

Final Report

# DECENTRALIZATION STRATEGY DESIGN: COMPLEMENTARY PERSPECTIVES ON A COMMON THEME

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# DECENTRALIZATION STRATEGY DESIGN: COMPLEMENTARY PERSPECTIVES ON A COMMON THEME

## 1. Definitions

To the public finance economist, decentralization usually means *fiscal decentralization*. Reforming the intergovernmental fiscal system is usually their first priority. To the political scientist, decentralization usually means a set of *governance* issues, a focus on who has authority and responsibility. The political scientist tends to focus on the structure of power and authority and how it is wielded. To the institutional economist, decentralization usually involves getting an *incentive system* in place so that individual behavior meets expectations. To the sociologist, decentralization usually means *participation* and the role of informal organizations and community groups is a major focal point. I will consider all these foci in this paper, and suggest in the conclusion an additional element -- decentralization strategy for enhancing *local economic development* -- for strategy design.

Decentralization is a change in the institutional framework in which political, social and economic decisions are made and carried out.<sup>1</sup> The idea of decentralization is equally applicable to a single organization, public or private, and to complex groupings of organizations, such as governments. In public sector discourse, we usually apply the idea to the relationships between central government roles and responsibilities and subnational, such as states' (or regions'), and local governments' roles and responsibilities. In the transition from centrally planned, socialist systems, to more market-oriented systems, sometimes both privatization of state-owned assets and decentralization policies are being examined simultaneously. This paper focuses mainly on decentralization, although the role of the private sector in the actual production of some services is also pertinent.

In a state of the art paper for U.S.A.I.D. Dennis Rondinelli reviewed the literature and practice on decentralization and concluded there are three forms:

- **Political:** involves increasing political power of citizens or elected representatives;
- **Spatial:** involves diffusing population and economic activities geographically, to decrease concentration in fewer large cities.
- **Administrative:** involves transfer of responsibility for planning, management and raising and allocation of resources from central to field offices of central government,

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<sup>1</sup> Rondinelli, Dennis, James McCullough and Ronald Johnson, "Analysing Decentralization Policies in Developing Countries: A Political-Economy Framework," **Development and Change**, 20(1989). Rondinelli, Dennis, John Nellis and G. Shabbir Cheema, **Decentralization in Developing Countries: A Review of Recent Experience**. (World Bank: 1984).

to subordinate units or levels of government, or other semiautonomous institutions.<sup>2</sup>

Silverman examined the implications of decentralizing some facets of decision-making for economic policy and sector investment. Both he and Rondinelli identify three forms of political and administrative decentralization:

- **Deconcentration:** transfer of responsibility from central agencies in the national capital to field offices of central agencies (regional, provincial, local, etc.);
- **Delegation:** transfer of responsibility from central agencies to organizations not wholly under central control (semi-autonomous corporations, subnational units of government);
- **Devolution:** transfer from central to autonomous units of local government with corporate status (units with a statutory or constitutional basis for powers distinct from central government)<sup>3</sup>

Bahl uses the terminology somewhat differently, although emphasizing the same differentiation. He refers to administrative decentralization as permitting limited local discretion whereas devolution involves significantly greater local discretion.<sup>4</sup> Throughout this paper, I will use the term decentralization to refer to transfer of responsibility and authority from a central, single political and administrative entity, such as a central government, to multiple political and administrative entities that have some formally defined degree of autonomy from the central entity.

Statutory and/or constitutional provisions usually define this degree of autonomy. An amendment to India's Constitution in 1993, for example, gave formal, constitutional status to local governments and defined certain authorities and responsibilities that local governments may exercise. That constitutional amendment *decentralizes* some of the political, administrative and economic functions formally performed by central and state governments and assigns those functions, or parts of them, to local governments.

As applied to governments, the key characteristics of decentralization involve changes in governance and in the status of governmental institutions. Various functions may be decentralized, but the change in governance implied by decentralizing authority and responsibility to local governments has three important characteristics to be considered decentralization:

- Chief policy officials of local government are accountable to citizens or residents of the jurisdiction, not to central government agencies or officials (e.g., chief executive

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<sup>2</sup> Rondinelli, Dennis A. **Decentralizing Urban Development Programs: A Framework for Analyzing Policy.** (U.S.A.I.D.: Office of Housing and Urban Programs, 1990), pp. 9-13.

<sup>3</sup> Silverman, Jerry M. **Public Sector Decentralization: Economic Policy and Sector Investment Programs.** (World Bank: Africa Technical Department, 1992); and Rondinelli, **Decentralizing Urban Development Programs.**

<sup>4</sup> Bahl, Roy, Presentation for U.S.A.I.D./Caro, March, 1991.

such as mayor, legislative body such as municipal council).

- Key management or administrative department heads are accountable either directly to citizens or residents or to chief local policy officials.
- Chief local financial officials (responsible for both revenue and budget) are accountable either directly to citizens or residents or to chief local policy officials.

Assigning responsibility to local governments while still holding local officials accountable to central government is a very limited form of decentralization and is less likely to achieve the expected benefits than a more autonomous local control. However, local government autonomy does not imply that central government has no authority to set limits, such as on borrowing authority, but it means that local government does not clear decisions with central government within the limits of statutory and constitutional provisions that define the decentralized system. In the United States, local governments enjoy varying degrees of autonomy, although in no case are local officials accountable primarily either to federal or state government. The more autonomous local governments in the U.S. are those with constitutionally protected charters, the less autonomous are those whose authority and responsibility falls under general statutory control. Most states have constitutional provisions for granting *home rule* status to cities that meet constitutionally defined criteria. The *home rule charter* defines authority and responsibility that cannot be changed by action of the state legislature, and thus affords a fuller measure of autonomy. Generally, larger size is a key criterion in defining eligibility for home rule status.

Autonomy in the sense of having a constitutionally protected status (e.g., charter) which cannot easily be changed by legislative or executive action at a higher level of government confers on local government status sometimes referred to as "corporate" status. Corporate emphasizes that local government institutions are the managers of assets "owned" by current and future residents; local officials therefore are responsible for managing those assets for the benefit of current and future residents

The corporate concept is especially important in societies moving from a centrally planned, socialist system toward a more market-oriented system. At least two things happen in this transition. First, the concept of state ownership of all (or most) assets changes to enable private ownership of some (or most) assets, allowing private owners to choose how to use those assets. Second, those assets that remain state-owned are less often thought of as "owned by the government" and more often "owned by citizens or residents" and managed on their behalf by public sector managers.<sup>5</sup>

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<sup>5</sup>As I extend the discussion of decentralization in this paper, this corporate concept of a local government as a public sector manager of assets that are truly owned by residents or citizens becomes important. To forecast that argument, decentralization frequently fails to achieve the expected benefits when central control of resources and decision-making authority is transferred to local officials who exercise their new control and authority as if it were for their own benefit instead of perceiving their new position as managers of resources on behalf of the residents who are the "true" owners. Decentralization improves governance when mechanisms to hold local officials accountable for their "corporate management" work; it fails when local officials become the new autocracy replacing the impersonal and distant autocracy of central government with

Decentralization is not all or nothing. There are degrees of decentralization that depend on the extent of:

- Independence from central government of selection of policy, administrative and financial officials;
- Authority to decide without prior approval of central government the quantity and quality of basic services.
- Proportion of total expenditures for basic urban services funded by "own source" revenues (revenues that are determined by and collected by local government);
- Authority to assign value to tax base and to set rates on that base;
- Authority to establish schedules of charges and fees for services;
- Authority to accept or reject or modify central government plans for infrastructure and other services to be provided by central agencies.

## **2. Benefits**

Decentralization can have advantages both to the effective functioning of civil society and to the efficient management of resources. One set of advantages is the expected civil society benefits from decentralization.

### **2.1 Civil Society Benefits**

- Greater accountability of public sector officials to the citizens being served;
- Better public sector problem solving; and
- Increased incentives for citizens to participate in public sector decision-making.

#### **2.1.1 Accountability**

One of the functions that decentralization of authority to local institutions is said to perform

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personal and close autocracy.

by some is the “defence against the abuse of central power.”<sup>6</sup> This notion implies that local governments, and other local organizations, if they have significant power in the governmental system, can act as a check and balance against the power of central government. Central governments can be held to account more effectively by strong subnational governments. In turn, citizens can much more directly hold local officials accountable for their actions.

