Decentralization of Public Finance: Centralizing Forces in Developing Countries

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Over the past few decades, a wealth of expectations and motivations have emerged from government decentralization in the Third World, most of which lie outside the mainstream justifications and expected results outlined in the public finance literature, which are more closely associated with decentralization in industrial countries. Political, social and economic development has become intimately entwined with strengthened local governments in the Third World.

Yet, as a whole, decentralization in developing countries has rarely lived up to its varied and often excessive expectations. What has often emerged is the actual increase in central power; the weakening of local government, a significant number of which have ended in bankruptcy and disarray; and the widespread illusion of public representation in government institutions. Empowered local government, however, does have a role to play in developing countries, which must be developed carefully.

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Part I
Introduction

Government decentralization has become a global phenomenon affecting countries from both the First and Third World. To all it has generally represented a means of improving government organization, fostering efficiency in local service delivery and encouraging an enhanced grassroots participation in government process. Yet, decentralization has come in a multitude of forms and has come to mean different things to the various people and institutions involved, particularly in the Third World, where issues of political, social and economic development have become intimately entwined with strengthened local government. In these countries, there has emerged a wealth of expectations and motivations supporting the implementation of a decentralized government system, most of which lie outside the mainstream justifications and expected results outlined in the public finance literature, which are more closely associated with decentralization in industrial countries.

Despite the optimism that decentralization has inspired in local government reform, significant obstacles remain in achieving the results expected in developing countries. Decentralization practices were influenced by and created in the context of the industrial nations, particularly in federal countries such as the United States. Thus, these reforms were based on the political, social and economic structures and norms of these societies. Yet, developing countries have experienced significantly different histories, many with civilizations dating back many thousands of years, in contrast both to industrial countries and even to each other. The institutions and norms that currently exist in these countries often blend together, although not always harmoniously, legacies from their ancestral civilizations and from their more recent colonial rulers. As such, many of the concepts, assumed present in industrial countries, simply do not exist in the Third World, with examples being consumer choice, willingness to pay and public participation in the government process.

Many of the reforms that have been implemented have not taken into consideration these differences. Other programs have recognized and tried to accommodate such differences, yet remain incompatible with decentralization. As a whole, decentralization in developing countries has rarely lived up to its varied and often excessive expectations. What has often emerged is the actual increase in central power; the weakening of local government, significant numbers of which have ended in bankruptcy and disarray; and the widespread illusion of public representation in governmental institutions.

So how does this bode for the future of decentralization in developing countries? Why does optimism for local government reform remain, despite the overwhelming evidence that decentralization is not achieving the results expected?

The first section of this paper will introduce a brief history of decentralization and the pendulum swings of interest it has followed. Part III steps back from decentralization in the Third World and explores decentralization from a public finance viewpoint, as developed in the industrial world context. The next two sections, Part IV and V, return to decentralization in developing countries with Part IV providing three diverse case studies from the continents of Africa, Asia and Latin America. Part IV also outlines the need for and benefits expected from decentralization in these countries. The last major section is Part V which attempts to provide an explanation for local government reforms in the developing world falling consistently short of expectations. The paper's findings are summarized in the concluding section, Part IV.

Part II
History

The roots of the fiscal federalism model stem from the United States evolution from a confederation of autonomous individual states in the 18th Century, each with powers protected from the central government of the time, to the more centralized, unified federation created by the 1788 Constitution (Musgrave 1984: 524). The United States Constitution created a system of multi-level government, which enumerated fiscal responsibilities and revenues to be divided, and in some cases subsequently re-divided, between the two top government levels defined: federal and state. The original division included exclusive Federal and State Powers as well as Concurrent Powers, the latter of which identifies powers that both levels of government can jointly exercise. The balance of power over these concurrent responsibilities has followed the pendulum-swing of political ideology, with judicial interpretation of the Constitution providing the medium between the current ideology and changes in the fiscal division.

The creation of the United States Constitution forming a single nation was a strong centralizing force for the American political scene, despite the 10th Amendment which deferred the powers not explicitly given to the federal government as reserved for the States (Dresang 1996: 46). The beginning of the 19th Century ushered in a period of diverging views over the role of the state between the Jefferson view, of a limited central government role, and the Federalist position, advocating a strengthened central role. The centralizing forces would remain dominant until the 1830's and the advent of Dual Federalism, which brought about a century of state supremacy. While the pendulum-swing had already begun to make its way back along the path, it wasn't until the Depression that the balance of power returned to the federal government, beginning a period of Cooperative Federalism. Cooperative Federalism encompassed the post depression era, the Second World War and the emergence of the welfare state, and led into the most recent period of centralization in the United States, Centralized Federalism. The 1980's, New Federalism and the Reagan presidency brought about the current era of state and local government strength, shifting the pendulum in favor of the subnational government levels (Musgrave 1984: 524-5, Dresang 1996:50-55). One of Reagan's legacies was the devolution of many federal functions to both the state and local level. Essential to the decentralization process was the significant replacement of conditional grants with revenue sharing.

Clearly the pendulum-swing has been a regular and an extended process defining the government division of powers. While this process for the United States has been in motion for over two hundred years, two characteristics about this swing are evident in recent global history. The first is that these swings are becoming more frequent over time in the United States and in other Western countries. The second, and more important to this study, are the changes in developing countries since 1950. Decentralization and modern local government, and thus the associated swings in forces, are recent phenomena, dating back only to the beginning of independence for the Third World. The pace and effect of the pendulum-swings in these countries have been far more rapid and traumatic than those experienced in the United States.

Modern local government in many developing countries has roots that extend prior to independence. Western style local government was introduced by the British and French into their colonies, mainly because, firstly, these developing economies were expected and encouraged to develop along a similar path to their colonial home countries (Hicks 1961:4). And secondly, local government was often used as a tool for colonially imposed control and to educate the native people on the practices of the colonial government (Smoke 1994:61). Local government generally, however, functioned with little to no fiscal responsibilities or resources. So, despite the previous presence of local governments, it was not until the 1950's and 1960's, with the independence of many developing countries, that the division of government powers became significant and a subsequent topic of debate. Thus began the first of the two surges (to date) of decentralization in the Third World (Conyers 1983:98). The second period was to reoccur in the 1970's and 1980's.

The first surge of decentralization began in the 1950's, in the last few years prior to and after the independence of many Third World nations from their colonial powers. While local government structures had been introduced and remained in rudimentary forms in these nations before independence, these newly formed nation-states were frequently faulted for their seeming lack of democratic process. Local government reforms were thus seen as not only a necessary component of a democratic government, but also as a practical method for these newly independent nations to appear more willing than their colonial predecessors to accept democratic, participatory government systems (Conyers 1984:99). The devolution of government powers also allowed the transfer of fiscal burdens from the central to the local level. The reforms that were being implemented at the time were being modeled directly from the decentralization programs and practices in the West.

A resurgence of decentralization occurred in the 1970's and 1980's, but only after the inevitable period of back-swing towards centralization. After the initial years of decentralization in the independent Third World, support for local government began to wane as the central government absorbed an increasing share of power (Mawhood 1983:8). Justification for the return to centralized government was based on the belief that central government decision-making was the key to rapid socio-economic change, and in counteracting the regionalism and ethnic separation prevalent within these often historically artificial nations (Mawhood 1983:6). The results, however, were generally unsatisfactory, falling far short of expectations. The centralist state began to be viewed as an erosive process for economic, political and social development and large scale centralized development plans were rapidly abandoned.

The results to date have been mixed, yet since the 1970's increasing numbers of developing countries have implemented some form of decentralization. The strengthening of local government authority has been advocated as a prerequisite for development. Motivations for this period of local attention have some similarities to the first surge: the downloading of central responsibilities, the desire to enhance democracy and participatory government process. Additional features for this period also exist, with the rationales and expectations, the players and the forms decentralization have taken being considerably more diversified in this latest decentralist period (Conyers 1983:98-101).

To begin with, the relationship between decentralization and national development has changed. Programs now focus on strengthening the role of local government process, rather than the central government as previously, which is believed necessary to enhance the effectiveness of national-level development programs (Conyers 1983:99).

Local democracy, a main objective of the previous decentralist period, remains intact for this recent period. The objective, however, is augmented, going beyond the desire to cater to local needs and elicit local support. In this more recent decentralization surge, direct local participation in the decision-making process of local policies is being aspired to (Conyers 1983:100).

A recent report lists four frequently mentioned major objectives of decentralization (OECD 1995:7):

1. To improve democracy and political equity;
2. To improve management efficiency;
3. To improve financial performance through increased revenue generation and rational expenditure decisions and;
4. To provide a better environment for private enterprise and responsiveness to local needs.

The expectations being placed on decentralization clearly have evolved beyond the simple improvement in quality and public responsiveness of urban service delivery.

The players in this second round are also more diverse. One of the points highlighted in the paper will be the fact that the real push behind decentralization, in many of these countries, has been from 'outsiders'—international development agencies, western aid donors and academia. These institutions are playing a considerably more involved role than previously (Conyers 1983:100). Donors, in particular, have become more involved and interested in implementing decentralization in developing countries since the mid-1970's (OECD 1995:31). The public themselves tend also to be more involved. While the track record to date is split, more decentralization movements are now being driven from 'below' (the general public) rather than simply from 'above' (or the implementation from the central government) as had been prevalent in the 1950's and 1960's (Conyers 1983:100). In general, public involvement in the government process has become more effective and widespread than previously.

The types of decentralization discussed and evident in the first swing towards decentralization concentrated on devolution and deconcentration. Devolution is the stronger form of decentralization and describes a clear division between the central and subcentral levels of government, with autonomous decision-making powers being transferred from the central to subcentral level. Deconcentration is the weaker form of decentralization where administrative tasks are transferred from the central government to local offices. Local government, under deconcentration, is not a separate entity, but a branch of the central government, with decision-making power remaining in the hands of the central government. The field offices are responsible for only the implementation aspect of public services. In contrast, under devolution, the separate local entities are also responsible, in addition to the implementation of services, for the political, or allocation, decisions involved.

In the recent period of decentralization, it was recognized that these two categories were not adequate to cover the range of variation in decentralization that had emerged. Versions identified of late include both deconcentration and devolution, in addition to delegation—or the transfer of central power to public corporations and other organizations that are only indirectly controlled by the central government—and privatization—or the transfer of government service provision to private entities (Rondinelli 1984:15). Rondinelli (1986) also further classifies deconcentration into field administration—where local decisions are transferred to field officials which are branches of the central government—and local administrations—where the local units of government are separate branches of government, but are under central control.

In the case of the developing countries, it is rare that central government involvement, in some form, is not part of local government decision making, regardless of the reforms implemented. Thus, true cases of devolution in the Third World, in intention and practice, are rare. In response, devolution in developing countries tends to be held up against less stringent requirements. If the local government unit still commands political and administrative discretion over urban service provision, but remains subject to central government supervision and financial controls, it is often still considered a form of devolution of government (Rondinelli 1986:137-9).

The following section of the paper takes a step back from the history of decentralization in the Third World and into the fiscal decentralization theory, underpinning and exploring the interest that has emerged in decentralized government systems.

Part III

Theory

In almost all political systems in the developed and developing world, the financing and expenditure responsibilities of subnational levels of government has become a critical political issue. While some countries have witnessed a growth in national control over government responsibilities, others are developing a more involved and autonomous role for lower levels of government.

The purpose of Part III is to examine the economic rationale for assigning certain government functions to certain levels of government, and the ability of each government level to finance these assigned responsibilities. There are certainly many factors that have accumulated into the current division of these responsibilities, including political, social and economic, of which the latter will be considered in isolation to the others in this section.

The section is broken down into two categories. The first category outlines the economic case for assigning expenditure responsibilities between the central and subcentral government levels. This subsection will provide the basic theoretical arguments, under the theory of social goods, of why government is involved in the provision of goods and services (rather than the private sector). This is followed by the arguments for and against central or subcentral provision. The last part of this category will be devoted to the analysis of optimal jurisdiction size. For each government-provided good or service, there will be an optimum theoretical size, determining the most efficient level of provision. This section will be explored in considerable detail as it is in the provision of goods and services that the main justification for decentralization of decision-making is found.

The second category examines the financial side of multi-level finance. The first part of the subsection concerns the generation of own-source revenue by each level of government. The analysis of which taxes are most appropriate at the local level will go beyond the general criteria of whether a tax, at any given level, is a good tax. There is, in fact, as the study will indicate, no tax that can fully satisfy the criteria of a good local tax at this level. The central government retains the distinct advantage in taxation responsibility, which is reflected in its dominance of tax revenue generation in practice. Yet, to create a sustainable decentralized allocation system, local governments require funds to fulfil their responsibilities.

The second part of this subsection explores the transfer of funds from the central government level to lower government levels. Such transfers exist in most government systems and are becoming an increasingly debated issue. Intergovernmental grants are a necessary component of a decentralized government system. Not only are they able to provide needed funds at the subcentral level, they also alleviate many of the efficiency and equity concerns associated with a decentralized finance system.

The Economic Case for Decentralization

The Economist's Definition of Decentralization

As defined by Harry Wolman (1990), "..to centralize is to concentrate by placing power and authority in a centre, while to decentralize is to disperse or distribute power from the centre." Wolman further categorizes several kinds of centralization/decentralization phenomenon: (a) political, in regards to policy decision-making; (b) administrative, in reference to administrative discretion; and (c) economic, relating to the location of economic decisions (whether in the hands of the public or private sector).

As with Wolman's paper, the focus of this section will be on political decentralization and the analysis of decision-making divisions among the different levels of government. Under such a classification, political power is centralized if the central, or national, level of government makes the substantial share of policy decisions. A system is classified as decentralized if such decision-making power lies with the local level of government (in this section, local government is used loosely, referring to any level of subnational government). Most of today's governmental systems are unable to claim pure centralized or decentralized power. Rather, each system can be regarded as lying somewhere between the two extremes of pure centralization or decentralization.

Wolman also notes an important distinction worthy of note. Decentralization should not be confused with or equated to a federal system. Equivalently, nor is centralization the same as a unitary system. To clarify the point, one should recognize that Australia is a federal country that is characterized by a dominant central government, while countries like Sweden can have a relatively strong system of local governments, yet a unitary form of government. In general, federal countries do tend to be characterized by a more decentralized government structure than unified political systems.

This section delves into understanding the economic reasons for the placement of greater fiscal responsibility at the local level. So while there may be a clear political distinction between a system in which local governments have a written constitution protecting their autonomy (a federal system) and the case of local governments with only centrally approved devolved power (a unitary system), this division will not be relevant from the economist's perspective. As, according to Oates (1972), "[i]t makes little difference to the economist whether or not decision-making at a particular level of government is based on delegated or constitutionally guaranteed authority." What is important to the economist is whether the local government is able to provide differing levels of services from the neighboring communities based on public preferences.

