aware of the options available to them in structuring solutions to problems, applied research may be extremely helpful. Finally, training may be necessary for some or all groups involved in DFMD initiatives in a given country, particularly because the issues are novel and complex. The need for trained personnel will undoubtedly increase as devolution policies take hold and local units begin to play a larger role in the management of their own affairs.

Decentralized finance and management problems will arise at different stages or levels across AID's three geographic regions. In some, missions and governments will already have moved to agreement at the policy level about appropriate next steps in project terms. In others, it will be necessary to either conceptualize problems more fully, or to get government support for the next steps. Clearly major components may be at different stages in different sectoral areas within a single country. In some, the principle of separating local provision of road maintenance (i.e. authorization and financing) from local production of road maintenance (e.g. filling potholes), may be already accepted. In those same countries, the idea that natural resources management activities might be appropriate areas for local government activities may be quite novel. Situations will differ from mission to mission.

ST/RD believes the DFMD Project will materially strengthen USAID's ability to design the institutional software necessary to help physical and other technical inputs achieve their project goals. The management and maintenance of infrastructure (irrigation, rural roads), the delivery of social services (agriculture extension, education, health), the protection of commonly-held natural resources (pastures, water, fisheries) and the success of institutions to capture local revenue to pay recurrent costs, all require complex, changed and often quite new patterns of cooperation, restraint, forbearance and initiative to work properly. Such behaviors do not arise automatically, but grow through and from appropriately designed, strengthened, or modified institutions. It is to apply a promising set of analytical frameworks as a starting point, and to learn in the field how better to solve these problems that this project is designed.

A recent AID Program Evaluation Paper noted:

Although local government projects are still a small amount of AID's portfolio, their importance is growing. This is partly due to a trend toward decentralization in several developing countries and partly to country- and mission-specific factors. The array of projects, however, shows no consistent focus and no consistent strategy. Instead, the portfolio includes a hodgepodge of decentralization initiatives, area development programs, and components of larger projects, as well as assistance directly to local governments. In addition, different institutional arrangements are used, such as assistance to national institutions which then help local entities, assistance at the regional level, or direct local level support. Likewise, various strategies are employed, including local management training, assistance in revenue generation, technical studies of financial management, and participant training. The record of these efforts also varies greatly. In sum, AID's local government portfolio is a mixed bag that has produced mixed results. (AID Assistance to Local Governments: Experience and Issues, 1983, p. 30)

This evaluation suggests that a centrally funded and managed project operating with a clear (and open to evaluation and learning) set of analytical frameworks might lead to greater cumulation and transfer of experience. We need to learn better why given decentralization strategies fail or succeed in solving these administrative problems in order for missions to choose with greater confidence among the "hodgepodge" of interventions available.

10. Applied Research Program and Hypotheses

The research problem of this project will be to determine what kinds of institutional and fiscal structures will most encourage effective initiation, management and recurrent cost financing of specified local⁴ development functions and donor- or government-financed infrastructure projects.

Comparative research will focus on institutional arrangements to promote:

1. local initiative in creating, operating and/or maintaining low-cost infrastructure projects, e.g., light vehicle tracks, small-scale irrigation systems, soil erosion control works, local education, rural health programs, etc.

⁴"Local" as used in this discussion includes everything from individuals working on their own property to provincial-level governmental institutions. It includes, e.g., quarters; hamlets; villages; administrative units which group hamlets or villages, such as the Nepalese panchayats or the Bangladeshi upazillahs; district governments; and special purpose institutions at any of these levels. The institutional and fiscal structures of concern extend to

2. operation, maintenance and financing of recurrent costs of capital infrastructure, e.g., rural roads, bridges, ferry services, health and educational facilities, irrigation networks, etc., by local user groups, local general purpose jurisdictions and local special districts; and,

⁴ (continued from previous page) provincial and central levels; the impacts of concern are local.

While recognizing the difficulties in delimiting the term "local", Norman Uphoff has offered a somewhat more restrictive definition ("Analyzing Options for Local Institutional Development" [Special Series on Local Institutional Development No. 1] , Rural Development Committee, Cornell University, October, 1984, pp. 11-14). He defines as local the community or village level, the component subdivisions of quarters and hamlets or neighborhoods, and the "locality", a grouping of communities which trade and cooperate with each other. Uphoff does not include individuals and families because they do not face the kinds of collective action difficulties confronting the immediately superior institutions of quarter, hamlet, neighborhood, community and multi-community localities. He also excludes the sub-district and district level, as too distant from individuals and families to be considered relevant sources of help or cooperation.