Much of the argument that decentralized institutions can perform some governmental functions better than central institutions depends on the individuals in those decentralized institutions looking outward and downward to the residents of their jurisdictions or constituents of their institutions as the source of validation of their activities, rather than looking upward to central government officials for that validation. This outward and downward orientation often requires that local officials view their role as managers and stewards of the physical and human resources or assets in their geographic area for current and future residents. Individuals of course may be motivated by many incentives, but it is the incentive to please central government officials that seems to dictate the actions of so-called local managers in highly centralized systems. Official decentralization does not automatically make local managers and officials accountable to local residents.

Under a decentralized regime, there is likely to be greater accountability between public sector managers and the residents they serve. The managers who are responsible for the quality and quantity of services are easier to identify. Local governments are closer to and more familiar with threats to the health, safety and security of citizens. Obviously external threats to national security are not likely to be as known to local government as to central, but many forms of air and water pollution, hazardous materials releases, and unsanitary conditions are more visible to local citizens and officials than to distantly managed central government agencies. Furthermore, local governments that are responsible to their constituent citizens as opposed to central government are more likely to see the need to monitor and regulate possible threats to health and safety, provide better services and respond to local residents. Local institutions thus are in a better position to enforce regulatory standards because they are closer to the problem and because they can be more directly accountable to residents for failure to enforce environmental health and safety standards.

Democratic systems typically rely on election of key executive and legislative officials to achieve accountability. Corporate systems also rely on selection and replacement mechanisms for holding officers and managers accountable. “Peer” pressure, in the sense of citizens putting pressure on public officials is an effective accountability mechanism in the Philippines where local officials see themselves as part of the community. Non-governmental organizations (NGOs) and informal community organizations often play a key role in ensuring accountability by publicizing the behavior and accomplishments (or failures) of public officials. In most highly centralized systems, NGOs are relatively weak as even the local managers who are directed by central officials realize that their future is dependent on their upward accountability to those central officials. In decentralized systems, NGOs and other community groups can play a significant role, with or without extensive electoral systems, in holding local officials accountable if those local officials are

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<sup>6</sup>Wright, Glenn, “The Division of Central-Local Government Functions”, (mimeograph, 1995) quoting Jim Sharpe, “Local Government: Size, Efficiency, and Citizen Participation,” Steering Committee on Local and Regional Authorities, Council of Europe.

reasonably autonomous from central control.

Performance measurement systems that identify and monitor, both quantitatively and qualitatively, the local government's performance, when publicized, are an effective means of holding public officials accountable for their actions. Citizen participation in identifying what are the most important performance expectations for the local government, followed by regular monitoring and reporting on progress toward meeting those expectations has been a powerful tool in many U.S. cities. Seattle, for example, developed a list of performance measures that citizens and city officials alike define as the qualities of a *sustainable city*. An example of such a measure is *the presence of native salmon in the river*. Regular reports in the form of a simple graphic that indicates the city is moving toward, away from, or no movement at all toward sustainability.

Political culture influences the selection of specific accountability mechanisms, so prescription of particular models is not appropriate across all systems. However, to achieve the benefits of decentralization, there must be clear definitions of local officials' responsibilities, and there must be means by which local officials can be held to account by local residents for the execution of those responsibilities.

### 2.1.2 Problem Solving

All forms of central planning rely heavily on the assumption that solutions to problems are known; therefore, the exercise of public authority involves priority setting and implementation of actions designed to achieve the desired results. However, the solutions to many of the problems that typically are thought of as public sector issues, and the most efficient and effective means to achieve public purposes, are among the most intractable problems humans face. Autonomous local institutions who are not governed by centrally defined, uniform standards and centrally planned approaches are more likely to produce innovative solutions. It is not that local officials are more innovative or experimental than central officials, but the institutional structure of numerous autonomous institutions trying to solve similar problems and trying to design effective and efficient approaches is more likely to produce innovations (both successes and failures). But the costs of failure will be less because it will have been implemented locally rather than uniformly nationwide. A corollary to this is that means of sharing information about successes and failures is necessary for a nation to take advantage of the "experiments" conducted by local institutions.<sup>7</sup>

Local governments similarly are in the best position to work with non-governmental organizations (NGOs) and other voluntary, community-based organizations. Local governments can be perceived as more responsive to community differences within the urban area. NGOs and informal sector institutions are more likely to work with local governments if they perceive local governments as accountable locally rather than accountable to central bureaucracies.

Similarly, economic development activities by local governments are more likely to reach small entrepreneurs and other individuals currently disadvantaged by the operation of private markets because they lack understanding of regulatory policies and lack access to sources of

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<sup>7</sup> Johnson, Ronald W. "Social Policy Planning in a Federal Structure: A Social Learning Strategy," *Evaluation and Program Planning*, (Winter, 1978).

finance available to formal, larger institutions. Local governments are more likely to be able to develop forms of assistance and business stimulation on a scale appropriate to the small entrepreneur. In addition, local governments are more likely to be able to work with voluntary groups and community organizations in stimulating the development of small scale, often informal economic organizations to achieve larger scales of production.

### 2.1.3 Increased Citizen Participation in Public Affairs

The more remote the chances seem for influencing any event, the less likely anyone is to expend the energy to try to influence the event. Several kinds of disincentives discourage participation in a highly centralized system<sup>8</sup>

- The costs of acquiring information about the performance of centralized institutions is high. Individuals and organizations find it more difficult to monitor and evaluate the performance of central government institutions except when the costs (often taxes) are obvious and the consequences of failure are obvious.
- Even if well informed about the performance of centralized institutions, it may be necessary literally to have a presence in the national capital to attempt to influence that performance. Only wealthy and or well-organized groups or influential citizens are likely to have access to central government figures in the capital, and even central employees whose base of operations is in a regional office may have to travel to the capital to have any influence.
- The costs of negotiating change may involve extensive time commitments in addition to material resources, and many cannot make the time commitments for issues that affect them locally but are decided by officials whose responsibility includes many local jurisdictions.

Decentralization of some responsibilities to local institutions reduces these disincentives to participate in governance. In addition, by encouraging participation through reducing the costs of participation, the likelihood that even individuals and loosely formed or informal associations will choose to try to influence public sector decision-making increases. Furthermore, active seeking on the part of local officials of formal and informal public-private partnerships, such as enlisting the cooperation of community organizations with the city to address social issues, increases the sense among both residents and officials that the local community is being managed by and for the residents. The caveat of course is that local officials in the decentralized system must be perceived as being responsive to that participation. When that is the case, it is a spiraling reinforcement as participation begets change which begets additional participation, and so forth.

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<sup>8</sup> Focus of attention on transactions costs and incentives to participation has been an important contribution of a political economic and institutional economic approach to development issues such as Ostrom, Elinor, Larry Schroeder and Susan Wynne, **Institutional Incentives and Sustainable Development: Infrastructure Policies in Perspective** (Boulder, Colo.: Westview Press, 1993)

## **2.2 Economic Benefits**

In addition to those civil society benefits, decentralization should produce economic benefits in the form of improved management of public sector resources. The main benefits are:

- Better allocation of public sector resources;
- Better mobilization of resources to finance public sector activities;

### **2.2.1 Allocation of Public Sector Resources**

In a market-oriented system, competition among multiple producers acts as the main incentive to keep the costs of production low relative to the quality demanded by the consumer. Resources are allocated across competing demands by the market mechanisms of prices and consumer choice. In a highly centralized system, for public goods and services, there is a lack of reliable information about the costs of those services, about their quality, and about the overall performance of public sector institutions. There often is a confusing welter of contradictory policies toward the costs of services that are delivered at the local level and about the allocation of resources across geographic areas. Under these circumstances, it is difficult to evaluate the costs and benefits of present resource allocations. With more local responsibility for financing services using resources mobilized within the local area, the quality and quantity of services produced is more likely to be regulated by the actual costs of those services and by real demand for services.

A closer association between benefits of services and their costs is likely to lead to a better spatial allocation of resources as neither urban nor rural areas will be as subject to distortions caused by hidden subsidized costs. Closely following this will be a better spatial distribution of population as job seekers in urban areas will require wages that make the costs of urban living affordable, and employers will pay those wages as long as the economic gains from economies of scale and agglomeration economies of urban areas exceed the costs of factors of production. Those industries unable to operate in urban areas at true market costs will move elsewhere or cease production, and population will tend to stabilize around a market balance of costs and opportunities.