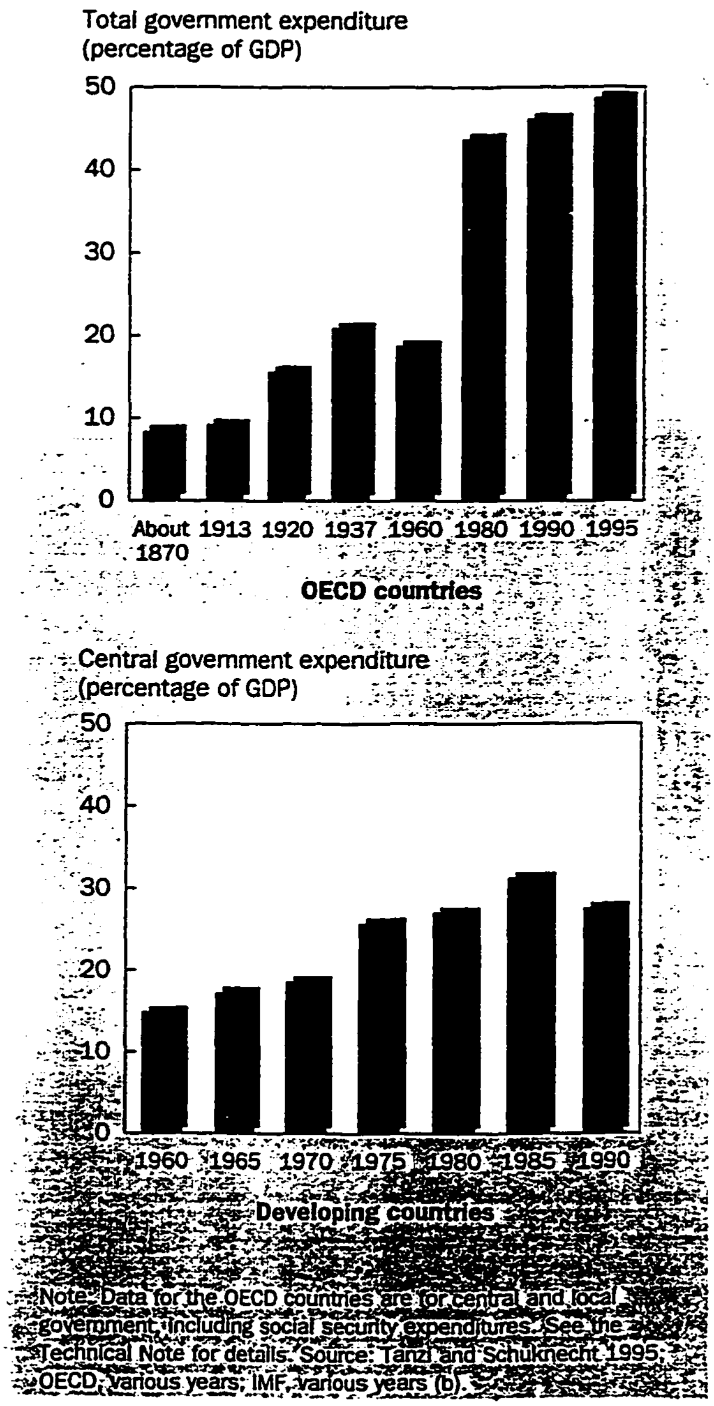
A difference that *is* important to an economist is that between decentralization and deconcentration. Where as decentralization implies decision-making that is *independent* of the central level of authority, deconcentration is merely the transfer of administrative responsibility from higher level government unit to a lower level unit, without the transfer of decision-making power (Moyer 1957:56-61). This, in fact, explains the difference between Wolman's category (a) and category (b). In reference to fiscal decentralization in the developing world, the distinction between category (a) and (b) is important, with few governments in the Third World achieving political decentralization (or devolution).

The Theory of Social Goods and the Allocation Function of Government

History has traced what has been a phenomenal growth of government in the last century, particularly since the Second World War, the emergence of Keynesian Economics and the Welfare State (Figure III-1 reveals the growth of the state in terms of expenditure). As noted by Nutter (1978), "[w]herever governments were once small they have become bigger. Nothing is so rare as a shrinking government", to the extent that today government activity influences almost all sectors of the economy.

Figure III-1

The Growth of State



Source: World Bank 1997:2

From an economic point of view, the existence of government within a nation's economy is due to the inability of the market mechanism to perform all of the economic functions required of it. This inability can be ascribed to such conditions as (Musgrave 1987:4-5):

- The distribution of incomes within a society not conforming to the values of the society;
- The levels of employment, price stability and economic growth not meeting a set of societal norms; and
- Market failure due to the lack or prohibitively high cost of information, obstacles to free entry, natural (decreasing cost) monopolies, externalities and the underprovision of merit goods.

The role that the government plays in an economy can be broken down into three major functions, which respond to these market failures.

- *Stabilization Function*: To maintain the economy at high levels of employment with relative price stability
- *Distribution Function*: To create an equitable distribution of society's income
- *Allocation Function*: To efficiently use resources within an economy

As will be shown, the most important function to be considered in the study of local government is the allocation function.

Most goods provided within an economy can be classified as private goods: goods that exhibit rivalry in consumption and the attribute of excludability. With the absence of market failure, the private market is able to allocate societal resources efficiently in regards to these privately consumed goods. In direct contrast, a pure social good is one that is characterized by non-rivalry in consumption and non-excludability. Such goods create a source of market failure that causes market operations to be unable to efficiently allocate society's resources. The reason for the market failure lies in these attributes of non-rivalry and non-excludability.

Non-rivalry in consumption is exhibited when an individual's consumption of a good does not reduce the amount of benefits other individuals can derive from their consumption of the same good. This implies that the marginal cost of an additional user of the good is zero; for once the good has been provided, additional consumers will not alter the absolute cost of providing to any level of extra demand. Non-excludability is present in a good when, once it is provided, no individual or groups of individuals can be excluded from the benefits of its consumption.

Goods can exhibit one, none, or both of these characteristics, the combinations of which are displayed in Figure III-2. Well-used examples of a public good that exhibits both non-rival and non-excludable features are national defence, lighthouses, and streetlights. Public goods can also be categorized as non-rival with excludability. An example being cable television. Additional consumers will not affect the benefits derived by existing users of the good, yet the producers of cable television are able to exclude certain individuals by requiring the purchase of special equipment to receive the transmission. Examples of public goods that are rival yet which are unable to exclude consumers are city streets, public parks or beaches. These goods can be considered as rival in consumption because, after a certain point, congestion will reduce the amount of benefit consumers can derive from their use with each additional consumer. While exclusion in these cases may be technically feasible, usually it will be prohibitively expensive to do so.

Figure III-2

Public and Private Goods

	Excludable	**Non-Excludable**
Rival	***Pure Private Good*** Clothing, Food, Etc.	***Common Property Good*** City Streets, Public Parks, Beaches.
Non-Rival	***Club Good*** Cable Television, Toll Roads.	***Pure Public Goods*** National Defence, Lighthouses, Streetlights.

Market failure is present in all three of these cases. With non-rival but excludable public goods, market failure is due to the unique cost structure. Initial provision of the good is not free, but once provided, with each additional user there is a zero marginal cost. Yet, as individuals can be excluded, user costs are applied to recover the cost of provision. This causes an inefficiency as, first, the user price is not equated to the marginal cost (which, in this case, is zero). Second, by placing a cost on the use of the good, this is discouraging the optimal use of the good, for once the good is provided, scarce resources have been utilized and it is best to make full use of these resources.

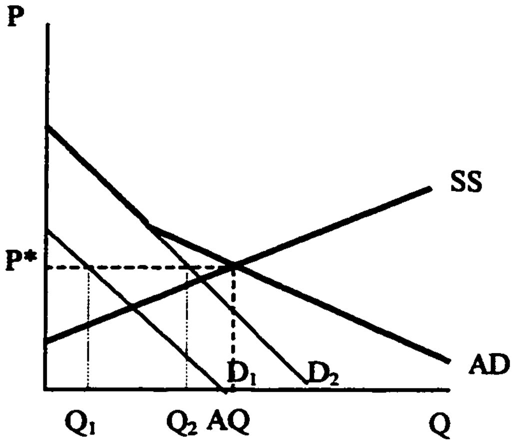
In the case of a rival but non-excludable good, market failure is present due to the "free rider" problem inherent in the non-excludability characteristic. As individuals cannot be excluded once the good is provided, each individual has an incentive to derive benefits from the good, while underestimating the value of the benefit. This will result in an unstable situation because, as each individual attempts to free ride, there will not be enough "declared" demand to provide the good (Musgrave 1987:44-45). This results because, in the provision of social goods, individuals are assumed to reveal their true valuation for the good. From this, individual valuations for the community are summed up for each level of provision to create an aggregate demand curve. Optimal provision is then found by equating this aggregated demand curve with the supply schedule.

This derivation of the optimal provision solution is similar to that of a private good, with the difference in the method of aggregating the demand curve. For a private good, summation is of a horizontal nature: for any given price, what is the total amount of good demanded from all individuals? The answer lies in the summation of each individual's demand at that price ($Q_1 + Q_2 = AQ$) (see Figure III-3). For a social good, due to its non-rival nature, once provided, all consumption is identical (e.g. national defence). Yet, individual valuations of a unit's consumption will differ depending on individual preferences. Vertical summation is required to find the community valuation for each level of public good provision ($P_1 + P_2 = AP$). This is where the free rider problem enters. Each individual has an incentive to undervalue the benefit they receive from each unit of public good provision. Thus, the aggregate demand curve is underestimated and results in an inefficient (under) provision of the good (Musgrave 1987:46-47). If the providers of the good are able to ascertain each individual's true valuation, or benefit from an amount provided, then an efficient amount of the good can be provided, with each individual paying a price corresponding to his/her marginal benefit.

So how does the public sector ascertain the true valuation of socially provided goods within a community? In the private market process, an individual's true value of a good is revealed through the price system. If the price is too high, an individual will simply not pay for the product. Such a process is absent for social goods due to their unique nature (as outlined above). And if individuals were required to volunteer this information there will be an incentive to undervalue the benefits received. Government officials are thus left to approximate public demand for public goods, with varying degrees of success.

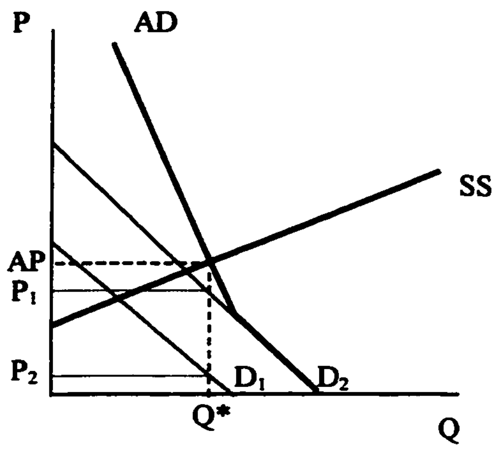
Figure III-3

Summation of Private and Social Goods



Private Good

Efficiency requires equality of marginal benefit derived by each individual with marginal cost



Social Good

Marginal benefit derived by the two consumers differ and it is the sum of the marginal benefit that should equal marginal cost

In a democratic society elected government officials make public allocation decisions. This electoral process has been viewed as a (albeit) crude but workable approximation to the optimal public goods allocation problem. Voters will choose their elected officials based on promises of tax rates and budget allocations. This is an important notion to the theory of local government service provision and will be explored further.

The Case for Centralized State versus Decentralized State

To help understand the potential benefits of decentralization, two extremes are analyzed. The first is a purely centralized government system, in which all decision-making power resides at the central level, the advantages of which will be examined below. The alternative case is a highly decentralized state in which such power resides solely in the hands of local governments. The advantages of this extreme will follow in the next section. To facilitate the analysis, government functions will be broken down into their three main categories (stabilizing, distributive and allocative).

The Case for a Centralized State

The Stabilization Function: In terms of monetary policy, the main stabilizing tool of government is the control of the economy's money supply. In all countries, this tool is left solely in the hands of the central government. If such a tool were the responsibility of the local governments, each locality would have an incentive to print money to be used to purchase goods from neighboring communities. The result of this would be price instability within the community.

A second rationale for central control over stabilizing policies is related to the open nature of local economies. While barriers to international trade have reduced significantly, trade within nations still remains less hindered than trade between nations. This ease in national trade results in the high marginal propensity of local consumers to import from other localities. Thus localities will be unable to contain any multiplier benefits from government tax cuts or budget increase (both of which are usual stabilizing tools) within their borders (Oates 1972:5).

Debt finance is another tool often used by governments for stabilization purposes. Within a small community, debt funds will usually accrue mostly from external sources, which tends to reduce the wealth of the community when the debt is paid back. Central governments are less likely to incur this problem, as their debts have a higher tendency to be internal, keeping the wealth of repaid debt inside the border.

A fourth motivation is drawn from the cyclical movements in the economy, which tend to be on a national scale and are considered best counteracted at the national level. If left to the subnational level, due to the high degree of interdependence between communities, most sub-national policies to improve their macroeconomy tend to become "beggar-thy-neighbor" in character. That is, policies that attempt to increase real income or to encourage industry relocation into their jurisdiction will be counteracted by reductions in neighboring communities (Oates 1968:44).

The Distribution Function: Due to the mobility of households and firms within a national economy, a program that has a more egalitarian distribution of wealth from the rich to the poor in a single community will cause an emigration of the wealthy and immigration of the poor. This will discourage measures to assist the poor, as communities will naturally prefer not to lower the aggregate level of income of the community. Thus, as with the stabilization function, due to the mobility across national borders usually being more constrained than that within the nation, an income redistribution program will have a greater chance of success if coordinated at the central level (Oates 1972:6-8).

This mobility also applies to capital. Local governments are constrained in the tax measures and regulation that they can adopt with regard to capital without risking capital flight to neighboring communities (Oates 1968:45-46).

Another socially desirable distribution of income concerns the equal treatment of equals (or horizontal equity) within a society. By equals, this refers to individuals with equivalent income levels. And by equal treatment, this is with regards to the level of public services provided and the tax rate charged for such services. The desire to achieve horizontal equity cannot be achieved without intervention by the central government. To provide for the same level of public services, each community must generate a certain amount of tax revenue. As communities will generally have both size and income level differences, uniform tax rates will generate varying levels of total tax income. Thus, like communities (in terms of income) will be unable to provide identical services at identical tax rates without coordination or provision by the central government. This intervention by the central government will usually come in the form of equalizing grants from the national to the sub-national levels of government, which are relatively larger per capita for poorer jurisdictions (Oates 1968:46-47). As commented by Oates (1968), "..the achievement of horizontal equity in a federal system implies either intercommunity transfers or a discriminating central government income tax", the latter of which is generally socially unacceptable.

The Allocation Function: The benefit of a centralized provision of public goods and services is evident when considering those goods and services which benefit *all* individuals within the nation. With decentralized provision, there will tend to be an underprovision of such goods and services as the benefits will accrue to a larger population than the community providing the good, yet these benefits will generally be ignored. The economically efficient provision (where the marginal benefit equals the marginal cost) can result only when the marginal benefits of all individuals in the nation are accounted for. Thus public goods and services which result in significant nation-wide benefits should be centrally provided (Oates 1972: 8-10).

Goods and services that provide geographically limited benefits may also benefit from centralized intervention if spillover effects are present. In the case of spillover benefits which fall onto neighboring communities (an example being the benefits from an air purification project), a sub-optimal (under) provision of the good results. With the existence of spillover costs, where taxes are levied on non-residents of a community (an example being a hotel tax), the provision of the good will tend to be greater than the efficient level (if corresponding spillover benefits are not present). Thus, there is a role for the central government to play in the readjustment of true marginal costs or marginal benefits through subsidies or taxes, where appropriate (Oates 1968: 51) (King 1984:24).