The definition of local used here expressly allows consideration of the interrelationships among private individuals, families, and firms, and governments. Many of the problems analyzed involve some form of coordination among private and collective activities, e.g., education, health, management of soil conservation systems or certain kinds of irrigation networks.

3. locally-developed and -operated renewable resource management schemes, e.g., farm forestry, pasture use regulation, watershed management, fisheries management, etc.

Research will seek to isolate the impact of institutional variables by comparing provision of locally-desired goods and services across jurisdictions which are similar in important respects except institutional arrangements.

DFMD-organized research will test specific hypotheses in AID assisted countries. Suggested hypotheses follow.

1. Local capital infrastructures will be better maintained by autonomous local jurisdictions than by central bureaucracies, assuming local jurisdictions have adequate funds for operation and maintenance.
2. Local decentralized, general purpose jurisdictions which incorporate multiple autonomous offices will produce higher levels of local initiative in creating and maintaining infrastructure and in managing renewable natural resources than will local decentralized general purpose jurisdictions with a limited number of offices controlled by a single hierarchical superior.

3. Local, decentralized jurisdictions which include special districts in addition to general purpose governments will be characterized by higher levels of local initiative in creating and maintaining infrastructure, and managing renewable natural resources than will local decentralized jurisdictions organized under a single general purpose government.
4. Local, decentralized jurisdictions authorized to both produce desired goods and services and contract for desired goods and services with other governments and private suppliers will function more efficiently, or generate higher levels of citizen satisfaction, or both, than local decentralized jurisdictions which can only produce, but not contract for, desired goods and services.
5. Among devolved, autonomous local governments, those with authority to design goods and services, without having to conform to restrictive national guidelines, will initiate, finance and manage more activities.
6. In currently centralized regimes, where local government activity is weak, purely formal, or non-existent, incremental delegation of authority over specific functional areas will prove more effective in encouraging local government activity than will direct devolution of general purpose governmental powers to local jurisdictions.
7. It is as easy to achieve fiscal decentralization under a unitary system of government as under a federal system. (LRAP)

Appendix.A

Numerous arguments have been advanced favoring decentralization as a government policy. Many simply present the converse of the centralization critiques. But several nuances justify a quick review of these propositions. Decentralization proponents, whether they favor deconcentration, delegation or devolution, usually support some variant of the following propositions:

- a. Information-based efficiency argument: Officials who are nearer to service users at the local level and familiar with their needs and concerns can do a better job of expending government funds efficiently (in accord with users' preferences) than can civil servants working at the national capital in central government ministries. A variant of this argument, which fits most firmly with the devolution option of decentralization programs, suggests officials in local governments are likely to be more responsive to local interests because they are more dependent on them: in theory, they require support of fellow citizens in order to govern effectively. This proposition is probably questionable where local governing elites have succeeded in setting up a system which allows them to "control the game" at that level. The proposition seems intuitively valid, however, in those situations where local

government officials are effectively liable to review and control by service users.

- b. Cost of institutional entrepreneurship argument: Local initiative can be encouraged by lowering the cost of institutional entrepreneurship, that is, the money, time and effort necessary to get authorization to undertake a collective activity. Decisions on farm to market and feeder road right-of-ways or the creation of watershed management associations will involve relatively low political costs if they can be taken by local citizens and or officials. Initiatives to launch such activities should thus not involve high time, energy and money costs. If the same issues can only be decided by regional officials, ministers or the national cabinet, the costs of institutional entrepreneurship will likely be high enough to discourage local citizens and leaders from undertaking such activities.
- c. Co-production efficiency argument: Very few labor-intensive collective activities can be undertaken by governments without sustained citizen efforts to "co-produce" the goods in question. This holds for education, human and animal health, environmental management, producer and consumer cooperative endeavors, and even road maintenance. If decentralization programs increase the chances that citizens will go beyond merely voting and lobbying for local projects to "co-produce" (help create) the goods and services they desire, they improve the likelihood for sustained economic development.

- d. Revenue-earmarking efficiency arguments: If local revenues are earmarked for local expenditure on tangible goods and services local users want, public sentiment may support or demand compliance with at least those aspects of tax laws which generate funds for local activities. If so, existing tax systems may produce more funds for local use without additional expenditures on revenue administration. If so, and if officials in fact expend earmarked funds as agreed, service provision and citizen satisfaction should rise, reinforcing sentiment in favor of compliance. Successful earmarking might even generate public support for higher taxes to finance locally-desired programs.
- e. Market discipline arguments: When decentralization through marketization is applied in the privatization of public sector enterprises or to ministry services, advocates have argued that the political nexus between politicians, managers and employers which allows them to squeeze the farmer or other producer to pay the differences between costs and revenues, will be broken. Market discipline should either weed out or reform hitherto ineffective production units, and increase their local and international competitiveness in the long run.