The allocation of resources to public sector services provision also is likely to be more efficient under a decentralized regime because local institutions are more likely to be aware of citizen preferences and needs. Unneeded quality or quantity of services is less likely to be produced because of this closer knowledge of the level of quantity and quality demanded. Furthermore, local institutions are less likely to provide or produce services at an unaffordable (without subsidy) cost because they are more likely to know the real willingness to pay (demand) and ability to pay (affordability).

### **2.2.2 Mobilization of Resources**

Local governments have a comparative advantage over central governments in two aspects of resource mobilization. First, local governments can collect more revenues that are "local" in

origin. For example, the business license tax is extremely difficult to collect from small businesses and individual entrepreneurs unless the collecting agent is close to the source. Central government, even with local collection agents, is less likely to have access to that tax base because the collection agents are upward oriented in their reporting relationships and are often not perceived as part of the local community. The business operations of strictly local organizations are almost uniquely accessible to local governments. The further the geographic distance from the national capital, the less likely is central government to have sufficient knowledge of and access to small business operations. Business taxes based on size of physical facility, the number of employees, or a simple business classification correlated with income are all means for determining tax liability easily within the capacity of most developing country local governments. And enforcement is much simpler for local governments because the businesses are known to the local tax collectors. Other licenses and fees, for example, permits to operate vehicles are more easily collectible at the local level from residents. Interregional commercial vehicles are more difficult for local governments to license.

The second component of comparative advantage for local governments is the assignment and collection of taxes and charges for benefits residents perceive as being provided by the local government. There is a greater willingness to be taxed and to pay other charges for services that are: (1) demanded by citizens in the first place, and (2) more within the control of the beneficiaries of those services, or of public officials who are accountable to those beneficiaries. The heart of the issue is the direct linkage between local government provision of a service and direct accountability to local residents. If residents perceive the local government as providing a set of services **and** perceive that the local government is accountable for the quality and quantity of those services, they are more likely to be willing to be taxed or to pay specific user charges.

Property taxes represent the single largest own source revenue for local authorities in most highly industrialized countries. This is followed closely by user charges and then sales taxes. In the United States, as federal assistance to state and local governments has declined, user charges and sales taxes are increasing faster than any other resources, and soon will exceed property taxes as a percentage of total local government revenue. The property tax rationale as an important local tax is based on the premise that property values accruing to the owner of the property, to the extent that they are affected by public sector direct actions, are more affected by the basic urban services provided by most local governments than by the services of any central government agency. The linkage is direct between the total bundle of basic urban services and property value, but not usually specifically to any one particular service. Of course, to the extent that central governments in developing countries provide basic urban services, then local governments are not perceived as benefitting property values. Particularly as central governments shift responsibilities to local governments, the value of urban property increasingly will be affected by the actions of local government, and the ability of the local government to tax and collect on property will increase. Sales taxes are much more directly responsive to economic activity, and are likely to play a more important role in developing countries as local governments increasingly have responsibility for fostering a positive climate for local and regional economic growth.

The other direct linkage between benefits of services and resource mobilization is for those services in which individual beneficiaries are clearly identifiable. Services that can be consumed on some kind of excludable basis, such as household connections to the water system, are susceptible

to direct charges to recover the costs of that service. Again because they are in a better position to know and to keep records on use, local governments are better able to collect user charges. Semi-autonomous water agencies reporting to the central government of course can also identify users and volume of use easily, but they lack the "local" character of local government. Beneficiaries seem more willing to avoid or postpone payment of user fees if the agency is a "distant" agency of the central government

### 3. Decentralization Options

Moving to a more decentralized system means choosing which decisions previously centralized will be devolved to local institutions and which functions previously carried out by central institutions will be performed by local institutions. Just as there are political and administrative benefits that decentralization should produce, there are political and administrative criteria for choosing which decisions and which functions should be devolved. Similarly, paralleling the resource management benefits of decentralization are economic criteria for choosing which decisions and which functions to devolve. In different political and cultural systems, this will lead to some variations in which services local governments can have the most leverage.

#### 3.1 Political and Administrative Criteria

Political and administrative criteria focus more on the nature and role of the institutions themselves:

- **Minimize externalities**, while an economic sounding criterion, means that services should be provided by the political or administrative institution whose jurisdiction is sufficiently large to prevent the costs (or benefits) from a good or service from spilling over on to non-paying, other jurisdictions. The scope of the institution's authority, which often means geographic scope, should extend to the limits of the costs and benefits of the function the institution performs. The presence of significant externalities, either costs or benefits, makes it politically and administratively less possible for a specific jurisdiction to provide the particular good or service. Local government determination of air and water pollution standards can lead to significant negative externalities for one jurisdiction if other, nearby local jurisdictions fail to provide for the same level of protection because the environmental hazards will "spill over" to the more tightly regulated jurisdiction.
- **Maximize economies of scale** means extend the scope of the institution's authority to that size, but no larger, that allows it to achieve necessary size economies and to enable acquisition of necessary assets. Administratively, however, economies can be lost when size exceeds economical scale -- technically, when marginal benefits no longer exceed marginal costs. Many central government institutions in developing countries exceed economies of scale. For example, central provision of services such as water, sewerage, streets, drainage and other physical capital intensive infrastructure usually exceeds economies of scale because of the tendency to employ the same design standards, the same administrative structure, and the same

technologies, regardless of variations in local conditions and consumer demand.

- **Sufficient legal and administrative authority** means the institution providing the service must be empowered to make the necessary planning, financing, implementation and evaluation decisions to make the service efficient and effective. Even where local governments are assigned the responsibility for services such as maintenance of physical infrastructure, their not having had the authority to influence the design choices of technology, quality and quantity of service reduces management effectiveness.
- **Sufficient services to provide a forum for conflict resolution** means the service providing institution is more effective if it is involved in a number of different services so that the same legal institution is seen as the forum for responding to residents' complaints and demands. Having to address demands for service or complaints to largely independent national ministries discourages residents from actively participating in the choices of quantity, quality and cost of services because they must deal with numerous separate bureaucracies, each with their own rules and procedures. Multi-purpose local governments can employ the same approaches to resident involvement and complaint handling across all, or most services, and thereby increase participation.
- **Performance accountable to residents** means that there must be clear management responsibility for the cost, quality and quantity performance of specific services and that management must be susceptible to being held to account by residents and/or direct beneficiaries of the services. Management responsibility is less clear in distant central government institutions, and the means to hold central bureaucracies accountable for specific service performance are weak. Local governments can be more accountable and more identifiable as the sources of good or bad quality and quantity/cost relationships in urban services.

In different political and cultural settings, application of the above political, administrative and economic criteria will not automatically yield the same results. Streets, roads, footpaths, drainage, water, sewerage, solid waste, public markets and similar facilities are commonly local by the application of these criteria. However, the criteria contain implicit prescriptions for the institutional framework that, if not followed, reduce or at least threaten to reduce the leverage potentially gained from assigning key responsibilities and authority to local governments. Of particular import, for example, is performance accountability. If local governments are assigned responsibility for a group of services, but key local officials are either appointed by or are actually employees of central government, then the main direction of accountability is local to central, rather than local to residents and/or service beneficiaries.