As with the distributive branch of government there exists a need for central intervention over the issue of tax variations across sub-national levels of government as such variations effect service levels. Due to the mobility of production and resources, inefficiencies arise when taxes vary within the nation. This results in an inefficient distribution of resources due to incentives to chose locations based on tax differentials rather than other comparative advantages (Oates 1968:52) (King 1984:24-25)

Additional considerations arise in the form of administrative inexperience and economies of scale. Local levels of government may lack experience in providing services to their constituents, resulting in a higher cost of provision. The lack of economies of scale in the provision of these services at the local level will also cause the cost of provision to rise. With numerous local governments providing certain services, the increase in costs (over a single centralized provision) can be more costly than the welfare gains made from decentralized provision. Central provision may be better able to capture such economies resulting in a more efficient pricing of the service (King 1984:27).

Clearly there is a significant role for the centralized government to play in the nation's economy. As will be further emphasized in the analysis of decentralized states, this role is most evident in the stabilization and distribution branches of government activity. There is, however, a role for local government to play, which is most economically justified in the allocative branch of government.

The Case for a Decentralized State

The Stabilization Function and The Distribution Function: There is minimal support for any active sub-national government role in the stabilization and distribution functions of the economy. Due to problems of open economies and high intercommunity mobility of economic resources (labor and capital) at the local level, local governments will have difficulty in fulfilling the mandate of economic stability and a socially just income distribution.

Oates (1990) notes two articles arguing for local level involvement in these two branches of government activity. In an article by Edward Gramlich (1987) a case is made for local government activity in the stabilization role through the saving of government funds in booms, to be used in times of financial need. In addition, there is also an argument for satisfying the varying preferences for stabilization policy among communities. As outlined by King (1984), different communities may have different levels of willingness to curb inflation and increase employment. However, the side effects from allowing local government control of stabilizing tools will tend to outweigh any such benefits. In terms of distribution, Mark Pauly (1973) highlights the evidence that individuals tend to be more concerned over the welfare of the poor within their own community, disputing the claim that welfare programs are a national public good (i.e.: with benefits to all in the nation). This means that the rich will mainly derive benefits from redistributing income to the poor within their own community rather than to the nation as a whole.

However, there is little support for local government involvement in these two functions beyond that of a cooperative nature within national government directives. As such, despite a few arguments for local government autonomy, tools for the stabilization of the economy and redistribution of income are left almost entirely in central government hands.

The Allocation Function: The primary rationale for the decentralization of government decision-making lies in the theory of public good provision. It has already been stated that public goods which exhibit benefits of a nation-wide nature justify central provision because, once provided, an identical amount of the good is received by all.

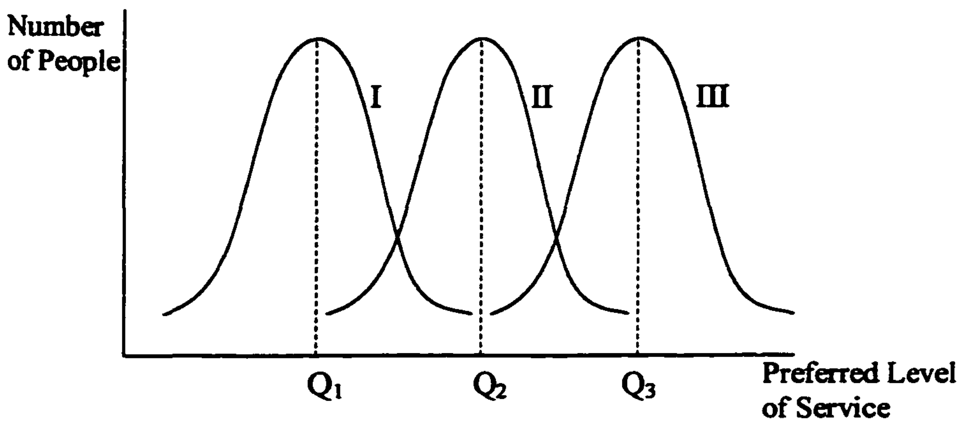
Yet, such geographically extensive benefits do not hold for all goods and services provided by the government. Many public goods, in fact, exhibit a limited geographical range to which their benefits accrue. While central allocation for geographically constrained goods can occur, this will result in a uniform level of provision across all subcentral jurisdictions. It is assumed that a central government that does provide varying levels of public goods to different localities acts as a decentralized power in economic terms and is thus treated as such for the analysis (Oates 1972:37).

If the tastes of all citizens nation-wide were identical, then centralized provision would be an adequate method of allocation. Central allocation, however, will not be efficient if preferences for public service packages differ. Efficiency gains can be realized by decentralizing provision if this satisfies the varying tastes of different groups of public consumers.

In Figure III-4, if I, II, and III represent three different communities, with clearly differentiating tastes for a particular public good, central provision will result in a service level approximating Q_2, the preference of the national median voter. With localized provision, each community can satisfy their own median voters' preference of Q_1, Q_2, and Q_3, respectively (King 1984:21).

Figure III-4

Preferences and Provision



Such gains are enhanced by individual mobility between communities as outlined in Charles Tiebout's classic 1956 article. The model he developed, while overly simplified, hypothesizes a network of diverse communities that offer varying levels of public goods, services and taxes. With the possibility, and ease, of individual mobility, consumers are able to 'vote with their feet', that is, to reveal individual preferences for a particular tax and expenditure package through the choice of residence between these competing communities. Thus the efficient allocation of public goods is assisted by the ability of individuals to choose. This solution to the allocation problem parallels that found in the private goods markets.

Another justification for placing the allocation of certain public goods in local government hands is the greater level of innovation, experimentation and competitive behavior likely to arise from the existence of competing local governments. The pressure to provide an attractive service package with a minimized tax rate will encourage and induce local governments to achieve more efficient modes of provision. Such incentives are less likely to appear with a single central unit of government providing all public goods and services (Oates 1972:12-13).

Greater efficiency may also be achieved through decentralization as it is felt that costs will be more directly linked to corresponding benefits at the local level. Such a link should result in a greater visibility of taxes at the local level and taxpayers being more critical of approving public budget expansions as the costs of the program are explicitly stated. With central government projects, even if the benefits are isolated to a single community, the funds are distributed nationwide, and thus the portion that each individual in the benefiting community will pay will be fairly negligible compared to the contribution if the same project is funded purely at the local level. Thus, there will be less incentive to limit unnecessary (that is, when marginal cost remains greater than marginal benefit) budget expansions if centrally provided (Oates 1972:13).

The main justification, however, for decentralized provision is in the increase in efficiency through the detection and satisfaction of consumer preferences. Centralized provision will result in a uniform provision and welfare loss (if preferences do, in fact, vary). The extent of this welfare loss is explored below.

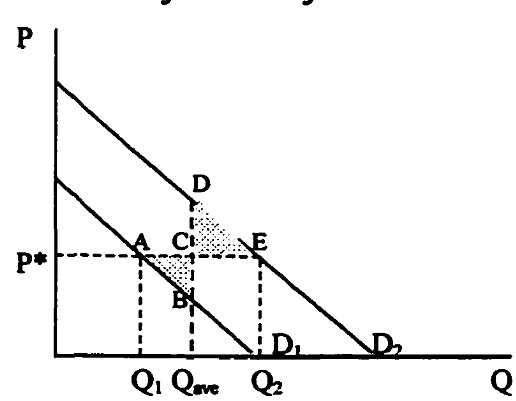
Welfare Gains from Decentralized State

Clearly, decentralized provision of geographically constrained services tailored to local preferences can enhance the well being of consumers with geographically varying preferences as compared with centralized provision resulting in uniform levels of services across all jurisdictions (Oates 1982:477).

To visualize this welfare gain from decentralized decision-making we use the example of one public good provided in two localities and the examination of consumer surplus, as depicted in Figure III-5. Within each location, demand for the particular good is identical, while the demand between the locations varies: location 1 demands Q_1 of the good at price P, and Q_2 is demanded by location 2. In this figure, price P* is the per capita cost of providing the good, assumed to apply regardless if centrally or locally provided. If this good were centrally provided, the government would provide a uniform level of the public good to all localities. The central government will choose, likely, a level of provision between Q_1 and Q_2, say Q_{ave}, similar to the decision in Figure III-3.

Figure III-5

Welfare Gain from Decentralization



If provision were decentralized, each locality would provide that amount corresponding to location demand. This would increase welfare in location 1, by the amount of ABC as there would no longer be an excess tax burden resulting from the centralized overprovision of the good. A welfare benefit to location 2 will also occur as the good will no longer be underprovided according to the location's preference (Oates 1977:9-10). It is this gain in welfare from satisfying individual preferences, and thus increasing consumer welfare, that is the main premise for decentralizing decision-making authority.

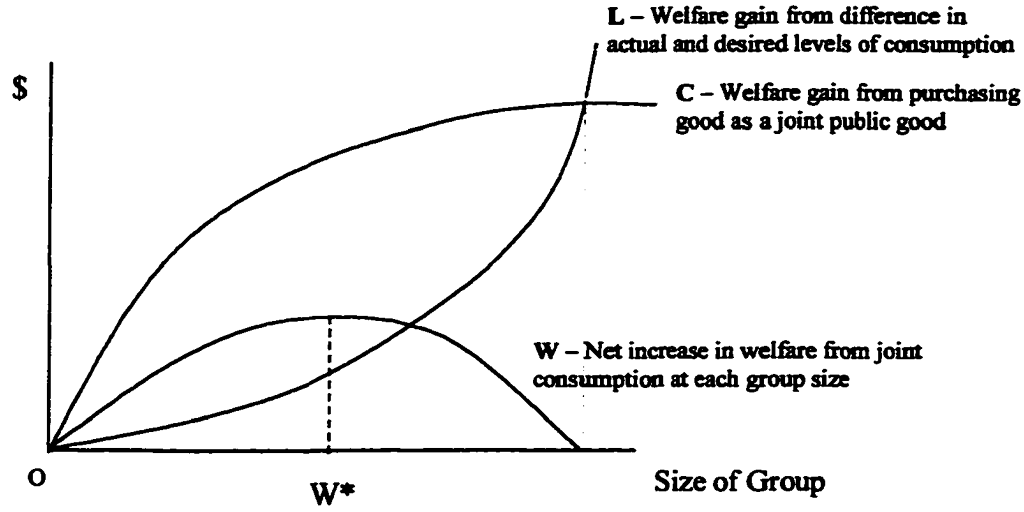
Optimal Size Jurisdiction

While the model that follows attempts to determine an optimum sized population for each service provided, a political structure will unlikely emerge to solely satisfy the findings of the model. Most political systems have already fully developed though historical, political and even economic factors. So, although boundaries of political units do change over time, it would be difficult and complex to create a system that "perfectly maps" (Breton 1965) the benefits of each public good to a specific jurisdiction size. The model, in fact, is usually used to determine the most ideal *existing* political unit to provide the good or service in question, or to assist, through economic justifications, in the placement of any of the rare local government boundary changes or creations (King 1984:50-51).

The trade-off in deciding which level is optimal is between the increased cost savings from joint consumption by larger groups (a higher level of provision) versus the welfare derived from more responsive levels of consumption in smaller groups (lower level provision). This trade-off is visualized in Figure III-6.

Figure III-6

Optimal Jurisdiction Size



The OC curve measures the welfare gain when a good is purchased jointly. At point 0, the group size is one, and the gain from joint consumption is, clearly, zero. At this group size, individuals can not take advantage of economies of scale. As group size increases the gains rise, following a decreasing rate due to diminishing economies of scale. The community size at which these economies will eventually be exhausted will depend on the type of public good.

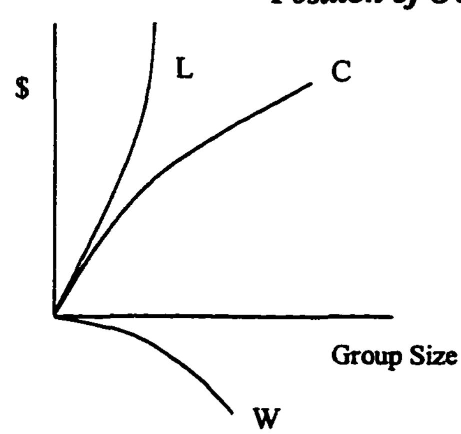
The OL curve represents the welfare loss created when a difference exists between the amount of the good desired by the consumer and how much is actually consumed. At point 0, the individual consumer who constitutes the entire group, can consume exactly the amount desired. Welfare loss at this group size will be zero. As the size of the group grows, the median level of provision is more likely to diverge from an individual's desired consumption level, thus generating a larger welfare loss.

OW is a curve depicting the net welfare for each consumer group size. In the diagram, welfare is maximized at W*. At this point, group size is then optimized for this particular good, and such a point occurs when the marginal gains from increasing group size are exactly offset by the marginal loss associated with a group size increase (Oates 1972:42).

A closer examination of the factors that influence the position of the OC and OL curves provides some insight into the determinants of the optimal degree of fiscal decentralization (see Figure III-7). The position of the OL curve will be higher (or steeper) if (1) the geographically divided groups of consumers have widely divergent preferences and incomes and (2) if individuals group together by these preferences and incomes. This will also increase the optimal degree of fiscal decentralization (smaller group size). The determinants of the OC curve, on the other hand, will depend of the nature of the good itself. One particular factor is the propensity of the good to exhibit economies of scale. The higher the propensity, the higher the OC curve resulting in a lower level of decentralization.

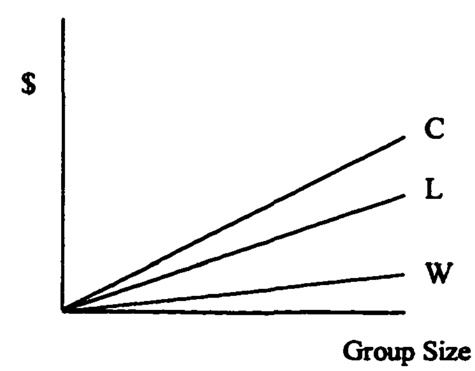
Figure III-7

Position of OC and OL Curves



Private Good

Clearly there is no gain to be made in joint consumption



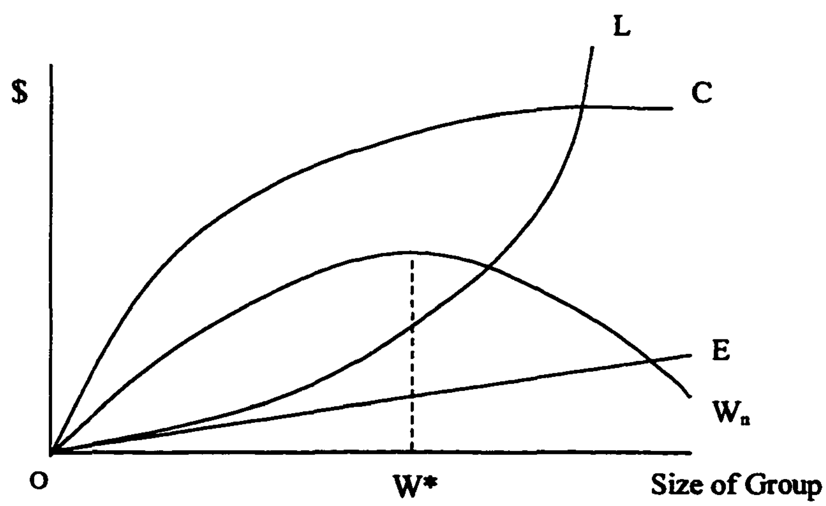
National Public Good

The larger the jurisdiction size, the greater the welfare benefit

Other complications that affect the optimal size jurisdiction problem are inter-jurisdictional externalities, costs of collective decision-making and consumer mobility. Interjurisdictional externalities will tend to be more of a problem in the consideration of the smaller jurisdictions. Thus a larger number of smaller units will likely result in less efficient levels of provision of particular social goods vis-a-vis the result from a more centralized system. In terms of the figure (see Figure III-8), this will add the OE to the OW curve, where OE represents the welfare gain of internalizing the spillovers by increasing jurisdiction size, to create a new net welfare curve, OW_n.