Overtly political arguments apply in some situations where national leadership perceives benefits from decentralization which may go beyond efficiency questions to issues of survival. These include:

- f. National unity arguments: While many national unity proponents press for greater central penetration of and control over fractious or dissident ethnic groups or "peripheral" areas to consolidate the nation state, others assert true unity will come sooner and be more durable if local areas have greater autonomy to work out their own policies and development options. Some decentralization efforts which seek this objective advocate substantial devolution of central government powers to local units. The effect would be to multiply centers of decision making, and thus to reduce the strategic importance of winning power at the center, by making it no longer "the only game in town."
- g. Participation arguments: Some argue that participation in the management of public affairs at the local level is a necessary condition for democratic government. Only if citizens involve themselves in government directly, as opposed to indirectly through representatives, can democracy be realized.

Decentralization Arguments in Context

All of these arguments have some value, yet a note of caution is also warranted. Clearly, the perspective taken here proceeds from the premise that decentralization efforts hold the promise of considerable benefits. Such promise alone, however, is not sufficient to assure long-term success.

Rather, ultimate success will rest upon broader political and administrative factors influencing the margin for reform enjoyed by decision makers. For that reason, the agenda for applied study proposes systematic analysis of interests groups. Each argument must, furthermore, be evaluated in the time and place context of a specific decentralization program. The kinds of broad political objectives spelled out under Points e., f. and g. will be anathema to some regimes given present conditions. Associated security risks may be considered quite unacceptable. Other regimes might consider points a. - f. irrelevant at present, unless efforts to achieve them directly reinforce national unity and participation. Sri Lanka, where Tamil separatist pressures continue unabated, may fall into this category.

Some regimes plagued by ethnic conflict have indicated willingness to devolve substantial authority to component jurisdictions, e.g., Zambia and Papua New Guinea. Other governments may be totally uninterested in decentralization as a concept. However, central government officials' concerns about financing recurrent costs of services, for instance road maintenance in Pakistan or Bangladesh, may lead them to authorize limited delegation or devolution if it promises to improve performance. Similarly some, such as Senegal and Morocco have recently begun major privatization programs for their state and parastatal enterprises. A desire to see, at

local levels, more effective efforts to combat environmental degradation, as in many Francophone Sahelian States, may produce other decentralization strategies.

The objectives and enthusiasm of key actors for decentralization in finance and management issues will vary as a function of the policy context. In some situations, it will be appropriate to seek maximum devolution. In others, studied incrementalism, with an eye to progress over the long haul through a sequence of small changes, will be the only politically feasible strategy, whatever the apparent economic advantages of more rapid structural reforms. Above all, regular reassessments of strategy will condition success of any project. Exogenous shocks, such as a 60% collapse in the pump-head price of oil from November 1985 to March 1986, may well change perspectives of key actors on the advisability of revenue or management decentralization.

Willingness to tailor advice on decentralization, in light of the given context, clearly conditions its relevance. A USAID project on decentralized finance and management must demonstrate this flexibility to both field missions and governments if it is to secure support. In all cases decentralized activities must be designed to maximize chances for success.

This will involve in part ensuring adequate support and supervision for reform efforts over time. More importantly, however, decentralized finance and management activities must be tailored to the capacity of potential service users. Unless participants believe they can master required jobs within their own time, information and resource budgets, such activities will never become operational.

In the past, decentralization efforts have been troubled by too generalized a prescription and too simple an application. Understanding well-enough that centralization was a problem, we tended to rather broadly recommend "decentralize!" Not appreciating the complex interdependence among governmental agencies, we tended to ignore the institutional context necessary to make decentralization work: fiscal systems, revenue-raising authority and capacity, personnel policy, national budgetary containment, and interest group analysis.

This project sees decentralization as contingent and complex. Not all problems will benefit from decentralization, nor should all be decentralized in the same way (private market, PVO under contract, business under contract, general purpose local government, special district, regional governments, etc.). Furthermore, none can be expected to succeed without attention to the institutional context. It is to help missions better make these choices and use the answers to solve their operational problems that this project is directed.