### 3.2 Economic Efficiency Criteria

Economic criteria focus on the nature of the goods and services to be provided by the public

or private sector rather than the institutions providing them:<sup>9</sup>

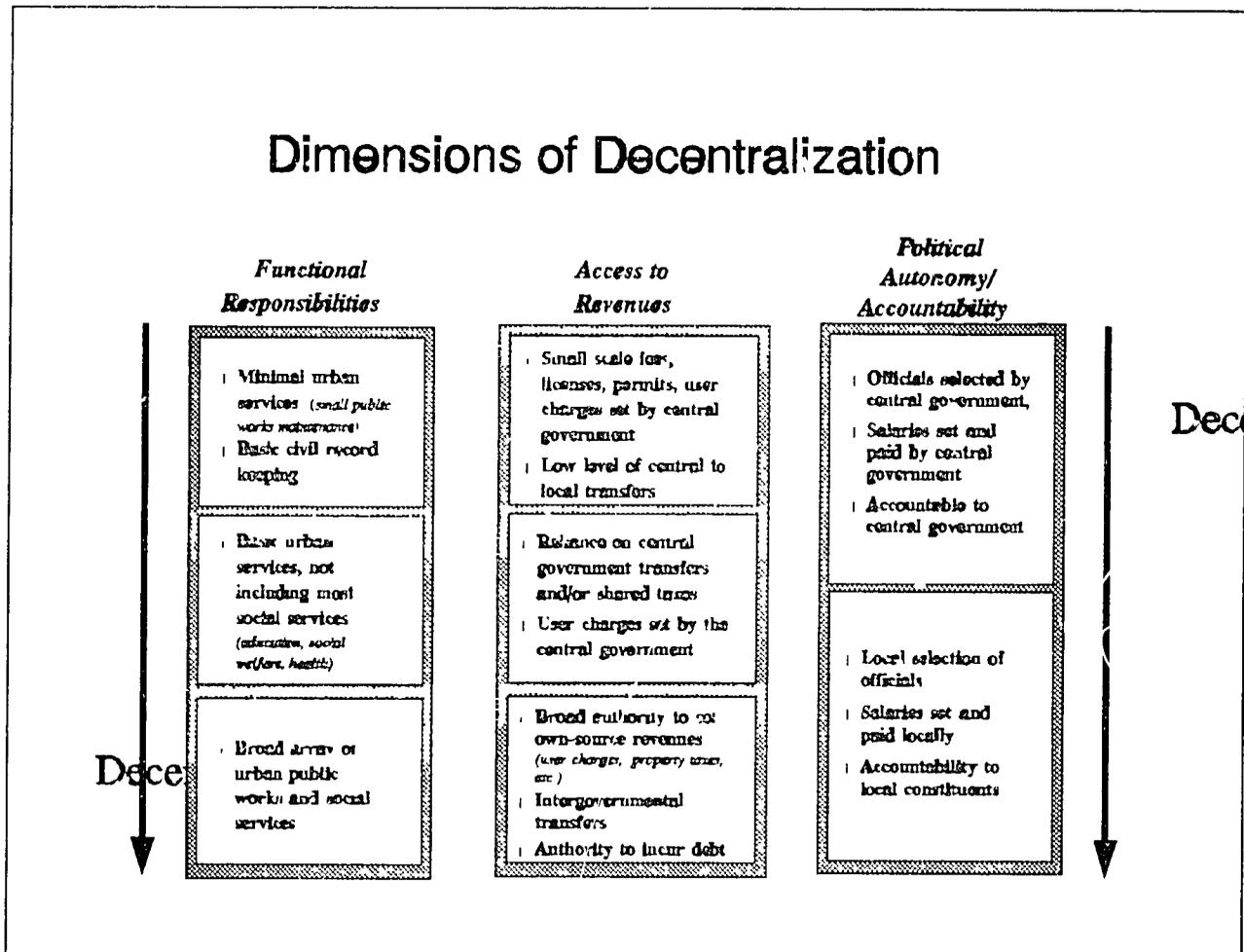
- **Non-excludable** goods and services are those that once provided some people or some area are difficult to prohibit large numbers of people from enjoying the same benefits whether or not they contribute to financing. Drainage and flood control are examples of urban services that once established afford protection to entire areas.
- **Non-divisible** goods and services are those for which the quantity and/or quality consumed is difficult to measure, and therefore difficult to establish unit pricing. Monitoring and enforcement of environmental regulations for air and water pollution are examples.
- **Unavoidable** goods and services are those which residents cannot avoid consuming or enjoying. Health and safety regulations are examples.
- **Natural Monopolies** occur because the scale of operations necessary to provide the service at all is so large as to preclude, or at least discourage, more than one producer from entering the market. Most utilities, within specific geographic and population size boundaries, are regarded natural monopolies, such as water treatment and distribution systems.
- **Insufficient private incentives** exist when the good or service requires specialized assets that are not sensible for private entrepreneurs to acquire or must be used in combination with other assets in complex management systems in such a way as to discourage private production. While this clearly varies from country to country depending on the size and nature of the private sector, a common urban example is fire protection.
- **High political saliency** is often used as the argument to support public housing provision where it is felt too politically explosive for large numbers to be without adequate shelter.
- **Minimum health and welfare standards** provide the rationale for some public regulatory and production services such as health and safety inspections, environmental regulations, solid waste collection disposal, and sewerage.

These criteria generally distinguish between goods and services that are largely public in character, therefore require a significant public sector role in producing those goods and services, arranging with the private sector for production, or regulating the otherwise private production of those goods and services. By themselves, they are not sufficient to resolve the basic questions of decentralization, to which level should the provision (including financing) of various services be assigned in order to achieve the most leverage in managing the urban system? However, there is

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<sup>9</sup> These characteristics are adapted from Silverman, **Public Sector Decentralization**, who summarizes public finance economics and public choice literature in arriving at these characteristics, pp. 10-11.

an implicit assumption underlying each of those criteria -- that any good or service should be provided in the most efficient manner possible (the first five are essentially efficiency criteria) and the most effective manner possible (the last two admit of possibly less than efficient public versus private choices on the grounds of political importance or social welfare).



#### 4. Experience with Decentralization Models

This section brings the experience of different decentralization models into the picture. Some, such as in western industrialized countries, are embedded in a long history, although even in such countries as the United States the division of responsibility and authority among levels of government can never be described as settled. Other models briefly describe here, such as the transition Russia and Eastern European countries are going through, are only the dimmest outlines of what may evolve as new roles for different levels of government.<sup>10</sup> The use of the term **model**

<sup>10</sup> It probably is inappropriate even to describe the early stages of transition to a more decentralized structure in some countries as *models*. The Russian and Eastern European experiences are important to include here not because they have yet succeeded in creating effective, new roles for lower levels of government, but because the decentralization issues they are trying to address

is in the most general sense of an example illustrating a few points of comparison and contrast. Each country, or group of countries, illustrate ways of addressing the basic questions decentralization has to consider

- Clarifying functional responsibilities among levels of government (what the public finance economists usually call *expenditure assignment*);
- Developing or assigning revenues appropriate to the functional responsibilities assigned to each level of government, and
- Devising a system of accountability that encompasses appropriate regulation of local governments by central government in arenas where that is essential and downward responsibility of local officials to their constituents.<sup>11</sup>

#### 4.1 Dimensions of Decentralization

In the following exhibit, these basic dimensions along which decentralization features may vary from country to country are illustrated. The illustration oversimplifies how one can model decentralization, but it stresses the main features

The division of functional responsibilities among levels of government is the first key dimension. In the most centralized system, local governments have mainly civil record-keeping responsibilities and maintenance of small public works services. Central governments build all the infrastructure facilities and typically operate all but the smallest water, drainage and other facilities. An intermediate position on the dimension involves extending to local governments additional responsibilities for basic urban services, such as streets, solid waste collection and disposal, drainage, and in some cases water systems. For the latter, the common pattern is for central government to design and build water treatment and distribution systems, and in the case of larger water systems then turn them over to local government or a local water enterprise for future operation and capital expansion. At the far end of the dimension are local governments with responsibility for a broad array of services including most or all infrastructure services and in many countries many social services such as primary and secondary education (or just primary), health and social welfare

Access to revenues is the second key dimension. At the extreme in centralized systems, local governments have limited authority to charge small fees for services, such as stamp taxes or fees for registering and processing documents, may have small fees for operation of various businesses and professions, and typically cannot levy any taxes. A more intermediate position is still fairly severe limits on local governments' ability to set their own taxes and charges, but to establish a system of intergovernmental transfers or shared taxes so that local governments have a relatively stable and predictable revenue stream. Where user charges and local taxes are permitted,

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are wound around the simultaneous transition from centrally planned to market economies.

<sup>11</sup> Dillinger, William, **Decentralization and Its Implications for Urban Service Delivery**, (Washington, D.C.: World Bank, 1994), pp. 241f.

the rates typically still are set by central government. At the other end of the spectrum, local governments are authorized to levy their own taxes, set their own rates for taxes and user charges, and generally are authorized under some degree of supervision to incur long-term debt for capital investments. Intergovernmental transfers are still common, but local governments typically have more discretion over their use.

The third dimension is the degree and types of political autonomy and accountability. At the extreme centralized end of this dimension, local officials are selected by central government, their retention in local positions is controlled by central government, and their salaries are set and paid by central government. Accountability of local officials is toward central government with various detailed regulations and procedures determined by central ministries. Performance monitoring is by central government. At the other end of the spectrum, both legislative and executive officials are selected locally, removal from office is controlled locally. Salaries are determined and paid locally from local government revenues. Local officials' performance is visible to local residents and accountability is directed toward the community and local constituents.