Figure III-8

Internalizing Interjurisdictional Spillovers



Decentralized allocation of public goods calls for the creation of subnational government units to optimally provide these public goods. In the analysis of optimal size jurisdictions, the cost of creating and maintaining the additional administration and electorate complexity of such a system must also be included. A similar representation can be drawn as that used for the spillover costs. This time, however, OE represents the economizing of costs by creating fewer government units (Oates 1972:48-49).

Consumer mobility has been recognized as a characteristic that enhances the benefits of the decentralized system. There are also losses associated with this consumer mobility. The Tiebout hypothesis has shown how welfare gains will induce like individuals to locate in close geographic proximity. However, there is no mechanism to naturally stop individuals entering a community once it has reached optimum size. With a community of only pure public goods, geographic size is not an issue. Yet, most public goods will exhibit congestion problems after a certain point. The ability of consumers to move will exacerbate the problem of congestion as entrants will base entry decisions on the current level of congestion. This, however, is not appropriate as their own entry will increase the congestion level and associated costs, yet the entrant will not take such costs into account when making the entry decision. Clearly, this will result in a jurisdiction size that is greater than the efficient optimum (Oates 1972:49-52).

Decentralization of Finance

The decentralization of governmental systems can not only be analyzed and characterized in terms of expenditures, but also revenue. A governmental system that is characterized by a decentralized provision of public goods and services needs also to generate the local level funds required to finance autonomous public expenditures. There are five methods of financing a decentralized allocation program: taxes, charges, revenue sharing, tax sharing, and loans. Each will be briefly discussed for their ability to finance local government expenditure, efficiently and equitably. The first two will be discussed in the section below. The next two will be discussed under the section of intergovernmental grants, as they are transfers of money collected at the central level and transferred to the lower level government units. Such sharing can come with or without conditions applied by the central government. Loans will be the last topic discussed.

Taxes and Charges

There are two important motivations for the decentralization of taxation. First is the attractiveness of preference revelation. If the local government administers its own expenditure and taxes, individuals will reveal their preference not only for public good provision but also for financing/tax packages through their mobility in location. This mechanism is not available at the central level, as taxpayers will face the same "uniform" tax/expenditure package regardless of location (Oates 1972:127).

The second benefit of decentralized taxation is the linking of costs to benefits—without such a link government will likely to see the continued expansion of expenditures beyond efficient levels. Musgrave (1987) stresses that one of main benefits of decentralization is the bearing of costs by the jurisdiction in which the benefits are reaped. With decentralized financing individuals are likely to understand the real cost of approving additional expenditures, basing their approval on the true marginal benefit exceeding the marginal cost of the good. In the absence of this, expenditures may be approved without the individual who benefits either realizing what the full costs of such a program are or having to incur the actual full costs, as they can be passed onto tax payers nationwide.

In a decentralized system of public good provision, the central government will be responsible for financing its own functions, namely (1) the stabilization function (2) the distribution function and (3) public goods which have nationwide benefits. The local government will be responsible for financing those public goods that have a benefit range roughly corresponding to the geographical jurisdiction boundaries.

When evaluating any tax whether local or national within the economy, there are four main criteria to examine (Musgrave 1987:207). The first is the equitable distribution of the tax burden, as it is believed that everyone should pay his or her fair share of the tax. The fair incidence of a tax is usually guided by one of two principles: the ability-to-pay and the benefit principle. The ability-to-pay principle, while not directly dependent on the benefits received, is based on equity issues; each individual pays an amount that society feels he/she is able to afford, regardless of the level of service received. A more efficient tax system, economically speaking, is that based on the benefit principle, where an individual pays a level of tax in line with the level of benefits derived from public goods and services. Second, the excess burden of the tax should be minimized, usually achieved by reducing the interference that taxes cause with efficient market operations. A tax, thirdly, should be understandable and clear to the taxpayer. This is best achieved by creating a link between the cost and benefit of the service, often accomplished through earmarked taxes. Lastly, administration and compliance costs should be minimized.

However, the solution to finding an efficient and equitable tax is typically a good deal more complicated at the local than at the national level. The complications arise from the effect taxes have on the interjurisdictional flows of economic resources at the local level and because of other constraints which will adversely effect the taxes characteristics. As we will see, the central government will have a clear advantage in the field of taxation, as it is largely free from these constraints (Oates 1977:32).

Mobility of Economic Resources: Clearly each taxpayer will desire a community, with all else equal, that provides the desired level of public goods for the smallest tax price. In a decentralized system which offers tax and expenditure differentials, evidence shows that, indeed, individuals will move based on fiscal differentials. Let us examine the effect mobility has on a few different tax types. Imagine a country in which each jurisdiction imposes a system of pure user fees. This system can be seen to be economically efficient, as each individual will move to a jurisdiction that provided their optimally preferred tax and expenditure package. However, it will likely not score well in terms of equity issues. So while the benefit tax fares well in terms of efficiency when it is collected at the local level, it also creates equity concerns. In contrast, the ability-to-pay taxes, as will be seen, tends to rate well in terms of equity, but raises efficiency concerns when administered at the local level.

To highlight this point suppose each of these jurisdictions used an ability-to-pay based tax; say, for example, the income tax. Within a decentralized system, this will result in the occurrence of excess burden. As individuals are mobile within a nation, the relatively rich will have an incentive to move out of jurisdictions with a relatively more progressive tax system to jurisdictions with a more regressive tax system. While, the relatively poor will be induced to move into the community with the progressive tax rate. The result is an inefficient relocation of economic resources and a further requirement in the jurisdictions with progressive tax rates to increase the income tax rate to compensate for the lowered tax base. This increase in the tax rate will then encourage further exodus out of these communities of families with above average income levels (Oates 1972:132). A similar tax, but this time placed upon business income will result in a similar inefficient relocation, this time of business capital, to jurisdictions with no or low business tax rates.

With tax incidence on mobile factors such as capital and labor, a decentralized tax system will result in an inefficient resource allocation of both factors. Yet, it is this same mobility of economic resources that benefit the decentralized decision-making of public goods and services. Land, on the other hand, cannot relocate based on tax differentials, and is a resource widely utilized in most local government tax structures. The property tax cannot be evaded through relocation and has some favorable equity characteristics (the rich are likely to own land that has greater value, and are thus subject to a higher amount of property tax). This tax is also neutral as incidence is capitalized by the value of the land (land prices will fall when the tax is incurred) (Oates 1972:143-144).

If local governments do wish to efficiently utilize taxes that fall upon mobile factors of production, they will need to harmonize their tax rates and types between jurisdictions. The result of tax harmonization is to remove the incentives for resources to move to different jurisdictions based solely on their fiscal packages or horizontal inequity (receiving similar services for a differing tax price). Tax harmonization does not, however, imply a uniform rate of taxation across jurisdictions (Raimondo 1992:116).

The gains from tax harmonization need to be weighed against the loss incurred from a restricted or controlled tax rate that will likely result from the harmonization. Individuals have preferences for taxes, just as they do for public services, and these preferences may not be satisfied when taxes are harmonized with surrounding jurisdictions (King 1984:207).

Tax Exportation: As shown in the expenditure analysis, tax exportation can lead to inefficient levels of service and occurs because local governments are able to shift part of their tax burden onto individuals and resources outside of their jurisdiction. The most common example of tax exporting is the taxation of tourists through commonly utilized services, such as hotels and restaurants. The result is an inefficient overproduction of goods and services as the shifting of this cost has effectively reduced the price paid by the community. Spending is then pushed past the efficient level where marginal benefits equal marginal costs (Pogue 1978:434-435)(Oates 1977:15, 1972:140-142). Exporting taxes, however, need not be inefficient if the tourists derive benefits from the additional goods and services provided by the additional tax revenue they create. Along these lines, it can be argued that exported *benefit* taxes do not raise efficiency problems (Groenewegen 1990:105)(Oates 1972:142). Despite the efficiency problems of tax exporting, it is likely to continue as the political attractiveness of taxing nonresidents will generally outweigh the economic arguments of doing so (Bird 1993:75).

Tax Competition: This is another factor leading to inefficient levels of service. As mentioned, the mobility of capital and labor can create additional inefficiencies in an economy through tax incidence differentials. Many jurisdictions will, in fact, take advantage of this mobility by competing with each other, particularly for capital investment. By lowering capital tax rates, communities are able to increase their attractiveness to businesses relative to other communities (to the extent that the additional taxes would have financed nonproductive amenities).

The result of tax competition between jurisdictions will be a reduction in the overall level of local public services provided, below the levels dictated by efficiency. There are many which support the arguments for the encouragement of tax competition due simply to their belief that economic competition in itself is beneficial (Groenewegen 1990:103). It is noted in Groenewegen that tax competition in the form of local user charges need not be considered inefficient. It is when the tax base is mobile, like labor and capital, that competitive tax rates induce inefficient resource allocations.

Administration and Compliance Costs: Collecting taxes will, of course, incur a cost upon the economy through the reduction in private purchasing power by the removal of the tax revenue. Tax collection will, however, impose additional costs through the administration costs of actually collecting the revenue. Such costs will tend to be higher when the tax is imposed by numerous subnational governments than a single central authority as collection is usually subject to economies of scale in administration costs (King 1984:215-216) (Groenewegen 108-109).

Some general guidelines for tax structure of local government systems emerge from these unique local government problems (Bird 1993:75):

- Local governments should favor relatively immobile tax bases.
- Tax source should naturally rise (without raising the tax rate) so as to keep pace with expenditure growth over time. Good examples being the income and sales taxes.
- The revenue should remain relatively stable from year to year.
- Avoid taxes that can be exported to other communities.
- The tax should be visible and accountable to the public.
- Administration and compliance costs should be minimized.

This suggests that local governments should be limited to immobile taxes, such as property taxes, and user charges, both of which happen to be the more regressive tax options. So while most other taxes will be faulted for their mobility-induced distortions, it is these regressive taxes that will hold up in most efficiency aspects for local government use, although simultaneously falling unfairly upon the nation's poor.

Intergovernmental Grants

A fiscal imbalance exists between the central and subcentral levels of government that has led to the evolution of intergovernmental grants. The fiscal gap exists at both government levels, with local governments usually not being able to draw from lucrative tax bases, such as the income or sales tax, as these taxes are not optimally placed under local authority. Yet, local government expenditure levels have risen consistently. With the central government, the opposite is true; revenues have grown significantly while expenditures have not. Intergovernmental grants have been used to bridge this gap in local revenue and expenditures, and is another method, in addition to taxes, charges and loans, for financing decentralized public good provision.

Three additional rationales exist for the use of intergovernmental transfers, other than rectifying this fiscal imbalance, all of which deal with the alleviation of problems associated with localized public finance. While the ultimate method of removing these problems is to provide centrally a uniform level of services, clearly, while it is removing the problems, it also removes all of the advantages associated with decentralized provision. Intergovernmental grants are viewed as an alternative solution that can take advantage of both the decentralized provision of goods with an alleviation of most associated problems (Pogue 1978:453). These three additional rationales deal with the problems of spillovers, merit goods and fiscal inequity and are discussed later.

Types of Grants

The major division between grants is their conditional or unconditional nature. Unconditional grants are transfers of funds to local government levels without centrally applied conditions. They are usually in the form of lump-sum funds that can be used to finance any expenditure desired at the local level. Such funds have been seen to best rectify the problems of fiscal imbalance and fiscal inequity.

Conditional grants are those that are specified, by the central government, to be spent only on particular sectors of the economy. Grants of this nature are used to encourage the provision of merit goods and the correction of spillovers. Conditional grants can be broken down into matching and non-matching (lump sum) grants. Matching grants require the recipient government to "put up" a certain amount of their own funds to receive central funds. From here, matching grants can be further specified as open-ended or closed-ended. If the grant is closed-ended, the central government has a limit to the amount it can transfer, regardless if the recipient government continues to spend its own resources on this good. If open-ended, the central government transfer will continue until the point when the recipient government discontinues to use its own revenue to finance the specified good.

Problems alleviated by Grants

Spillovers: A spillover occurs, as mentioned previously, when the benefits from local public goods do not coincide with the defined political boundaries. Central government transfers are justified in the presence of spillovers, as local jurisdictions will tend not to take into account spillover benefits when deciding the amount of the public good that will be provided. This oversight will generally result in an underprovision of the public good. With the use of a matching grant, the central government can provide the local government with a unit subsidy, reducing the unit price of the good, and thus encouraging the locality to increase its production of the good. This matching rate should be calculated so that the subsidy is equal to the spillover benefits.

Merit Goods: A merit good is one that society would like to have provided, but it would not generally be financed at the individual level. The central government can encourage the local production of a merit good by effectively lowering its cost compared to other goods. Conditional grants, whether lump sum or matching, can achieve this effective price reduction.

Fiscal Inequity: This is one of the most debated issues of multilevel government finance. As seen in the taxation section, with decentralized taxation, even if each locality has identical tax rates, the wealthier community is able to generate higher revenue yields and thus localities will be unable to treat equals equally. That is, individuals with equivalent tax rates will not receive identical service levels in all parts of the country. This inequity has been the prime motivation for unconditional "equalizing" intergovernmental grants. The use of unconditional grants can raise the level of per capita revenue in poorer jurisdictions to enable them to provide public services levels equivalent to wealthier communities.

Problems with Grants

Grants can cause the level of autonomy of local governments to appear to be greater than it is in reality. In general, even lump sum grants will have conditions attached, limiting the choices available to local governments in their service provision and taxation. So while grants may be able to rectify some of the problems associated with decentralized decision-making, they may also reduce many of the benefits as well.

Not only do grants hamper the efficiency gains through the inability to satisfy local preferences, there are also problems with the ability of grants to achieve stated goals efficiently. For example, matching grants require knowledge of the spillover level to determine the appropriate matching rate. Such information is usually either too costly to obtain or simply unavailable (Pogue 1978:476). Matching grants also induce inefficient behavior and resource allocation by the recipient government. To receive additional central funds, localities will often overprovide the good receiving the matching grant in terms of their own funds, reducing the amount of funds left to provide other—even those of equal or increased public desirability—local services.