Appendix B

Possible Project Applications: Irrigation in Pakistan

ST/RD believes DFMD will be particularly useful in projects where local recurrent costs, and infrastructure maintenance and management are serious challenges. These features apply to several AID interventions: to elementary and non-formal education, basic health services, rural roads, and, perhaps most strongly, to irrigation projects.

Irrigation projects are usually characterized by extremely complex and diverse management problems. In many cases, funds must be raised to pay capital and operating costs, tedious and laborious maintenance must be performed, water must be allocated fairly among many users, conflicts between users (and sometimes between user organizations in large systems) must be resolved, and such outputs and inputs as the water delivered and the fees paid must be kept track of. All these "downstream" functions must be articulated to management of the water source; whether it is a reservoir, a river, or a pump-well system, and its management poses a separate set of technical and natural challenges.

AID, other donors, and host government projects have, not surprisingly, often fared only moderately well in resolving these challenges. The outcome has been wasted water, lost crops, alienated farmers, deteriorated and lost

irrigation systems, social conflict, and investments which never paid their way, directly or indirectly. Sederhara in Indonesia, the Philippine Small Scale Irrigation Project, the BICOL, the Gezira Scheme, Rahad Irrigation, Pakistan's On Farm Water Project have all run into one or more of these problems.

One of USAID's major new initiatives in irrigation is the Pakistan Irrigation Systems Management Project. In discussing it, the Mission's project paper pointed out the diversity and importance of management and maintenance issues which have contributed to the system problems.

Comprising one of the largest irrigated areas in the world, its canals and drains "are in a badly deteriorated condition due primarily to the absence of adequate and timely maintenance." Siltation, embankment erosion, human and animal abuse, have led to serious physical deterioration, canal breaches, interruption of service and flooding. Financial constraints have also been a severe problem in this irrigation system, particularly as the system has grown and aged, as direct revenue from user fees has lagged, and provincial collections have not been earmarked for canal maintenance. Furthermore, canal management (allocation and delivery of water) was analyzed by the Mission as seriously suboptimal, with water wasted in some places and times, and insufficient to meet demand at others.

As the project paper notes, severe institutional gaps are responsible for many of these problems; improvement is a key component of USAID's project. The project paper, furthermore, quite rightly proposes to focus on the Provincial Irrigation Districts as the current "weak link" in the administrative system, and illustrates the complex multiple-institutions which are currently responsible for managing and maintaining the system. These include the Ministry of Water and Power, the Water and Power Development Authority, the several provincial governments, provincial agricultural departments and provincial irrigation departments.

As the project paper emphasizes, "Needed management improvements range from the global — changing the basic premise of the system from one of water disposed to water delivery — to the specific — increasing the productivity of both the labor and machinery required for the operation and maintenance of the system." It furthermore emphasizes the need to "seek ways to structure the public sector framework to capitalize on the independent decision-making force of the farmers and maximize their participation in the management of water resources."

These are the proper concerns. Looking at them from the analytical framework guiding this proposed DFMD project, we would address them by inquiring how incentives and constraints facing farmers, farmer groups and officials have led to current problems, and how they might be altered.

For example, let us consider maintenance. Analysis of irrigation projects suggest that those whose maintenance is critical to the system (upstream users) have little incentive to do much of this work voluntarily: they will obtain water regardless with little effort. Those downstream, however, are dependent on the maintenance of their upstream fellows. Upstream farmers have an opportunity to improve water flows with maintenance, but little incentive. Downstream farmers have a lot of incentive to do maintenance, but little opportunity, as problems well-upstream of them can cut off their flow regardless of their efforts. Precisely the same dynamics apply to allocation and water-stealing; and both problems help explain why raising adequate revenues is often a problem, for obvious reasons.

Such circumstances may be characterized as a "common pool good" situation where there is uneven access and there are downstream "externalities" to complicate life! The organizational dilemma arises from the fact that while water is a separable good, a working system is a joint good requiring maintenance by all. The first characteristic leads some to ignore the needs of others, and take care of themselves. The second characteristic means that in the long-run such behavior will destroy the system for most users: at best the system will run well below optimal levels.