Severe mismatches frequently occur in the earlier stages of movement toward decentralization. Some strategies focus mainly on enhancing local revenues, and usually are quite successful initially. However, if attention is not given to effective and efficient service delivery, local residents become disillusioned and revenue generation becomes a problem. In the opposite case, local governments often are assigned large expenditure responsibilities by fiscally strapped central governments, but insufficient authority to raise revenues or to share in centrally collected revenues makes it impossible to meet those expenditure assignments.

Following are brief descriptions of decentralization strategies and experiences in a number of countries and regions, illustrating some of the variability along those three

dimensions. There are no pure types, and the somewhat simplistic illustration in the following figure only highlights the major differences.

## **4.2 Models Being Implemented in Various Countries**

The Western European and U.S. models of decentralization belie the common recommendation to establish clear division of responsibility and authority between central and lower levels of government. In the western industrialized countries there are complex patterns of service provision and revenue generation that have evolved from simpler forms in which central and local, or central, state and local governments have had clear-cut, distinguishable responsibilities. In part the complex arrangements have emerged as central governments have exercised their regulatory powers to impose public health and safety standards such as air and water pollution controls and equity standards such as social welfare policies. In the U.S., these issues are in ferment as state and local governments argue that they are burdened by a welter of unfunded mandates.

In the western industrialized countries, there typically are constitutional and/or statutory divisions of authority and responsibility between central and subnational levels of government, and there is considerable separation of revenue authority. Clear lines of accountability link local (or state and local) officials to their constituents. Electoral mechanisms are the primary means by

which local officials formally are held accountable, but local governments that many characterize as the best performing rely on frequent *performance reporting* to citizens in the form of city annual reports, performance measurement systems, and *customer satisfaction* surveys<sup>12</sup>

Some specific functions or responsibilities are the exclusive jurisdiction of one or another level of government, such as central government responsibility for national defense and subnational level responsibility for solid waste collection and disposal. Other functions or responsibilities may be shared among levels. For example, public health and safety may be shared roles among all levels of government. Considerable complexity characterizes western industrial countries' decentralization models. Local governments themselves have further decentralized their own functions by considerable involvement of the private sector. For example, local governments in the U.S. frequently exercise the responsibility for providing solid waste collection and disposal services by contracting with private firms for the actual production of such services.<sup>13</sup> Local governments in western industrialized countries rely primarily on their own revenue sources, especially the property tax, as opposed to significant revenue sharing or shares of common tax pools

Indonesia's Urban Sector Policy Statement assigns responsibility to local governments for all basic urban services delivery. However, at this stage in its decentralization program, the GOI has not yet given autonomous status to local governments. Most local government officials still consider themselves employees of central government, and many aspire to promotion "up and out" of local government. Their perception is governed by their being part of the civil service system; their pay and benefits are set by central government. Furthermore, central government pays all salaries for local government staff via a central grant for salaries (Subsidi Daerah Otonomi -- SDO) and routine expenditures. Even if a municipality concluded it could be more efficient with fewer employees, the municipality would not be able to convert the salary savings into any other kind of expenditure. Local governments in Indonesia are authorized to enter into long-term debt arrangements for infrastructure investments, and many cities and quasi-autonomous local water authorities successfully are managing capital investment and debt financing programs. Statutory assignment of the property tax to provincial and municipal governments has significantly increased own-source revenues. A key next element in granting further autonomy will be the reform of the central to local revenue transfer system. Local governments have little discretion over how they use central government grants and revenue transfers, and the central government has been very reluctant to give up its control over how these grants and transfers are used by local governments.

The Philippines has achieved one of the highest degrees of autonomy for local governments. Local mayors and councils have been elected since soon after the end of the Marcos regime. These officials, although some may have larger political ambitions, clearly see themselves as responsive to the local residents and electorate and do not consider themselves central in any respect. However, the local Treasurer, who is the chief financial officer responsible for both budget and tax

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<sup>12</sup> Osborn, David and Ted Gaebler, **Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector**, (New York: Penguin, 1993).

<sup>13</sup> Dillinger, **Decentralization and Its Implications**, p. 15. The disjunction between provision, which is the exercise of responsibility, and production, which is the actual means of service delivery, is due to Silverman, **Public Sector Decentralization**, p. 9.

administration, still is closely tied to the central Department of Finance. Financial management, therefore, is still controlled to some extent by central government. The Local Government Code (1991) for the Philippines provides for extensive reassignment of responsibility to local government units, ensures local selection of local officials, and provides for a system of shared taxes and the authority of LGUs to establish and collect local taxes and charges. While there are many local governments that are not performing well, there are many larger cities and smaller municipalities that have developed innovative and entrepreneurial programs for local economic development. Local governments can incur long-term debt for capital financing, and at least one city has issued its first municipal bond.

India has mixed strategy for urban development with some assigned responsibilities to local authorities, but retention of considerable control by state and central institutions.<sup>14</sup> As a federal state, India, like the United States, varies from state to state in the authority and responsibility exercised by local governments. In many states, local governments do not control, and have a difficult time influencing, state development agencies in the selection of capital investment programs, although the constitutional recognition of local governments requires state governments to develop policy instruments and mechanisms to enable local governments to carry out their new responsibilities. State finance commissions must be created as part of implementing the constitutional provision according legal status to local governments. These finance commissions must review and clarify the expenditure responsibilities local governments are to carry out and establish revenue mechanisms to ensure the fiscal capacity of local governments to meet their expenditure assignments.

The Eastern European model has involved considerable reassignment of spending responsibilities for functions previously never performed by local governments, including social welfare, housing, education and basic infrastructure services. However, central governments have retained considerable control over major tax resources, beggaring local governments' ability to carry out their new functions. The main financial assets actually transferred to local governments has been ownership of numerous enterprises which local governments hope to exploit as a revenue source, partly through sale of these assets and partly through operation as profit-generating enterprises.<sup>15</sup>

The Russian model, to date, has involved devolution of responsibilities for basic infrastructure services such as urban transport, streets, water, sewerage, waste collection and disposal, district heating, and social safety net services. Very little transfer of own source revenues that are under the sole, or even primary, jurisdiction of the local government. While considerable effort has been spent developing basic intergovernmental finance principles, little implementation progress has been made. The basic Russian "tax code" of the soviet era remains pretty much in effect, although considerable changes have occurred that affect the central government's revenue

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<sup>14</sup> Datta, Abhijit, "Decentralizing India's Urban Development," *Cities*, February, 1985, p. 73.

<sup>15</sup> Richard M. Bird, Robert D. Ebel, and Christine I. Wallich, **Decentralization of the Socialist State: Intergovernmental Finance in Transition Economies**, (Washington, D.C.: World Bank, 1995, p. x).

sources, especially with the value added tax. Shared taxation between the central government and regional (oblast) governments was and is the norm, with the tax code detailing the shares of various income based taxes. Oblast sharing with city governments and in turn city governments with districts (raions) has never been as formula driven as that between center and oblast. Hence, cities negotiate revenue shares with the oblast. This has tended to prevail throughout most of the former Soviet states including even larger newly independent states such as the Ukraine. City ownership and operation of public enterprises as a revenue source and as a key economic function is seen as the road to the future financial security of the city. Cities even make equity investments in newly established private ventures.

The classic southern African model of decentralization was a legacy of the colonial period. As the colonial powers relinquished control, they established systems to govern in the newly established nation-states. The British model created local authorities that did not depend for legal authority on central government. Governed by locally elected councils, local authorities had their own staff, would have their own sources of funds including a large portion from local direct taxes, and would be responsible for a wide range of services including typically primary education, health, secondary roads and sanitation.<sup>16</sup> Local councils quickly became politically marginal, however, as the new nation-states became heavily centralized and often dominated by the leadership for life, or until revolution threw them out, of the key independence figure.

In Malawi, local authorities have basic responsibilities for primary education, public health clinics, road maintenance, solid waste disposal, and civil records functions. In addition, local authorities operate on a more or less cost recovery basis public markets, slaughterhouses, and transit accommodations for travelers (mainly travelers from more rural areas bringing goods to market, visiting health clinics, or making purchases in the local town). Local authority councils are elected. Local authorities historically have not been responsible for larger public works and infrastructure services such as water and drainage, but in recent years the central government has been developing with donor assistance a more decentralized basis for urban public works services provision. Local authorities have tended to look on various ways markets and transit accommodations and other enterprise-like activities can be used to generate revenues for more general public purposes. However, inadequate separation of cost accounts for these enterprise activities has blinded many authorities into thinking the enterprises were operating at a profit, when in fact they typically are a drain on local authority finances. Malawi has not progressed far enough from the highly centrally controlled system that revolved around the "President for Life" to describe as a decentralization program under way.