Loans

Borrowing funds is another source of revenue to the local level of government. At the local level (rather than the central level), the function of loans is mainly to finance long-term capital projects, whose benefits tend to accrue for years to come. The borrowing of such funds is often the only source of finance, without drastically raising tax rates and expanding tax bases in the short-term. Due to their long-term benefit streams, the use of debt finance seems an equitable solution to finance such projects. Central level debt finance tends, instead, to be of a stabilizing nature (Bird 1993: 103) (Oates 1972:153).

However, as mentioned in the first subsection, local debt tends to be of an external nature, reducing the overall level of welfare of the community when the funds and interest are repaid. Despite this drawback, loans are the most beneficial, and often the only practical, source of funds in providing necessary capital investment at the local level. Oates (1972) tends to dismiss the external debt concern, believing that it is not a viable argument against local level loans. For while it may reduce future wealth, it is also future residents who will receive benefits from this capital investment.

Summary

There is little doubt that efficiency gains result from decentralizing the provision of localized public goods. The geographic nature of the benefits of these goods allows for preferences to be potentially determined and satisfied at the jurisdictional level. However, this potential efficiency gain is only one of the forces in action here. Considerable problems exist with placing allocation decision-making power at the local level. These problems will create counteractive centralizing forces in multi-level governmental systems.

These problems exist at various levels. First, problems exist with the provision itself at the local level, with concerns over interjurisdictional spillovers, economies of scale and inexperience in administration. The efficiency losses associated with these concerns must be weighed against the benefits of decentralized provision. The greater the variation of preferences between communities and the greater is the similarity within jurisdictions, the greater are the potential efficiency benefits to be derived from decentralized provision. Ironically, this also results in an increased level of inequity due to the socially unacceptable clustering of individuals by income levels and horizontal inequity in service provision between jurisdictions. The section on optimal jurisdiction size also reveals a loss in efficiency related to the inability to "perfectly map" benefit distribution with jurisdiction boundaries. However, despite these problems, decentralization in service provision has remained a desirable method of improving the allocation of public goods and services. The welfare benefits must clearly be able to compensate for the efficiency and equity concerns in provision.

Secondly, problems exist with the financing of decentralized provision. Taxation is clearly more efficient and equitable when placed at the central level. Yet, local governments will require funds to finance decentralized decision-making, and taxation remains one of the sources of funds for almost all local governments. Clearly, the loss in efficiency and equity from locally administered taxation must also be weighed against these benefits from decentralized provision.

The desire to stabilize a system of decentralized provision has resulted in the importance of intergovernmental grants in multi-level finance systems. Such grants enable local governments to access the required funds to finance their public goods and service responsibilities while alleviating some of the major problems related to decentralized tax collection. While, these grants are able to improve the efficiency and equity of the decentralized system, they also involve some of their own problems. In the process of eliminating some of the problems they simultaneously reduce many of the derived benefits. In addition, while attempting to create a balance between the equity and efficiency of multi-level government system, a complex and elaborate system of grants, tax assignments and expenditure responsibility divisions is created.

The theory outlined here explores the rationale behind fiscal decentralization in the industrial world from an economic perspective. The theoretical expectations and the success achieved in practice in the First World have motivated the importation of the process to developing countries. While earlier attempts of decentralization in the Third World has had mixed results, the successes that have emerged have led to increased interest from donor agencies and academia and has led to further motivations for the more widespread and in-depth implementation in these countries. The characteristics of decentralization in the developing world, particularly the rationales and justifications, will be discussed in the following section.

Part IV

Rationale

This section of the paper explores the rationale for decentralization in developing countries, beginning first with brief case studies, which are intended to convey an overall sense of local government from three fairly diverse Third World countries: Uganda (Africa), Thailand (Asia) and Mexico (Latin America).

Case Studies

Decentralization in Uganda

(Case study from Gombay 1996)

Most studies on Africa divide their general analysis according to the anglophone and francophone colonial backgrounds. Local governments, in both cases, were instituted during colonial rule and the structures erected followed the traditions of their local colonial rulers, with the roots that were established during this time still evident in government structures today. Local government in francophone Africa can be described as a communal structure, with the level of responsibilities over their finances and services provided given to each commune corresponding to its size and financial wealth. Local governments in anglophone Africa follow a representative council structure, under which more emphasis is placed on the democratic election of local council officials (Stren 1996:33-36). Today, while differences remain between these two categories, the gap has narrowed due to the recent reforms of many African nations in the 1990's. Uganda, the first case study presented, is an anglophone nation and a former Great Britain protectorate.

Decentralization in Uganda began in 1994 as part of the 10-point program initiated by the National Resistance Movement when it assumed power in 1986. During the colonial era as a British protectorate (for the country never became a colony of Great Britain), Uganda developed a relatively adequate transportation infrastructure, education and health system. Its economic base focused primarily on small-scale agricultural production. The two decades following independence in 1962, however, were characterized by sporadic and uneven development, ethnic division and the militarization of power leading to the collapse of political and economic stability in the country.

In particular, and with relation to this study, the instability led to a diminished trust in government institutions. This is not surprising given that no fewer than half a million Ugandans were killed, with more than twice this number forced to flee their villages or even country. The socio-economic indicators, even to the present time, paint a dismal picture. Poverty is high, with more than 55 percent of the population below the poverty line in 1993. Life expectancy and birth survival rates are among the lowest in the world. Malaria, diarrhoea, pneumonia, and tuberculosis are widespread, with AIDS cases growing at alarming rates.

In January of 1986, the National Resistance Movement assumed power, removing the existing political structures and creating a new democratic system. This system drew its legitimacy from popular participation, in the form of elections from the village to the national level. A hierarchy of Resistance Councils was set up underneath the National Executive Council, or National Parliament, as shown in Figure IV-1.

This system was established in 1986, yet it was not until 1994, under the country's decentralization program, that authority and responsibilities were devolved to the local authorities. Under this devolution, the district, or RC5, level took over many ministerial decisions.

Figure IV-1
Structure of Resistance Councils and Committees, Uganda

National Executive Council
Composed of historical members of NRC plus one representative from each District (elected by NRC from among District representatives)

National Resistance Council (RC6)

District Executive Committee
Elected from among members of the District Council

District Council (RC5)
Composed of two representatives of each Sub-county and Town council plus one woman representative of each County and Municipality

County Executive Committee
Elected from among members of the County Council

County Council (RC4)(Municipality)
Formed by all Sub-county executive committees in a County

Sub-County Council (RC3)
Formed by all Parish executive committees in a County

Sub-County Executive Committee
Elected from among members of the Sub-county Council

Parish Executive Committee
Elected from among members of the Sub-County Council

Parish Council (RC2)
Formed by all members of the Village executive committee in a Parish

Village Resistance Executive Committee
Elected from among the residents of a Village

Village Resistance Council (RC1)
Composed of all residents in a Village

Source: Gombay 1996:88

The Uganda government system has a three-tier system comprised of the central, district and local levels. Despite the decentralization program, the central government still retains a presence in local government processes through several key ministries. The Ministry of Local Government (MLG), The Ministry of Lands, Housing and Urban Development, The Ministry of Health, The Ministry of Finance and The Public Service Commission all have a regulatory (particularly the MLG), advisory or an administrative role in relation to urban management. Various other ministries and public enterprises, which are linked to the provision of local services, impact upon the role of local authorities, examples being the provision of water, sewerage, police, utilities, and so forth.

An empowered local government is not a new concept to Uganda. Prior to independence the country implemented the Urban Authorities Act in 1958 as part of its Constitution, the purpose being to prevent a unitary system of government emerging after independence. Under this Act, the responsibilities and authority of the local level of government were enumerated and gave local officials power over their own administration, public lands, health services and education. The MLG was constitutionally able to remove local authority in areas where local services was deemed unsatisfactory, but were generally prevented from doing so due to central financial and human constraints. The Constitution was removed in 1966, however, dismantling the system of kingdoms that was created, and local government authority was not reinstated until the recent decentralization program of 1994.

The program has completed two stages to date. The initial step included the transfer of central government staff to local government levels. The second stage saw the devolution of administrative powers and financial management. An integral part of this stage included revenue sharing in the form of block grants and an equalization scheme. The second stage is currently still under way, but progressing at a much slower rate.

The central government's stated objectives for this program include the:

- Reduction of workload of central personnel by devolving responsibilities to local levels;
- Removal of development concerns related to the central government from local responsibility;
- Strengthening of local government capacity in the delivery of services;
- Improvement in the accountability and effectiveness of service delivery and an increase in the public's feeling of responsibility to participate in the policy decisions made by their communities; and
- Improved linking of the taxes and benefits provided.

In the first stage, only 13 of the country's 26 districts were to implement the program. The remaining 13 followed in 1995.

Despite the current stage of decentralization calling for resources to be made available to local levels so as to enable them to carry out their service responsibilities, such provisions are not being made, thus accounting for the slow progression of this second stage. Transfers of revenues from the central government to lower levels remain insignificant and the revenue sources available to local authorities (rates, rents and license fees) are insufficient and are becoming increasingly so due to their inelastic nature.

Just a few years since the initial implementation, there are few reports evaluating the success of decentralization in Uganda. Various constraints are currently being recognized as undermining the attempts to implement a strong autonomous and democratic local government system.

First, is the mistrust that much of the Ugandan population continues to feel toward government institutions, which undermines any attempt to strengthen autonomous government structures. Second, and a particularly recurring theme throughout developing countries, is the downloading of responsibilities to local levels without the corresponding transfer of needed revenues to finance such responsibilities.

A third factor is the low level of salary paid to local government officials. Gombay estimates that their salary barely covers three days of living expenses per month, thus requiring officials to hold other employment positions. Not surprisingly, vacancies exist at all Resistance Council levels. The influence of a fourth factor cannot be overlooked: Uganda is an extremely poor country. Thus, the extent of development required and the severely restricted resources available at any government level, must play a significant role in the success or failure of decentralization reform in Uganda.

While, again, evaluation is restricted due to the recent nature of the reforms, observers of decentralization in Uganda note one significant positive sign. The reforms implemented are attempting to create a true system of decentralization which is based on devolution rather than deconcentration, the latter of which has been the most common form of decentralization implemented in African countries to date.

Decentralization in Thailand

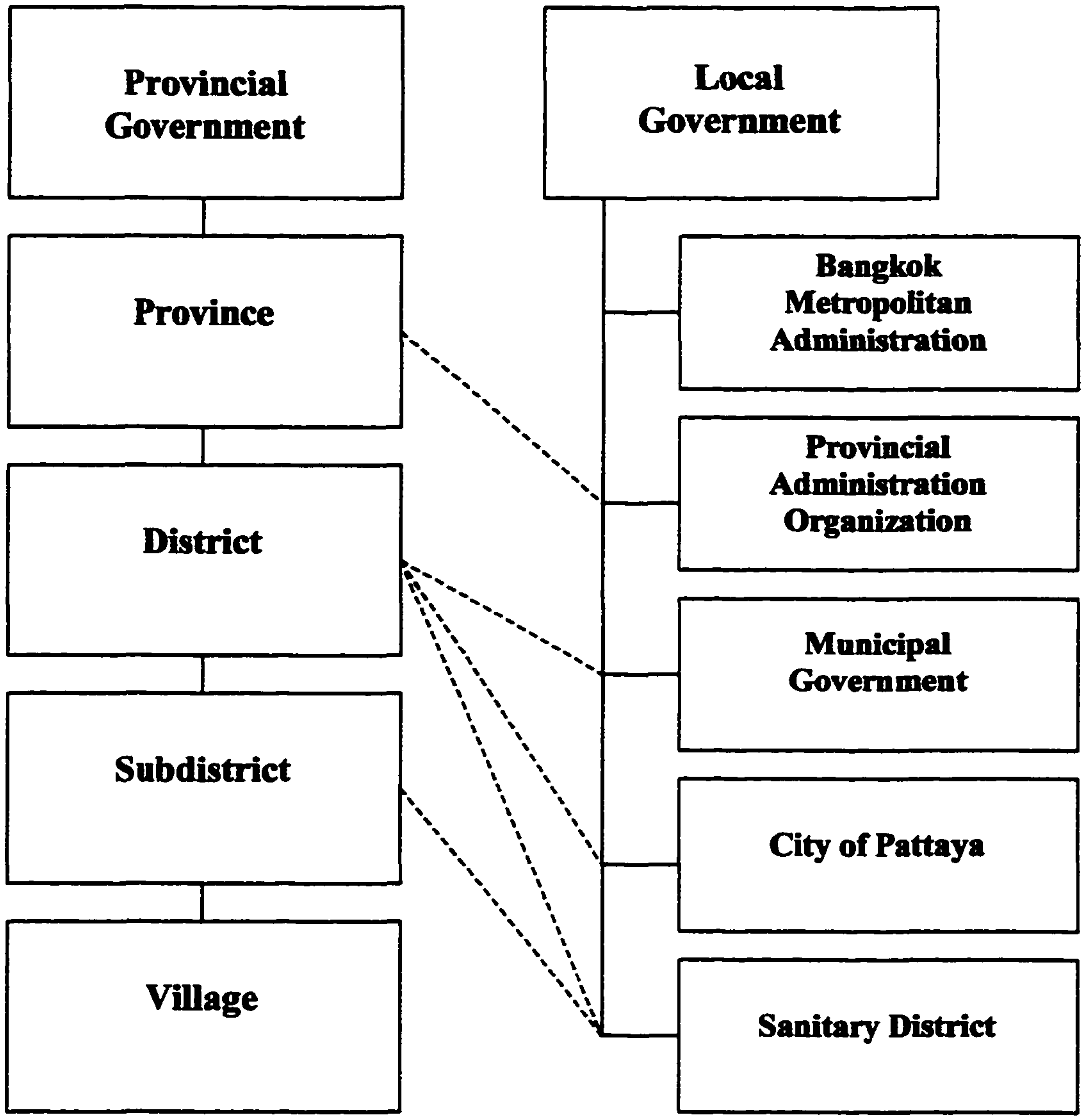
(Case study from Kokpol 1996)

Countries in Asia and Africa tend to differ significantly in the structures of their government. Prior to colonial rule, informal communal level authority characterized African ruling structures more. Asia, in contrast, has a history of central dominance, involving a formal hierarchical chain of command (Mawhood 1987:17). Thailand is no exception to this. In Uganda, the system of kingdoms that existed during the colonial period provided the roots for the current system of local government. Thailand, on the other hand, never became a colonial satellite and for the eight centuries prior to the 20th Century was ruled by an absolute monarchy. The Kingdom of Thailand, under the instigation of a coup d'état in 1932, abolished the monarchy, establishing a constitutionally based government. It was not until this time that a local government system became firmly established. Yet, the system that was created was unable to provide political stability and since its implementation there have been 15 coups (the latest in 1991), 17 parliamentary elections (with only 4 running to term) and 20 Prime Ministers to the present day.

Urbanization is a strong current in the Asian subcontinent, with 56 percent of the world's urbanization between 1970 and 1990 occurring in Asia. Thailand is, again, no exception to this, with 50 percent of the population residing in urban centers, and 57 percent of the population residing in the province of Bangkok alone. The government structure in Thailand has three levels (central, provincial and local), yet retains a centralized government structure which is evident in the relationship between these three levels. The Ministry of the Interior is the largest single ministry and, under its Department of Local Administration, this ministry is responsible for the supervision of all lower levels of government in Thailand.