Maintenance is a fairly well-specifiable service, fairly measurable, and done through known technologies. In this circumstance, institutional analysis might be used to design local units which capture within them both up and

downstream users. These units might themselves take on maintenance, doing it voluntarily, paying farmers directly, hiring laborers, or contracting maintenance to public service industries. In either case, these units must have authority to either cut-off water deliveries to non-payers or to tax them. They must be designed to include ("internalize") the upstream, downstream relationship, and might be expected to be more effective in this task than larger, hierarchical centralized bureaucracies have been. This is because the farmers themselves have an incentive to see compliance occurs, smaller numbers and local visibility will make violators more visible, and social pressure along with taxing authority can be used as teeth. Such organizations need to be "nested" in large arrangements with other farmer organizations, in order to settle disputes among organizations and to offer appeal routes to settle intra-organizational disputes. Research by Robert Hunt of the Sussex Institute of Development Studies, among others, has strongly suggested that failure of such farmer organizations in the past has grown from failure to include both sets of users, leave out key authority for the units, and/or failure to "nest" the groups in appropriate inter-organizational systems.

Similar analyses can be made for other management problems which may pertain to this project. An effective allocation management system, for example, is a good characterized by "jointness": if it is in existence, all served by it will benefit, so each person has an incentive to let others invest time, energy (and the danger of social criticism) in it, and spend their own time on their farm. Allocation institutions, therefore, need

mechanisms which can require collective support. Once again, local associations with taxation or allocation teeth are required. Once a management area has been defined and a revenue source is in place, then a variety of arrangements might be pursued to actually provide for allocation on a day-to-day basis: management could be contracted out to private specialists, done by traditional group leaders, by a local elected officials or perhaps by some other arrangement. An important incentive for group members to invest in such a system could be the greater control over water allocation the group would then have instead of depending on the centrally-based bureaucracy. Such management and allocation issues will also probably exist among local user groups. Thus, inter-organizational arrangements among them for self management at that level may also be feasible and more effective than current arrangements. Of course, this implies proportionate and coordinated changes in procedure by such national and regional entities (such as WAPDA, another topic for analysis in the DFMD project).

Irrigation systems appear to be characterized by contradictory patterns of scale economies: at the "top" or storage end, there are usually great economies of scale. At the "bottom" or delivery end, there appear to be great diseconomies of scale, with larger administrative units simply unable to achieve effective maintenance, efficient and equitable allocation, resolve local conflicts, and raise revenue. Common pool characteristics, free-riding, the generation of "down stream externalities, the need for co-production, all suggest smaller units out to be designed (among other concerns) to encapsulate these contradictory local incentives. Furthermore, the development of such entities opens the possibility of using

public service industries which can contract with these primary units and other administrative levels and play a large role delivering maintenance, management and accounting services, and shrink official budgets. Revitalized Provincial Irrigation Departments would be a key actor in resolving conflicts within and among the local units, and setting basic standards for public service industry entrants. WAPDA would continue to maintain large economies of scale at the "top" or storage end of the system, but relax control below.

It is this sort of an analytical role we expect the DFMD project might play. Helping to define the organizational trade-offs involved in centralization and decentralization, helping determine what levels activities might be best lodged, helping design institutions (and relations among institutions) which will bring citizens, officials, and contractors incentives to reach desired goals is precisely what the project is intended to do.

Our recommendation regarding the Pakistan Project are very preliminary as the authors of this preliminary paper have no detailed knowledge of this area. However, the project would mix general analytical and "architectural" skills, with those who have detailed field knowledge to fit mission needs, wherever those might be.

There are many projects currently coming on which we believe can usefully employ decentralization through our analytical approach. The Indonesian District Roads Maintenance and Upland Farming System Project will face serious maintenance and recurrent cost challenges. Nepal's possible redesigned Rapti Zone Integrated Rural Development project faces similar

challenges. Maintenance may be a problem in Bangladesh's Zilla Roads Project. Recurrent costs and maintenance will be key issues in Sri Lanka's irrigation program and Pakistan's effort to strengthen rural roads (Rural Roads Maintenance Project). We believe this project can provide technical assistance to help missions in designing, managing and redesigning these projects, and in policy dialogues with host governments over reforms to solve maintenance and recurrent cost problems.

Appendix C

Other Regional Possibilities

While discussions have not proceeded as far at this date with the Latin America or Africa Bureaus, early conversation suggests there may be interest in strengthening local revenue capacity in El Salvador. In Africa, the North Shaba project (currently under design) is faced with significant local revenue and maintenance questions in its roads component, and important service delivery issues in dealing with agricultural extension. Zaire's relatively strong construction capacity in the private sector suggests that the public sector industry strategy may be fruitful. Our experience there with PVOs, furthermore, suggests that a similar strategy may work in solving agricultural extension problems. Of course, each of these strategies, if found to be appropriate after further analysis, needs to be undergirded by effective local revenue systems, which are linked into supportive national fiscal systems and carefully designed at the local level. Our institutional analysis intervention would be appropriate to help specify these parameters.