Kenya has undertaken significant efforts to increase the authority and responsibility of local authorities. Numerous new local councils have been created in the last decade, and others have been upgraded to somewhat more autonomous status. Particularly important has been the recognition that local authorities play a key role in the economic development of their immediate region. Central government attention in their local authority strengthening programs especially is

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<sup>16</sup> Ostrom, Schroeder and Wynne, **Institutional Incentives and Sustainable Development**, p. 164, drawing from Philip Mawhood and Ken Davey, "Anglophone Africa," in Donald C. Rowat, ed., **International Handbook on Local Government Reorganization**, (Westport, Conn.: Greenwood Press, 1980), pp. 404-414.

being given to the functions towns and small urban centers can play as the marketing focal point for rural economic, mainly agricultural, activities and as a source of increased small scale production industries. Central government is addressing revenue adequacy by means of shared revenue sources -- mainly the agricultural cess -- and increased user charges. Central government retains control over the amount of the local authority share and over rate setting for user charges. Smoke has noted that Kenya has made progress with assuring local authorities a more predictable and robust revenue stream without simultaneously preparing local authorities for effective use of those revenues.<sup>17</sup>

Senegal, like most West African countries, has had a highly centralized system with strong controls over both the political system and economic production activities. Recognizing the need to decentralize somewhat in order to stimulate the economy, Senegal reassigned some responsibilities from central ministry offices in Dakar to regional offices and set up procedures for these regionally based offices to consult more with local institutions. New local governments have been created with some degree of functional autonomy and authority to raise revenues. Both a local executive (mayor) and the council are elected locally. However, for the larger regional municipalities that serve as capitals, central government appoints municipal administrators who have most of the executive functions. Specific functional responsibilities for local governments are not well defined, and as a consequence, whether or not the local government provides a service or provides it well varies from community to community. There are no service standards or performance measures to help evaluate the quality or quantity of local services. Central government retains control over local taxes, setting rates, and collecting revenue through local offices of the central Ministry of Finance. The limited decentralization thus far attempted has not made much of an impact on either civil society or the economy.<sup>18</sup>

In Central and South America, considerable deconcentration of central government agencies has occurred since the 1960s. A common model for division of authority and responsibility in the region has relied on a strong national planning agency which has the major responsibility for allocating central government capital infrastructure investments regionally. Regional or departmental development plans, developed by the regional or departmental office of the national planning ministry/agency, often have incorporated various mechanisms for local input in the form of lists of services and facilities desired, but the central government's hand exercised through the regional planning authorities has been the dominant force. Local government codes or statutes historically reflect the Spanish colonial period, typically assigning to local governments mainly civil functions such as birth, death and marriage registrations, other public record keeping functions, and maintenance of facilities built by central government agencies. Revenues have been carefully controlled by central governments. Decentralization in the form of allowing significant autonomy to local governments and significant revenue responsibility for the most part has occurred in the most

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<sup>17</sup> Paul J. Smoke, **Local Government Finance in Developing Countries: The Case of Kenya**. (New York: Oxford University Press, 1994), p. 172. This brief description of Kenya's program to strengthen local authorities is from Smoke.

<sup>18</sup> Rondinelli, Dennis and Henry P. Mims, Jr., "Administrative restructuring for economic adjustment: decentralization policy in Senegal," **International Review of Administrative Sciences**, 56(1990).

advanced economies, including Brazil, Chile, Colombia and Mexico. In these countries, local governments have been authorized to develop a significantly larger own-source revenue base and have authority to incur long-term debt for construction of capital facilities.

Each of these examples point to the principal constraint -- **the degree to which local government is, or is not, legally and perceptually the corporate entity responsible for the economic, social and administrative health of the local area**. To the extent that local officials consider themselves primarily responsible to the residents and institutions of the local area, and to the extent that there is clear assignment of authority and responsibility, local governments can manage more effectively than is true in most developing countries today.

## 5. Evaluating Decentralization Strategy Options

What lessons can be learned from experiences from different regions? Numerous issues are to be resolved in developing a decentralized system. The following subsections develop the most important issues based on the preceding discussion to serve as a kind of *checklist* to help structure dialogue on form and extent of decentralization.

### 5.1 Expenditure and Revenue Assignment

The literature on decentralization is unanimous in concluding that there must be basic agreement on which functions central government will continue to perform and which functions will be decentralized to subnational levels of government. The experience in many countries, however, suggests there is no single, correct assignment of functions. The big divide is over whether local government responsibilities should focus on what are often thought of as basic urban services -- solid waste collection and disposal, water, sanitation, streets, markets, transport terminals, mass transit (in large cities), public order, civil record keeping -- or whether in addition local governments should have important responsibility for education (at least primary education), health and social safety net services. However, it is clear that decentralized systems evolve from the simpler to the more complex.

In the previous section on **Decentralization Options** are several criteria for guiding expenditure. In a short, checklist form, these are:

Revenue assignment follows expenditure assignment. Wallich notes that in Russia, there is a *cart before the horse situation*. The most extensive work has been done with tax reform, developing legislation to delineate revenue shares and revenue authorities for each level of government. "The availability of revenue is dictating the distribution of responsibilities among the different levels of governments, rather than the other way around."<sup>19</sup> The first principle of revenue assignment, then, is that revenue authority must be consistent with expenditure responsibility. As noted in several of the individual country "model" discussions, this principle has not yet been followed. More specific

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<sup>19</sup>Wallich, Christine I., **Fiscal Decentralization: Intergovernmental Relations in Russia**, (Washington, D.C.: World Bank, 1992), p. 5.

### **Expenditure Assignment Guides**

1. Public goods that cannot be provided efficiently by the private sector such as public health regulation of sanitation and waste disposal and natural resource management such as control of use of ground water resources (characterized by non-excludability, non-divisibility, and unavoidability).
2. Natural monopolies like the utility services of water and sewerage.
3. Services whose benefits do not spill over beyond the local government's boundary
4. Politically salient services that if not provided by local governments could undermine political stability.
5. A sufficient number of visible services, including roles in settling disputes and other "negotiation" roles so that the local government is seen by residents as a source and locus of political authority

*Note: assigning responsibilities for services based on the checklist above does not automatically mean the local government is also the producer. Local governments may **provide** the service by contracting with private parties who **produce** the service.*

guides for revenue assignments include:

### **5.2 Accountability Mechanisms Affect the Incentive Structure of Local Officials**

Focusing on "assignment of responsibility and authority" alone will not ensure efficient and effective systems. Specific mechanisms also must be established by which officials and managers can be held accountable for their performance. Mechanisms can be both administrative and political.

### **5.3 Incentive Systems that Reward Performance of Local Officials**

As previous sections of the paper have argued, most local officials in developing countries do not view local government service in political, administrative and operational roles, as a viable career or as an end. In part this is due to an inadequate monetary reward structure and in part to the perception that local governments are merely administrative agents for implementing decisions made at a higher level of government. As long as central governments make the key decisions, and also determine the reward structure, the incentives are likely to remain insufficient to attract and retain quality local officials.

### **5.4 Visibility of Local Government Performance (results) to Local Residents**

## Revenue Assignment

1. Use beneficiary charges where the benefits of the service can be identified clearly with individual users. The greatest scope in most developing countries for improving local government revenues is to charge service beneficiaries for the costs of the service (water, solid waste collection and disposal, building inspections, permits for construction, etc.).
2. Where benefits of a service are primarily to improve general health and welfare, such as public health services which enhance income earning capacity, local governments need some access to income taxation. This usually is achieved not by authorizing local income taxes, but by central government either financing the service or transferring revenue to the local government. In the Philippines, the Internal Revenue Allotment is a shared tax (via transfer) that provides on a clear formula basis a stable, predictable revenue source to local governments to enable them to provide health and social services that benefit primarily residents' well being and future earnings capacity.
3. Where the benefits of a service primarily affect the value of private property, develop a property tax system and/or property betterment levies and similar mechanisms to capture the value added by local government services.
4. Use the intergovernmental transfer system on a formula basis (as with the Philippines IRA) to provide predictable revenues for local governments to provide those services the central government determines are efficiently provided locally but for which local governments cannot efficiently recover the costs through benefit/user charges, fees, and property taxes or charges.