While the provincial and local government structures exist, for the most part, as separate bodies in Thailand, both levels are directly accountable to the central government. There are a few relationships between the two lower levels, which are displayed in Figure IV-2 and some are discussed below.

Figure IV-2
Structure of Provincial Government and Local Government, Thailand



Source: Kokpol 1996:146

The country is made up of 75 provincial governments (this excludes the province of Bangkok, which, like the City of Pattaya, has a separate and unique government body. Both operate similarly to the local government system). Each province is made up of a hierarchy of district, subdistrict and village level authorities. The provincial governor, at the top of the provincial pyramid, is an appointed central official from the Ministry of the

Interior. At the village level (the bottom of the pyramid), the headperson is chosen via direct elections, with the head of the subdistrict then chosen by and from among the village headpersons of that subdistrict. At the district level, the chief officer is a member of the Department of Local Authorities. Personnel at all levels are also appointed by the central government. The administrative work of the central government is delegated to the provincial and district level, however, as with many lower level governments in developing countries, the decision-making process and the budget plans remain at the national level, all indicating that Thailand's government follows a deconcentration model.

In terms of local government in Thailand, as mentioned above, it was not until 1932 that the Kingdom's local government structures were set in place. Prior to this, however, in 1897, an experiment was undertaken resulting in the establishment of Sanitary Districts. Today, after their previously limited role, these districts provide the most basic level of local government and number almost one thousand throughout Thailand. Their functions include the maintenance of roads and waterways, water supply, garbage disposal, lighting and health care. The District Officer, who is part of the provincial government structure, heads all of the sanitary districts within his or her jurisdiction, with an appointed sanitary council directing most sanitary districts. Most, because council members of larger sanitary districts are chosen through election if their revenues exceed a certain cutoff point. However, in 1994, only 128 of the 990 sanitary districts qualified. The revenues collected at this level accrue from taxes on land and structures, fees, automobile taxes and grants from the central government.

Two further levels of local government exist, in addition to sanitary districts. The first, the municipality, number 138 (in 1993) and are of significant concern as they are considered the most decentralized form of government in Thailand. The mayor of each municipality and the mayor's assistants (the number of which depend on the size and status of the municipality) are all appointed by the provincial governor from among, and subject to the approval of, the elected councillors of the municipality (each elected for five years). The municipal level of government has no direct central government representative in its organization. The provincial governor, in addition to his appointment role of the municipal mayor, also has final approval over the municipal development plan. So although the municipality has the autonomy to prepare its own plan, it is limited by provincial approval. The plan must also coordinate with the national and provincial development plans.

Rarely does this level solely undertake the functions of the municipal government; most are shared with the central government or are also privately provided (see Figure IV-3). Municipal revenue accrues from locally levied taxes (23 percent of revenue, with the majority from business taxes), indirect taxes (45 percent), and central level grants (accounting from the remainder).

The third form of local government is the Provincial Administration Organization, which operates in the provincial areas that are not covered by sanitary districts or municipalities. Basically this tends to imply the coverage of predominately rural areas. There are 75 Provincial Administration Organizations, one for each province (again, except for the Province of Bangkok), and their functions and revenue sources are similar to those of a sanitary district. While the council is elected (versus the usual appointment for sanitary districts), the administration is dominated by central government representatives, with the head of the provincial level government (governor) acting as the executive of the local level Provincial Administration Organization.

Figure IV-3
Government Functions by Level, Thailand

Functions	**Central Government**	**Municipal Government**	**Public Enterprise**
Public peace and policing	✓	•	•
Road construction and maintenance	✓	✓	•
Refuse collection and disposal	•	✓	•
Street cleaning, lighting, firefighting	•	✓	•
Drainage system	•	✓	•
Education	✓	✓	•
Public health care	✓	✓	•
Job creation and economic promotion	✓	•	•
Telecommunications, electricity	•	•	✓
Water supply	•	✓	✓
Traffic management	✓	✓	•
Land-use planning	✓	•	•
Public housing and slum improvement	•	✓	✓
Civil registration and ID card	•	✓	•

✓ Perform
• Not Perform

Source: Kokpol 1996:154

Overall, however, government in Thailand is a centralized process with the activities of both subnational government levels under the close scrutiny and influence of the Ministry of the Interior. The central government is the only level with any political power, with the two lower levels acting as its branches, or field staff.

Various characteristics account for the minimal role of local government in effecting urban service delivery. The first is the financial arrangement between the central and local levels. Inadequate revenues at the local level foster the dependency of local activities on the central government. There are few projects undertaken at the local level that are not influenced by central government funds and direction. The move towards decentralization since 1994 has seen attention focus on relieving the financial constraints of lower government levels and, due to be implemented in 1995, a reform of various taxes to increase the generation of own-source revenues to local governments.

Second, there is a high level of central influence through the ability of the central government to appoint and manage staff and officials at all level of local government. Local authorities also lack the prestige and status, particularly from the public, that would enable them to successfully develop their own agenda. The quality of the local personnel is also further hindered by this lack of status, with central government employment offering greater prestige and advancement possibilities which have lured the more qualified personnel.

The need for Thailand to strengthen its local governments is a growing concern and believed necessary for the democratic development of the Kingdom. Without the matching of finance and personnel to enable local government to provide their designated services, such progress cannot be made.

Decentralization in Mexico
(Case Study from Massolo 1996)

Latin America lacks significant traditional local government roots and most Latin American nations have existed as strong centralized states since independence from Spain in the late 18th and 19th centuries. Decentralization and democracy have only emerged in the last two decades as a desirable model in this region, although the extent of these reforms in this time has created what some have called a "quiet revolution" in Latin America.

Mexico remains one of Latin America's most strongly centralized yet democratic nations. Under the country's Constitution, passed in 1917, the government is classified as a federation with three tiers (central, state and local) and follows a presidential model. Party politics is pluralist, yet it is only semi-competitive and has remained dominated by a single party (the Institutional Revolutionary Party). The president and governors (the heads of the national and state level governments) are elected for 6-year terms and cannot run for re-election. Municipal officials, including the mayor, hold three-year terms, are elected by direct vote, and cannot serve consecutive terms.

The country's Constitution explicitly sets out the formal relations between the Federal and State government level as well as the State and Municipal government level. Municipalities, according to the Constitution, are responsible for their own government having both economic and political independence. Reform of local government in the early 1980's did achieve the devolution of significant responsibilities away from the state level of government to the local level. In addition these powers were enumerated into the Mexican Constitution and include such services as drinking water, sewerage, lighting, garbage disposal and collection, street maintenance, public safety and traffic, and public parks, markets and cemeteries. The municipality has three methods in which to provide these services. Service can be provided (1) directly through the municipality, (2) indirectly through state assistance or, alternatively, (3) by contracting out to private entities. The latter is a common method utilized and has been done so for services ranging from drinking water to sanitation. Municipalities are also given full discretion over their development plans.

In terms of the financial aspects, the Constitution again allocates the Mexican local authorities discretion over the use of their own funds, with revenue accruing from three sources. The most significant source is the transfer of funds from the federal government, which account for an average of 80 percent of municipal budgets. Under the Fiscal Coordination Law (entrenched into the country's constitution), the Federal government is to distribute at least 20 percent of it revenue to local government. There are two funds which transfer revenues from the central to the local level. The first is the General Participation Fund, which is made up of 18 percent of all central revenues. This fund is channelled first to the state level, and each state must then transfer 20 percent of this to the local level, which is usually adhered to. A second fund, the Municipal Development Fund, creates another transfer of funds from the federal to the state level, which must, this time, be entirely distributed to each state's municipalities based on property taxes and water supply fees collected. The result has been, however, that municipalities receive far less than the 20 percent of transfers that are to be received under the constitution, with total municipal resources accounting for only 4 percent of total public resources (with 16 percent for the state level and the remainder at the federal level).

The second source is own-source revenues. Revenues from this source were augmented in the 1980's reforms with the transfer of the right to collect property taxes from the state to the local level. This remains the most important locally collected revenue source. Municipal governments are also able to obtain loans, the third source of local revenue, and which are subject to state level approval. The majority of loans come from the Banco National de Obras y Servicios Públicos and are mainly for water and sewerage, road, and sanitation projects. The Obras Bank receives financial support from the World Bank and the Inter-American Development Bank for such local projects.

Ultimately, the state level of government retains control over the total amount of revenue each municipality receives each year. So while the municipality has constitutional discretion over what can be done with its funds, a higher government level controls the inflow, and thus has been able to influence decisions made at the local level.

Thus, despite the constitutional decree of what seems like a system of autonomous local authority, in reality the Mexican government is a highly centralized state. The federal system that has been entrenched into the Constitution has not been followed, with the majority of political power and decision-making residing with the President and the central government level.

Obstacles to the effective provision of local government services include the three-year term of local authorities. Training of municipal government has been recognized as key to reform, yet with such brief periods in office and a new administration each term, the training results are insufficient. Social and political groups are also supporting the removal of incentives to corruption, which remains a significant obstacle to effective local government. As mentioned, under the Fiscal Coordination Law, 20 percent of federal transfers are earmarked for the local level. Yet, this is largely ignored resulting in municipal government commanding only 4 percent of all public revenues. New reforms to local government are being sought, which call for an increase in the ability of municipal governments to raise adequate revenues from their own sources.

Municipal government in Mexico seems to lack the political power and legitimacy to enforce its constitutional rights. This is highlighted in the party dominance of local government—with 94 percent of municipal mayors belonging to the Institutional Revolutionary Party. The poor public participation in municipal elections and pervasive corruption in the voting system heighten the legitimacy problem. Voter turnout has ranged from 15 to 40 percent in most jurisdictions.

These three case studies have been used as an introduction into the state of decentralization and government structures in developing countries. While broad generalizations can be made regarding government systems, each country has its own unique features and characteristics. Accordingly, decentralization in the Third World has taken many forms and has had diverse results. One difference to be highlighted is whether the decentralized system being implemented is based on the devolution of real decision-making power or the deconcentration of administrative responsibilities. The latter has been the most prevalent in the developing countries, and is the form existing in Thailand and Mexico in practice. While both have implemented decentralization reforms, their government systems remain centralized with few real responsibilities being transferred to the local level. For the responsibilities that have been devolved, central restrictions, inadequate resources or the presence of centrally appointed employees who remain accountable to the central government impede the decision-making power. In Uganda, on the other hand, while resources (both financial and personnel) hinder the ability to remain autonomous, the intended system of devolution is being more closely followed, implying a more positive outlook for effective reform of local government in this country.

In the next subsection of Part IV, the rationales behind decentralization in the Third World are explored: Why is decentralization needed? What caused the change from promotion of centralization to decentralization? And what are the results expected from implementing a decentralization program?

Rationales and Characteristics

Why Decentralization is Needed

The extent of urban population growth across the globe has been breathtaking. During the years from 1980 to 2000 the population in urban centers worldwide will increase by an estimated 1.4 billion people, increasing the urban-to-rural population ratio by 10 percent to approximately 51.3 percent of the world population. Of the World's urban population, by the year 2000, 66 percent are expected to reside in developing countries (Hope 1996:80). This population increase is placing an extraordinary burden on all governments in retaining the quality and quantity of urban services. In particular, the urban governments in the developing world, which collectively account for an estimated 1.2 of the 1.4 billion urban population increase over this 20-year period, are acutely feeling this burden.

To further clarify this phenomenal increase, while only 22 percent of the developing country population were urban in 1960, this proportion increased by approximately half, to 34 percent in 1990. This figure is expected to reach over 50 percent by the year 2020 (World Bank 1995:12).

Another important trend in the developing world is the concentration of urbanization in already large cities. In 1950, there were only 23 cities with over 1 million people in the developing world; this figure grew to 116 cities in 1980. It has been estimated that by the year 2000, 60 cities in developing countries will have a population of 5 million or more (Cheema 1988:243). The rapid rise in urbanization, particularly in exceedingly large cities, has caused the demand for urban services to rise more than proportionately. The World Bank experience has been that for cities that exceed one million people, the management burden begins to escalate, with un- and under-employment, inadequate housing, poor access to social services, environmental pollution and congestion all being associated with excessive urbanization (Cochrane 1983:44).

Part of this rising burden experienced by cities in developing countries has been due to the shift in poverty incidence, with the majority of the impoverished now concentrated in the largest urban areas. The next two decades are expected to see a continued migration from rural areas to urban slums, further increasing the extensive demand for urban services. In contrast, the supply of these services has failed to keep pace with this rapidly rising demand, resulting in poor quality and critical shortages of basic social services, infrastructure and public facilities.

The State of Urban Services

The obvious and traditional rationale for decentralization is that in the context of the developing world, significant problems are evident in the provision of urban services, including transportation, affordable housing, potable water, education and the public health. These are explored below (Cheema 1988:247-248):

Transportation: Services provided by public transportation systems tend to be of low quality or non-existent. The result has been the disconnection of outlying regions from urban centers and the rapid increase in privately owned motor vehicles—for both private use (mainly automobiles and mopeds) and for privately owned public transportation services (in the form of automobiles, rickshaws and buses).

Housing: There exists a serious shortage of low income housing with many of the units in dilapidated conditions: without running water, electricity or sewerage systems. Yet even these urban slum units remain beyond the reach of the majority of urban poor, many of whom are forced to reside in squatter settlements.

Water Supply: Access to potable water is one of the most pressing problems. Low water quality is one of the leading causes of diseases and public health problems in developing countries.

Education: There exists a lack of classroom space and qualified teachers, and the continued rise in numbers of school age children has resulted in competition for these already limited spaces. The children of the urban poor tend to be those left with inadequate education, perpetuating the poverty cycle.

Public Health: Serious public health risks exist due to the insufficient management of sewerage, garbage disposal and flood control. The poor are further disadvantaged, as they must rely on meager government facilities, while those with higher incomes can buy access to private health care.

The strain, placed mainly on local government, to adequately meet the needs for urban services is evident in the deficient conditions of the services provided and existing public facilities. The provision of urban services in industrial countries, provided primarily through lower levels of government, has also experienced strain from increased demand and the tightening of allocated resources. Yet, there clearly remains a distinct difference in the ability of local governments from the Third and First Worlds to manage the responsibilities assigned. Local governments are also responsible for providing services to rural areas, where the majority of the developing world still resides. Such areas, while not experiencing the congestion problems of the urban areas, face their own constraints, including their remote and often inaccessible locations, and small population bases from which to raise revenues for services.

In this context, the role of the local government level in the provision and financing of public services in developing countries has evolved into a complex and highly politicized topic. Due to a variety of forces (to be discussed further), the decentralization of government responsibility, which is more often than not unaccompanied by sufficient resources, has been a sweeping Third World phenomena over the last few decades. Of the 75 Third World countries with populations greater than 5 million, 63 of them have implemented some form of fiscal decentralization (World Bank 1995).

As will be discussed in the following section, the problem for many countries has been that the decentralization of government responsibilities was initially considered a simple but necessary step in the process towards economic, political and social development in the Third World. Recent experience, however, has shown that the process was, and continues to be, often undertaken without due care, and with many expecting decentralization to be an instant cure-all remedy for all societal ills. The results, as measured by subsequent government performances, have more often than not fallen far short of expectations (Smith 1985:185). The process of implementing decentralization in less developed countries is also, and often unfortunately, noted for its rationales extending beyond the economic justifications. In fact, many programs have been implemented without reference to economic considerations, that is, without the prime basis being the increase in economic welfare from providing local public services more efficiently and effectively, and according to public preferences.

The mixed experience of the Third World in implementing decentralization measures has called into question the applicability of the theory of decentralization, which has been developed and refined in a First World context and motivated mostly by economic efficiency and equity concerns, to the unique context of the developing world.

Reasons for the Limited Historical Importance of Local Government

Clearly, there exists a need to improve services in developing countries, yet this is a need which has not been met, by most standards, by the central government in these countries. However, the reforms to strengthen local governments are finding the limited role of local government in the past a significant obstacle in successfully implementing effective, efficient and legitimate local structures. This subsection explores some of the reasons why effective local government has been absent in the past.

Centralized government structure is a characteristic more often associated with developing countries than their industrialized neighbors, with local government influence in the economies of the former bordering on the insignificant. 1980 figures on public sector employment and spending clearly support this assertion. In terms of public sector employment, local government accounts for 11 percent on average in industrialized countries (with a high of 25 percent) verses 4.5 percent in the Third World (which ranges from an average of 2.5 percent in Africa to 8 percent in Asia) (Smoke 1994:13). Government spending has a similar differential, with local government in industrialized countries averaging 32 percent of total government spending compared with a 15 percent average in developing countries. These figures capture the size of local government and the First/Third World differential—with local governments in developing countries clearly remaining of smaller size. In addition, there is an even larger differential in influence when one takes into account the absence of real power devolution in the developing world, as local governments often merely act as the administrative units of central authorities. Yet, the statistics do not capture this.

Smoke (1994) has outlined a few reasons explaining the historically minor role local government has played in these nations. The first is the introduction of western forms of government during colonial periods which were alien to native cultures and practices. Even in areas with traditionally strong community-level autonomy (like much of Africa and parts of Latin America), the practice of locally elected or centrally appointed field officials deviated from the accepted customs—in many cases, these positions were traditionally held by village elders. In addition to the alien structure of western government, the role government traditionally played in developing societies also deviated from the role introduced by colonial powers. This was particularly evident in remote rural areas, where daily activities typically operated outside the influence of the modern economy and thus also the modern government.

A second and widely recognized factor was the emphasis from early development economists on the need for centralized control to foster economic growth. The 1950's and 1960's were decades of central planning, large-scale industrialization and development that was designed to take advantage of economies of scale to optimize economic growth. The local government role in such a system was minimal and resulted in their neglect in terms of access to financial and human resources and involvement in political decision-making.

Resulting in the limited experience and expertise in management and service delivery, this neglect reinforced the obstacles faced by developing countries in strengthening local government institutions. In addition, with the finite resources available in many of these countries, central governments tended to be recalcitrant in sharing what little was available to strengthen central-local relations. Such relations, though, are considered an integral component of working western government structures and necessary for the development of local government through the sharing of information, technical expertise, management training and financial resources.

Traditional beliefs also reinforced the reliance on central government.

> A widely held suspicion in the Third World is that the principle mechanism of economic decentralization—the Market—is immoral and anarchic, and that its impersonal operation rewards the few at the expense of the many.
>
> —Rondinelli 1984:1

The widespread distrust of market mechanisms and its imperfections could only further support and legitimize the continued prevalence of centralized economic planning, intervention and control (Rondinelli 1984:1).

The most frequently cited explanation for local government impotence in the government system, and likely also the most influential obstacle, is the simple unwillingness of central government to share the significant powers they have acquired, particularly since colonial independence. And when local governments were actively given any form of responsibility, the centrally enforced restrictions and monitoring prevented the development of any real autonomy in local institutions (Smoke 1994:15). Many central officials today still assert that the strengthening of local government autonomy and capacity will only enhance the separatist tendencies of the regional enclaves (Allen 1985:13).

These factors have combined to result in the prevalence of a higher level of centralized government control in less developed countries. Yet, today the importance of strengthening local government to improve the delivery of urban services and foster economic growth has been almost universally recognized by Third World policy makers, academics and western donor agencies alike. The factors behind this almost complete reversal in recommended development policies are outlined in the section below.

Renewed Interest in Decentralization

Various global and localized forces have been attributed to the growth of interest in decentralizing fiscal autonomy to lower levels of government. A clear factor has been the changing world economy. After the tremendous growth that was experienced in the post World War II era, economies have faltered in the last two decades. This trend has been evident in both more and less developed countries.

Factors particularly relevant to developing countries range from the decreased volume of exports, rising prices for energy and other imported goods, and the evident failure of many import-substitution and centrally planned policies that were believed necessary to nurture and develop these immature economies. Economically, the result has been the significant growth in debts, reducing already limited government resources. In response, many central governments in the Third World have viewed decentralization as a method of passing on their expenditure responsibilities to lower levels of government, and have often, into the bargain, passed on only limited and typically insufficient access to the revenue resources required to finance these new local responsibilities (Rondinelli 1984:2, 1986:3).

As mentioned, the increased rates of urbanization in less developed countries and the existence of most of the world's mega-cities in these countries, has led to increased demands on urban service provisions. Most of the populations of these cities live in unacceptable living conditions: high rates of poverty, lacking potable water and basic sanitation, health care and education, insufficient infrastructure and increasing rates of urban violence. This, along with the limitations of central government resources and the inability to adequately address these problems, has led to pressure to devise some creative and viable alternatives. Increased local government involvement has been a popular option.

Industrial countries have also experienced rising debt problems. This has led to cutbacks in aid to less developing countries in terms of direct aid, and in terms of aid to non-government organizations and charities involved in assisting Third World countries (Rondinelli 1984:2, Smoke 1994:19).

With the improved education levels and political and social awareness in many of these countries, community members are increasingly recognizing the limitations and inherent structural problems related to central government administrations, and in response are desiring to bring government decision-making and service provision closer to the community level (Smoke 1994:19). Many Third World countries have been formed along colonially imposed borders which often crisscross cultural and ethnic divides. The result has often been borders containing diverse and at times opposed groups of people. There has been a surge in the movements to preserve the unique indigenous customs of certain ethnic enclaves. The desire for more autonomous self-rule, including the services governments provide, has been entangled into these ethnic preservation movements (Smoke 1994:19).

Another clear factor explaining the growth in interest in increasing the autonomy of local level government is the simple swinging of the pendulum. As mentioned, the late 1950's and 1960's saw an often dramatic increase in government centralization, this being the commonly espoused method for these newly independent countries to develop the infrastructure and stability required for economic development. The pendulum has inevitably been swinging back after this period of centralized forces and the dissatisfaction with the results (Rondinelli 1984:27-28).

While in many cases it is unlikely that the dissatisfaction with central planning or the grassroots movements alone would have been successful in mounting the obstacles faced in strengthening local government, one factor that has played a singularly pervasive and influential role is the commitment to, and belief in, decentralization by development agencies and donor countries. Due to the severe debt problems facing many developing nations and their widespread reliance on donor aid, these agencies and donors have found developing countries willing to accept the conditions along with the financial and technical aid supplied. These conditions have come in the form of structural adjustment programs, which have emphasized the strengthening of local government institutions and their involvement in national development programs.

How Decentralization is Believed to Improve Problems for Developing Countries

Again, the literature and case studies provide many motivational reasons for implementing decentralization in developing countries and, when pulled together, represent the diversity of expectations and burdens being placed upon decentralization. The disappointment of many decentralization programs can surely be explained by the simple extravagance of the expectations!

One often mentioned motivational force is the lack of any indicative evidence that central service delivery has resulted in ideal living conditions in the Third World urban areas. The often, at best, mediocre performance of many central governments in successfully reaching and servicing areas outside the capital city leave many to doubt that central service delivery is necessarily superior to services provided at the local level (Smoke 1994:17). Others have extended this argument further, suggesting that local government provision is, in fact, superior in delivering road construction and maintenance, irrigation and other such basic services (Rondinelli 1984:7).

A second force is the enhanced linking of costs and benefits of urban services at the local level, resulting in a more transparent and accountable process. The improvement in the quality of urban services provided, and the enhanced transparency, accountability, responsiveness and efficiency of the services, both mentioned above, are traditional expectations from decentralization as developed in the Western theory. The literature, however, outlines additional benefits which are also expected when fostering a decentralized government system in a developing country. These include improving local government, improving central government, economic development and instilling a democratic government process, and are outlined below. (These categories are fairly loosely defined, with relations often existing between two or more of the categories.)

While significant factors are the obvious and predictable benefits resulting from a well-designed functioning decentralization system, other factors are based merely on, well, wishful thinking. The extent of such expectation has, in fact, led to the regular disappointment of officials and citizens in the decentralization process, often leading to the premature dismantling or retraction of the reforms.

Local Government

Local institutions tend to be regarded as the closest and most accessible level of government to the grassroots population (Bahl 1992:x). As such, a heightened understanding of and responsiveness to local customs, traditions, conditions and needs is expected. It is believed that this will improve the relevancy and efficiency of services provided by not only the local levels of government but also by the central level. For, through better intergovernmental communication, information that is collected by local governments regarding their communities can be shared with the central level, shaping and enhancing the effectiveness of national-level policies.

The decentralization process is also expected to strengthen these communication lines mentioned above, both between government levels and between local constituents and their government representatives. The freedom to allow local institutions to develop and mature through the participation in the decision-making process is expected to lead to the improvement of intergovernmental relationships (vertically and horizontally) and the sharing of information and technical and management skills. Autonomous local government is also expected to encourage the interaction between the public and local authorities (Rondinelli 1984:7).

The central government process is currently viewed as highly inefficient and the cause of many unnecessary delays in service delivery. Bangladesh is a case in point where

> [d]escriptions of the issues and the options available must first pass from the lower levels of administration to the higher level and then, after the inevitable delays, a decision is rendered which may or may not be a reasonable one and which sometimes comes too late to matter.
>
> —Schroeder 1989:3

An increase in the speed of decision-making is anticipated through avoiding the excessive red tape often associated with Third World centralized systems, and an additional saving of time and resources spent in securing the decisions. The morale of local officials is also believed to be increased if they are no longer required to seek approval for each decision made (Allen 1985:6).

The use of voluntary services is not uncommon in the developing world, and such services are more likely to be offered for local projects, freeing limited government resources to be utilized elsewhere (Allen 1985:8-9). Self-help groups and networks have also flourished in response to the inadequate services being provided (McCarney 1996:11). A last benefit mentioned is the believed greater willingness of residents to pay local taxes rather than central taxes, particularly if there is, as expected, a closer connection between the benefits received and the taxes paid (Smith 1985:188).

Central Government

The devolution of decision-making to lower levels of government can also result in benefits to the central government. One clear benefit is the removal of routine, repetitive tasks from the central level, allowing central authorities more time to devote to programs that require central attention. With the extent of development required in many developing countries, central authorities tend to have enough issues to contend with (Rondinelli 1984:7).

The use of local officials in areas outside of the capital can also be more cost efficient than sending out officials from the central office (Allen 1985:8). A third benefit is the expected increase in the number of skilled administrators, which in fact is a benefit to all levels of government. Government officials require a certain level of skills to operate effectively, and such skills are best strengthened by undertaking meaningful projects in which non-trivial managerial decisions are regularly made (Rondinelli 1984:6-7).

A more duplicitous benefit or intent of decentralization has been to increase the power of the central government—or 'centralization through decentralization'. Decentralized structures can, and, in some cases, have been created to enable tighter central control over remote areas. Local officials are thus useful to the central government in their role of collecting and sharing information. Instructions, however, remain flowing from the top downward (OECD 1995:7).

Economic Development

With the extensive need for economic development in many developing countries, the desire to implement programs that foster such development is understandable. Attached to decentralization are significant expectations for the development of developing societies.

By increasing the autonomy of local government, one of the traditional expected benefits is the development of new ways of using scarce resources more efficiently by local officials (Rondinelli 1984:7). With the current environment of limited central government resources and weak underdeveloped private sectors, local governments are expected to improvise in providing the needed infrastructure and atmosphere to enhance economic development (Smoke 1994:16), although, it is commonly felt that decentralization requires the increased utilization of resources, particularly in the short term.

It is further expected that the strengthening of service provision by local governments will help to reduce regional inequalities that exist in development levels across jurisdictions and also reduce the alienation—politically, socially and economically—of particular groups and regions (OECD 1995:7, Rondinelli 1984:28). The validity of such a statement is questioned, however, in numerous articles that argue that decentralization leads to increased social and regional disparities, mainly attributable to the regionalization of affluent members of society who can more readily take advantage of the localized power structure (Allen 1985:13).

It is felt that the involvement of local governments in the economic development of their communities, and in supporting national level projects, will encourage the increased participation of the locals in such development—due to the belief that local government can command greater respect from the citizens (Smoke 1994:16). The case studies presented at the beginning of this section reveal a different story, though, of local government respect. In all three cases, local government lacked the prestige and status that is more characteristic of the central government in developing countries. The local government, on the other hand, does seem to have a necessarily more grassroots association with the public, suggesting the ability of local government to eventually earn such legitimacy and respect.

It is believed that that closer association of the local government with the public will be beneficial in informing citizens of and gaining their support for national development policies. The knowledge that local authorities are able to collect regarding their communities can be channeled upwards to be utilized in such policies, enhancing their effectiveness (Rondinelli 1984:5-6). The collection of such information and close contact between local government and constituents is also considered essential in choosing the optimal service and tax bundles and creating effective community development plans.

In Smith's (1985:87) book on decentralization he states that the dramatic social and economic changes related to development can be cushioned when the public participate in the development process and, as is further explored in the next category, increased participation is another expected result from strengthened local government.

> Mexico is presently going through a dramatic economic and political crisis, but if the values and rules of democracy were rooted in local societies and municipal government, the enormous problems and challenges could be more easily solved
>
> —Massolo 1996:248

Democracy

There has been much discussion on the association between democracy and decentralization in developing countries. Democracy has been advocated as the key necessity for economic, political and social development. And, as democracy is believed to emerge from the local level, the expectation of the development of democracy from the implementation of a decentralization program has been a particularly recurring theme.

The environment that decentralization creates, with the increase in elected councillors and the opportunity for citizens to participate in the development process is believed to be an ideal school for democracy (Allen 1985:10). Local government activity is also expected to develop the civic consciousness and 'political maturity' of citizens (Smith 1985:187). Representation from more diverse and inclusive groups (political, religious, ethnic and tribal) is expected to increase, which is believed will foster national unity in nations where substantial diversity has frequently resulted in conflict.

Developing countries, as mentioned throughout the previous sections, are characterized by an affinity for strong centralized economies. The increased role and autonomy of local government is expected to control and offset the tendency for central government elite to dominate the country's political structures (OECD 1995:7). One counterargument to this is the possibility of subsequent control over local politics, once erected, by local bureaucrats and/or the local elite, again impeding the democratic process.