Most citizens in developing countries think of central government institutions as the most important public sector influence on their daily lives. By and large, this is an accurate perception as the services that affect daily lives at least in urban areas still largely are controlled by central government institutions. Aside from the presence or absence of a service, there are very few visible indicators of the quality, quantity and cost of services. Even to the managers, central or local government, of basic urban services, there are very few indicators of quality, quantity and cost being collected and reported. The large increases in local revenue mobilization that have been observed in most countries when revenue mobilization programs are put into effect are achievable for only a short time if residents do not see a visible improvement in the quality or quantity of services, and a quality and quantity that matches demand for service.

While the presence or absence of a service, and severely poor quality are visible without any effort to publicize, more subtle results of local decisions to change the quality or quantity will not be visible, unless there is systematic communication of local government performance. Since local officials are accustomed to seeing their reporting relationship upward to central government, rather than downward to citizens or residents, overt communication strategies will be necessary to make local government performance visible to citizens. An example of an overt communication strategy

## Accountability Mechanisms

1. Electoral systems represent the ultimate democratic means of holding some public officials to account, but depend on an interested **and** informed electorate. The capability of citizens to change government leadership when dissatisfied with performance is the crux of political accountability, and electoral systems can accomplish that. However, they are only a means. Even in the absence of electoral systems, if local government officials respond to citizens demand and preferences, then they are accountable. Community groups and NGOs have proved capable of changing public sector officials, and they are most effective when targeting their pressure to local government officials.
2. Clear assignment of the specific responsibilities of managers and operations personnel means the organization structure and the organization of financial management systems make it clear who is responsible for the services and financial performance of specific departments or subdepartments. Clear responsibilities makes it possible to determine when performance is acceptable.
3. Performance measurement systems, important enough to be discussed shortly by themselves, can act as a *performance contract* between residents and local officials. Operational statements of the quantity and quality of output expected of departments and subdepartments, and hence of their managers, are the first step in establishing a performance measurement system. Further, accounting records that are sufficient to enable evaluation of the cost per unit and quality and quantity of service are necessary to use performance measurement as an accountability mechanism. By publicizing local government performance in terms of specific performance indicators, local officials can be held to account more easily.
4. *Peer* pressure from community groups and NGOs who monitor local government performance can be an effective mechanism to increase the accountability of local officials.
5. Publicity, both adverse and positive, can serve as an accountability mechanism.
6. Checks and balances, in the local government case typically achieved by a local chief executive and a separately elected legislative council is an effective accountability mechanism.

is the preparation of an "Annual Performance Report" that describes in language and charts accessible to most residents the basic features of revenues and expenditures, sources for those budget items, measures of the quantity and quality of services provided by local government, comparisons with previous years, and if assisted by central government, comparisons with other

## Incentive Systems

1. The primary incentive for local officials is the degree to which they feel they are able to make decisions independently and to affect the local community without interference from central government. Sufficiently clear scope for autonomous local decision making acts as a performance motivator.
2. Command of resources is a performance incentive. Local officials are more likely to view their work as important the more resources they control. In the U.S., the introduction of general revenue sharing in 1972 (lapsed in 1986) was followed by increased competition for local office as the availability of funds to carry out local projects increased. *There is a downside to command of resources in that the opportunity to use public resources for private gain increases -- see discussion of accountability mechanisms in the previous section.*
3. Salaries that are commensurate with the level and amount of responsibility, and that are comparable to central salaries for similar responsibility, are essential to maintain the incentive, and to discourage diverting public funds to private use. A national salary standard for local officials can have both positive and negative incentives. It helps prevent corruption in situations where local communities cannot exercise sufficient control over local officials. On the other hand, it discourages entrepreneurship and rewards mediocre performance the same as superb performance.

similar local governments.<sup>20</sup>

## 6. Conclusions

Material on decentralization as a result of the last decade's extensive efforts in perhaps a majority of developing countries to decentralize some elements of their systems is not lacking. At the outset of the paper, I identified public finance, political science, institutional economics and sociology approaches to decentralization. All have had their influence, often by serving as advisors to various governments considering or developing decentralization policies. Partly as a consequence of the activities of international assistance agencies and technical advisors, and partly through observation of other systems, decentralization programs thus have tended to focus on a few key elements:

- Getting the expenditure and revenue assignments *correct*, especially focusing on the intergovernmental fiscal system;
- Getting the political and administrative systems in place so that local governments have sufficient autonomy;

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<sup>20</sup> Hilton, Rita, Ronald W. Johnson, and Larry Schroeder, **Performance Indicators for the Local Government Sector**, (Washington, D.C.: World Bank, Urban Development Division, 1994).

- Getting incentives *right* so that individuals and institutions perform as expected and desired;
- Fostering community participation and encouraging NGOs to become involved in local government so that governmental systems adequately reflect citizen preferences.

As a consequence, this paper has focused on those elements in reviewing the literature and practice of decentralization. The least developed aspect of the literature and practice of decentralization is insufficient attention being paid to the role of the local government/city in regional economic development.

Part of the lack may be explained by some antipathy toward the role of government in promoting economic development. The specific role of infrastructure, some of which is in many countries a local responsibility, in promoting economic development has been well addressed.<sup>21</sup> But a more general perspective on the relationship between decentralization and local/regional economic development is still being shaped.

One element in that relationship is on the city as an economic actor in the global economy. Focus on that concept has for the most part been restricted to very large cities. Neal Peirce's **Citistates**<sup>22</sup> suggests that large metropolitan areas, which with few exceptions spill over any one single local government jurisdiction, increasingly are significant actors in the world economy. He argues that even more than nation states, large cities along with multinational corporations will be key actors in the global economy. The ability of any *citistate* to play that role successfully will depend on their ability to address three critical barriers:

- Socioeconomic imbalance (Peirce, writing about American cities, refers to the gap between wealthy suburbs and impoverished center cities) between the rich and the poor living in close proximity. In many developing countries it is in part wealthier urban neighborhoods and poor peri-urban areas;
- Physical sprawl, cities spreading out over large land areas creating environmental and economic weaknesses. Sprawl adds to the cost of facilities such as capital-intensive infrastructure, adds to environmental degradation by destroying forested areas and by increasing use of energy, and making economically viable exchanges within the urban area much more expensive;
- Ineffective governance. Problems spill over existing jurisdictional boundaries, especially the larger the urban area, but true even for small towns and surrounding villages. Attaining an "area-wide" perspective on governance issues and acting in

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<sup>21</sup> Schwartz, J. Brad and Ronald Johnson, **Maximizing the Economic Impact of Urban Water Supply and Sanitation Investments**, (U.S. Agency for International Development: Water and Sanitation for Health Project, 1991).

<sup>22</sup> Peirce, Neal R., Curtis W. Johnson and John Stuart Hall, **Citistates: How Urban America Can Prosper in a Competitive World**, (Washington, D.C.: Seven Locks Press, 1993).

concert across an entire local area regardless of the official jurisdictional boundaries is almost impossible.

Peirce's focus is the United States, and it is large urban areas. A somewhat similar theme, but more international in focus, is Kenichi Ohmae's **End of the Nation State**.<sup>23</sup> Ohmae argues that there are four reasons for the decline of the economic role of the nation state:

- The easy mobility of capital across national boundaries, with limited ability of governments to control that capital mobility;
- The increased ability of corporations to disperse management, production, marketing and sales to widely separate points on the globe;
- The increased ability of consumers to demand, and to satisfy demand, products tailored to their tastes and budgets; and
- The increasing access through communication technology to information.

These trends identified by Peirce and Ohmae are easier to relate to large cities, and more difficult to relate to countries with few or even no large urban agglomerations that are potentially serious economic actors on a global scale. But the elements are applicable to cities anywhere in the world, and some aspects seem applicable to even smaller cities and towns. While to relate these issues for smaller towns to their participation in the *global* economy may seem grandiose, the perspective that even a small urban area cannot effectively support and stimulate a local economy for its participation in the larger regional economy can impact on designing a decentralization program.

What are the implications for a decentralization program, especially in a limited economy? One element, missing in most of the decentralization literature and in the practice, is to consider the units to which authority and responsibility is to be decentralized as *natural economic and social entities* as opposed to thinking only of legal jurisdictions defined only by preexisting boundaries and other legal standards. For example, does it make sense to focus decentralization effort on a town or city whose official jurisdictional boundary encompasses perhaps only fifty to sixty percent of the population that interacts economically and socially on a frequent basis? Might it not make more sense to design a decentralization program that treats as a focal point towns/cities and their surrounding economic zone.<sup>24</sup>

The inset box on the following page suggests foci of activity for incorporating a local economic development focus in a decentralization strategy. These are not instead of the other elements of a decentralization strategy discussed throughout the paper, but are complements to help

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<sup>23</sup> Kenichi Ohmae, **The End of the Nation State: The Rise of Regional Economics, How New Engines of Prosperity are Reshaping Global Markets**, (New York: Free Press, 1995).

<sup>24</sup> Rondinelli, Dennis, **Secondary Cities in Developing Countries: Policies for Diffusing Urbanization**, (Beverly Hills, Calif.: Sage, 1983).

remedy a weakness in many decentralization programs. Some surprises might emerge from incorporating these additional elements. One could be the definition of what constitutes a *decentralized entity* to whom new authority and responsibility are to be devolved changes. Another could be the assignment of functional responsibilities that might otherwise have been left to central government. For example, Chile's decentralization program decentralizes functions that most developing countries have felt were critical national government responsibilities -- education and health. Some might argue that education is too vital to national economic development to be left to chance at the hands of local jurisdictions. However, Chile seems to have hit upon mechanisms that help finance education and help ensure its quality, while still devolving it to local administration. Initial evidence seems to be that local institutions feel they have a large stake in making sure that their local residents are well prepared to enter the workforce and to be competitive with other regions of the country.

While the subject of local economic development is not new, there is as yet limited linking between perspectives on local economic development and decentralization. The following insert is an initial outline of several additional activities that may be included in a decentralization strategy development that hopefully will generate experience and insights into this linkage.

#### **Elements of a Local Economic Development Component of Decentralization Strategy**

1. Decentralize to the level at which it is possible to influence the local economy as opposed to decentralizing automatically to a historically determined local jurisdiction that probably does not have authority over much of the local economic zone. One might accomplish this by defining the *local jurisdiction* as coterminous as possible with a natural economic and social zone. Identify economic exchange patterns, social exchange patterns, and attempt to establish an authority such as official town/city boundaries or a multi-town/village authority that can act for the economic and social zone. Other alternatives include developing incentives for several historically defined jurisdictions to act collectively in pursuit of economic and social goals that are appropriate for the local region.
2. Develop assistance strategies to these *new* local entities that help them identify their comparative economic advantages and their economic and human resource base that enables them to participate in the larger regional economy.
3. *Assign* authority and responsibility for functions to these *new* entities that can be managed locally, but more importantly are vital to these entities' ability to develop their economic viability.
4. Develop assistance strategies and incentives that help local officials recognize the linkages between how they perform their newly assigned functions and the economic viability of their *jurisdiction*. Concomitant strategies for working with community groups, informal organizations, NGOs and so forth to develop the same perspective.

# Annex A

# DECENTRALIZATION

<i>APPROACH</i>	<i>STRATEGIES</i>	<i>TOOLS</i>
None	<ul style="list-style-type: none"> <li>• Central command and control</li> </ul>	<ul style="list-style-type: none"> <li>• National laws</li> </ul>
Administrative	<ul style="list-style-type: none"> <li>• Create legal entity of city</li> <li>• Central government appoints local officials</li> <li>• Assign some functional responsibilities to local governments (such as O&amp;M of facilities built by central)</li> </ul>	<ul style="list-style-type: none"> <li>• Central direct construction of infrastructure</li> <li>• Central transfers to local for tightly controlled purposes (e.g. categorical grants)</li> </ul>
Financial	<ul style="list-style-type: none"> <li>• Local governments increase own source revenues</li> <li>• Local governments allowed some debt financing</li> </ul>	<ul style="list-style-type: none"> <li>• Revise central government transfers to allow more local discretion (e.g. block grants)</li> <li>• Local taxes, local authority to set rates and user charges</li> </ul>
Political and civil society	<ul style="list-style-type: none"> <li>• Local election of officials, but often still tied to national party slates</li> <li>• Independent local selection of candidates and local election</li> <li>• Increase number of actors participating in local government, local affairs</li> <li>• Greater local control over form and structure of local government, and the responsibilities performed by local government</li> <li>• Increase accountability of local officials to community</li> </ul>	<ul style="list-style-type: none"> <li>• Electoral reform</li> <li>• Encourage NGO's and other community groups' participation in local government</li> <li>• Encourage media reporting on local government issues</li> <li>• Local government increases civic education activities, publish the budget, prepare annual reports</li> <li>• Develop local government performance measures and make performance information available to media and public</li> </ul>
Economic development	<ul style="list-style-type: none"> <li>• Local government becomes a key actor in regional economic development</li> <li>• Seek competitive advantage, niches in the regional economy (global economy for large cities)</li> <li>• Economic development has higher priority than most other priorities</li> </ul>	<ul style="list-style-type: none"> <li>• Strategic planning</li> <li>• Local government working with business groups</li> <li>• Local governments establish collaborative relationships with surrounding other local governments, villages, communities</li> </ul>
Sustainability	<ul style="list-style-type: none"> <li>• Local government becomes key actor in environmental sustainability, participating in creating a balance between resource use/exploitation and resource renewal and conservation</li> <li>• Local remedies for environmental degradation, promote movement toward less resource intensive economic activities</li> </ul>	<ul style="list-style-type: none"> <li>• Increase operational efficiencies to reduce waste (e.g. reduce unaccounted for water)</li> <li>• Use incentives for private parties to reduce emissions, other pollutants</li> <li>• Assist private sector in identifying environmentally sustainable processes and practices</li> </ul>

The matrix describes five "phases" or stages in decentralization, preceded by "none" - or a completely centralized, command and control system. Following "none", column 1 lists five different "approaches" to decentralization -- administrative, financial, political and civil society, economic development and sustainability. Use of the terms phase or stage implies that countries go through these approaches in a strict sequence. That would exaggerate experience around the world. However, there is enough experience to suggest that some countries do start with fairly simple "administrative decentralization" in which local governments are given some formal status, the central government retains control over appointment of local officials, and some functional responsibilities are assigned to local governments, but the central government still retains control over most functions.

This administrative decentralization is often followed by a financial emphasis in which local governments are given greater authority to raise their own revenues and the emphasis is on increased revenue autonomy from central government.

The third phase is political and civil society reforms where greater local control over the selection and retention of local officials, increased citizen participation and so forth are emphasized. Some countries may even "stage" through various phases of political reform. For example some countries may introduce local election of mayors and councils, but only through inclusion of local officials on a national slate where citizens vote strictly for the party. A more decentralized and potentially more participatory reform is local selection of candidates and election of individuals independent of a national party slate.

The fourth phase is when local governments become much more recognized, and see themselves, as actors in their own regional (and in the case of very large cities, the global) economy. Local governments undertake focused economic development activities in this phase. Sometimes this economic development is the highest priority objective, without regard to environmental conditions and consequences.

The fifth phase we have labeled sustainability. The local government moves beyond a narrower definition of economic development and focuses on long-term sustainability, often involving a balance between exploitation of regional resources and replenishment strategies. Local governments also become more sensitive to operational efficiencies, decreased resource usage in delivering services, improved operation and maintenance is seen as important as additional capital works, and so forth.

Column two in brief fashion outlines the main strategies employed during each phase or decentralization stage, and the third column shows some of the tools used to implement the strategies.

The matrix should not be taken literally as a sequential phasing everyone has to go through. On the other hand, it is unlikely that local governments who have little autonomy in terms of selection and retention of local officials, little own-source revenues or control over revenues, or little room for active citizen participation could "jump" to being a key actor in local economic development, much less toward policies and practices that promote long-term sustainability. We are asserting in the matrix that each successive "stage" implies that most of the features of the

previous stages also are present. Of course, a decentralization program could undertake to incorporate simultaneously financial, political and civil society, and economic development aspects. We have not worked through all of this yet, but our judgement based on our experience is that going directly from a highly centralized system to one incorporating most of the features of financial, political and civil society, and economic development would have many more failures than successes among a country's local governments.