The case studies presented at the beginning of this section indicate the often less than ideal results of decentralization in developing countries. Yet, the evidence supporting the expectation of significant benefits from strengthening local government capacity are widely acknowledged. Thus, despite the historically limited role of local governments in the past, the mixed results of reforms to date and the tendency of decentralization to merely deconcentrate administrative responsibilities rather than political power, there is considerable support and interest, particularly in the last decade, in reversing this situation.

This support is largely based on the overwhelming theoretical benefits of decentralization and, likely more importantly, to the (albeit, small) number of cases in which improvements (regardless of how modest) have been achieved and can be directly attributed to decentralization. Rondinelli notes that,

> Indonesia's Provincial Development Program, Morocco's local government reform, [and] efforts to decentralize in Thailand, Pakistan, and Tunisia, and other cases [all] show perceptible improvements in resource distribution, local participation, extension of public services to rural areas, project identification and implementation, and employment generation
> —Rondinelli 1984:4

Yet, for these limited successes, there continue to be many disappointments. Decentralization has not yet proved to be an instant cure for the woes facing developing countries, and should not be treated as such. Significant efforts will be needed to overcome the obstacles that impede successful reform, and patience and realistic expectations of the results are necessary to reap the benefits associated with decentralization, a few of which have been outlined here.

Part V
Obstacles

Decentralization has seldom been able to live up to its varied expectations, as detailed in Part IV. This conclusion is widely supported by both 'insiders' (within the country in question) and 'outsiders' (international agencies, academics, and others). Conyers (1983:106) notes three forms of underachievement of decentralization programs in developing countries. The first relates to the inadequate degree of decentralization achieved. This can be due to the initial intentions of the program (in other words, the program never intended for significant decentralization) or due to the inability to achieve the relatively more substantial degree of decentralization envisioned. A second form of disappointment is based on the results of the program, in terms of improving local conditions and fostering development and public participation. The last concern relates to the level which the powers are devolved. Programs that see power remain under the control of the central level (through centrally appointed officials) or that are transferred to the local elite tend to be detrimental to the effectiveness and legitimacy of decentralization programs (Conyers 1983:106).

The success of decentralization reform in developing countries deviates from the results being achieved in their industrial counterparts. While problems still exist for local governments in developed countries (which usually relate to the all-too-common ailment of insufficient revenues combined with increasing responsibilities), these problems tend to be magnified and of increased complexity in developing countries. This section will examine the obstacles faced by these countries in their attempts to implement decentralization programs.

These obstacles are categorized as follows. (Note that this list is not exhaustive and first creates a general division according to what are considered the major and minor obstacles.) Of the major obstacles, the first, and most frequently cited, are the resource constraints facing Third World local governments, which are further divided according to the financial, human and organizational aspects. Second, the central government of these nations are more often than not unwilling to transfer their significant powers. With their superior resource capacities and with the perseverance of inadequate accountability mechanisms and legitimacy of government activity to the masses, decentralization cannot progress without the initiation, support and involvement of the central government. The last main obstacle relates to this aspect of public legitimacy just mentioned. With their historically insignificant roles and typically underdeveloped democratic processes, local governments often lack the legitimacy, or public support, that is essential to the Western understanding of a functioning local democratic government.

The three minor obstacles are the unique cultural characteristics of developing countries, the underdevelopment of their economies and the excessive expectations that have been placed on the implementation of decentralization, each contributing to the impedence of successful decentralization in the Third World.

Much of the analysis of the obstacles to government decentralization in developing countries—whether decentralization involves the devolution of government authority or simply the transfer of administrative function—lies outside the concerns of economics. This observation can also be said of most aspects of decentralization, including the rationales, history and application in these countries. This cannot be said of industrial countries, where economic concerns generally dominate the discussion of decentralization—in both theory and practice. The explanation likely lies in the formulation of fiscal decentralization which was developed based on the economic, political and societal structures and norms of western societies. Comparable structures in developing countries are often absent or have significant differences (both from their industrial counterparts and from country to country) which will impact upon the ability of the fiscal decentralization process blending within the existing economic, political and social climate.

Thus, in this section, the obstacles to decentralization include political (central government power, the ability to raise resources, and the legitimacy of government), and social (legitimacy of government, unique cultural characteristics), as well as economic factors.

Resource Constraints: Financial

The financial weakness of local governments is one of the most crippling obstacles to decentralization. As has been mentioned numerous times throughout the previous sections, one of the recurrent trends in all decentralization programs—both in developing and developed countries—has been the tendency to transfer expenditure responsibilities from the central to the lower government levels, without the matching transfer of access to the resources necessary to finance these responsibilities. This trend has been a major stumbling block to the improvement of urban service delivery in the hands of local authorities.

In addition to shifting the responsibilities of providing urban services, the trend has also been to shift the blame for the inadequacy of these services. In response to complaints by citizens, the central governments in many countries are often responding with the message of "don't complain to us; complain to your responsible local governments" (OECD 1995:27).

As explored in Part III, there are three categories of raising revenue by local governments: own-source revenue, intergovernmental grants, and loans. This section also revealed the inherent weaknesses associated with decentralizing revenues. The theoretical arguments, as outlined in Part III, strongly supported the decentralization of geographically constrained public goods. Yet, decentralization of responsibilities requires the availability of adequate resources, the decentralization of which lacks the extent of support afforded to the decentralization of service provision.

In Part IV, the expected benefits of decentralization, this time focussing on developing countries, were detailed and again revealed fairly strong arguments in support of decentralizing local services—not just in terms of an economic efficiency rationale but also politically. Decentralization in developing countries, despite the mixed results to date, still evokes extensive support from both 'insiders' and 'outsiders'.

As will be shown below, however, the arguments against decentralized finance also exist in the developing country context—and, as will be shown, the arguments in this context are more extensive than those factors outlined in Part III.

Two Schools of Thought

There exist two opposing schools of thought on how to best finance local government expenditures. The benefits and constraints of each will be explored throughout the sections below. The first school is that supporting the collection of the majority of revenues by the central level (or what Adamolekun (1990:49) refers to as the

Centralization School). The other (the Decentralization School) advocates the transfer of significant revenue-raising powers from the central to the lower levels of government, thus greatly reducing the dependency of local authorities on central-local financial transfers.

The division between these two differing ideologies is a source of recurrent debate among advocates of decentralization. There are concerns associated with both, neither providing an ideal form of financing decentralized services. Intergovernmental grants, as pointed out in Part III, provide an avenue for central control through the fiscal transfer to local government. This is of particular concern to local authorities in the Third World due to the heightened propensity of central government intervention and the absence of mechanisms (which generally should come from the general public) in restricting this involvement. Grants, however, alleviate the economic and political inefficiencies associated with locally collected revenues. On the other hand are own-source revenues, which provide local government with revenue that does not come with attached central obligations but, in the process, generate additional inefficiencies and welfare loss when collected at the local versus the central level.

Others, such as Olowu (1992:10), suggest that what is more important than the source of funds—local taxes or central grants—is that central governments ensure adequate revenues are made available to finance the responsibilities of the local level. However, each method does exhibit merits and obstacles to financing local services and each will be discussed further in the following sections.

Intergovernmental Grants

Intergovernmental grants provide an essential link between the central and local levels of government and a method of combining the desirable decentralization of services with the continued centralization of finances.

The share of local revenues accruing from central transfers varies greatly from country to country. Bahl and Linn's 1992 study on finance in Third World cities found a significant variation, as revealed in Figure V-1. Cochrane's (1983:15) earlier study concluded that grants from the central to the local level constituted 30 to 60 percent of revenues for urban local governments, a range significantly less than the 70 to 95 percent estimated for rural local government in the Third World. Other trends that Bahl and Linn (1992:432) observed regarding intergovernmental grants include the lack of correlation between the decentralization of responsibilities and dependency of grants. Local government in a centralized government system can be more, equally or less dependent on grants than a decentralized system. A second trend is the lack of indication as to whether grants between central and local governments are growing or reducing in size. These two trends are also captured in Figure V-1.

Figure V-1
The Importance of Intergovernmental Transfers for Local Government Finance

Subnational government share[a] of total government expenditure	*Intergovernmental transfers as a percentage of government revenues[b]*
Manila,[c] Philippines, 1970	30.0
Manila,[c] Philippines, 1975	30.0
Share of less than 10 percent	
Chittagong, Bangladesh, 1983	41.7
Dhaka, Bangladesh, 1983	34.6
La Paz, Bolivia, 1975	9.0
La Paz, Bolivia, 1985	2.0
Francistown, Botswana, 1972	1.9
Francistown, Botswana, 1986	47.0
Abidjan, Côte d'Ivoire, 1981	67.1
Addis Ababa, Ethiopia, 1973	18.7
Jakarta, Indonesia, 1973	21.1
Jakarta, Indonesia, 1981	39.1
Tehran, Iran, 1974	45.2
Kingston, Jamaica, 1972	67.2
Kingston, Jamaica, 1977	98.2
Dakar, Senegal, 1980	78.7
Colombo, Sri Lanka, 1977	19.0
Colombo, Sri Lanka, 1982	42.6
Bangkok, Thailand, 1968	19.8
Bangkok, Thailand, 1977	39.6
Tunis, Tunisia, 1972	0.7
Tunis, Tunisia, 1985	17.1
Istanbul, Turkey, 1968	28.0
Bukaru, Zaire, 1971	30.1
Kinshasa, Zaire, 1971	73.1
Lumbumbashi, Zaire, 1972	9.5
Mbuji-May, Zaire, 1971	29.8
Kirwe, Zambia, 1975	2.2
Lusaka, Zambia, 1972	6.0

c. Aggregate of all cities and municipalities in Metropolitan Manila.

Subnational government share[a] of total government expenditure	*Intergovernmental transfers as a percentage of government revenues[b]*
Share of more than 30 percent	
Rio de Janeiro, Brazil, 1967	1.7
Rio de Janeiro, Brazil, 1984	0.4
Ahmadabad, India, 1971	4.2
Ahmadabad, India, 1981	8.6
Bombay, India, 1971	1.0
Bombay, India, 1975	1.0
Bombay, India, 1982	0.7
Calcutta, India, 1970	18.5
Calcutta, India, 1975	19.4
Calcutta, India, 1982	54.9
Madras, India, 1976	25.1
Madras, India, 1979	13.7
Seoul, Rep. of Korea, 1968	23.2
Seoul, Rep. of Korea, 1971	15.8
Seoul, Rep. of Korea, 1975	14.3
Seoul, Rep. of Korea, 1983	22.0
Ibadan, Nigeria, 1982	64.4
Share of 10–30 percent	
Bogotá, Colombia, 1972	12.9
Bogotá, Colombia, 1979	8.8
Cali, Colombia, 1974	2.8
Cartagena, Colombia, 1972	12.8
Mombasa, Kenya, 1975	33.8
Mombasa, Kenya, 1981	32.2
Nairobi, Kenya, 1975	31.6
Nairobi, Kenya, 1982	24.7
Mexico City, Mexico, 1968	8.9
Mexico City, Mexico, 1982	26.3
Karachi, Pakistan, 1975	2.8
Karachi, Pakistan, 1982	3.0

a. In this computation, central grants to state and local governments are netted out of total central government expenditures to avoid double counting.

b. Total local government revenues including borrowing

Source: Bahl 1992:430-31

There are four observed concerns associated with grants in developing countries. The first, and most obvious, is the decrease in local government autonomy. Clearly, the central government desire to retain control over the activities of local authorities (as will be discussed in a later section) is easily exerted through the financial aspects of decentralization. As revealed in the Thailand case study of Part IV, few local projects are free of central government funds and direction, with revenue-constrained local government having few alternatives to accepting the attached conditions. In Nigeria, a reform of central-local fiscal relations in 1976 saw the dramatic increase in intergovernmental transfers. However, this increase also saw the stricter central control over local budgets, through the requirement of state approval (World Bank 1988:165).

As mentioned in Part III, the use of conditions on grants can paint a misleading picture of the degree of decentralization, and this is particularly true in developing countries where the use of conditional grants is widespread. A second concern over grants in developing countries is the arbitrary nature associated with the funds. With central government control over the transferred funds, there is little or no mechanism for accountability in either the amount or the timing in which they are transferred. The uncertainty over the amount of funds transferred causes problems with budgeting and leads to the chronic underfunding of programs. Erratic timing will contribute to unnecessary delays and cancellation of local projects (Rondinelli 1984:35).

To reduce this uncertainty in fund transfer, Brazil and Colombia are attempting to enumerate the timely transfer of revenue sharing into their constitutions (Peterson 1995:3). The use of formula-based calculations of the grant amount is expected to reduce the uncertainty in total amounts transferred each year. Formally entrenching intergovernmental grants can also be a part of the solution to reducing the extensive central intervention in local projects.

Yet, even constitutionally enforced regulations are not sufficient. First, as was shown in the Mexican case study, the entrenchment of the distribution of 20 percent of central transfers to local governments remains ignored by the central government and elicits little political uproar from the local authorities themselves. Second, in the case of Brazil and Colombia, and where the central governments are actually following the constitutional requirements, pressure is already being exerted from the central government to rewrite the constitutions. The central governments each state that the extent of the legally required transfer of funds is excessive and adversely affects their own public responsibilities (Peterson 1995:3).

The third concern over grants in developing countries relates to the disincentives created by providing local government with "free" revenue. Reliance on grants can result in less efficient use of these transferred funds. In Indonesia and Sri Lanka the central government distributes a grant to localities to pay the salaries of nearly all local government employees. As the local government need not match these payments, they have no incentive to be efficient in the number of public sector employees they hire or their productivity (World Bank 1988:165-66).

According to western public finance theory, the use of matching grants would thus be useful to reinstate incentives for local authorities to be fiscally prudent with their funds. Bahl and Linn (1992:448-49) note the use of such grants in countries as India, Indonesia, Sri Lanka, and so forth. Two problems associated with matching grants are their tendency to induce funds to be skewed towards the function being matched and away from other services. The second is the difficulty in estimating the appropriate matching rate.

In Nigeria, a second disincentive, and the fourth concern, is illustrated. With sufficient revenues being transferred from the central government, local government levels are actually encouraged to reduce their tax efforts. The 1976 fiscal reform led to a central-local grant increase of close to five-and-a-half times the previous years amount and increased the budgets in some localities up to 1000 to 2000 percent. These significant increases contributed to the removal of important taxes and the continued delay in reforming property tax assessments. One case in point is in the city of Ibadan, where the number of property tax payers fell from 27,000 in 1975 to 8,650 in 1979 (World Bank 1988:165). Thus the increase in revenues transferred from the Nigerian central government resulted in the substantial reduction in local tax revenue efforts.

In addition, the Nigerian transfers were first distributed to the state level, and from there subsequently passed onto the local level. As the grant to each state depended on the number of local authorities in the state, this encouraged the artificial increase in local government units. In 1979 there were 301 local government units. This rose to just fewer than 800 by 1983.

Loans

The local borrowing of funds in developing countries is almost exclusively handled through the central government (through special loan boards and municipal development banks), have conditions attached to their use (in both the processing and use of the funds) and, in many cases, the repayment of the loan is remitted. With such clear similarities to grants, loans in developing countries are often treated as such (Bahl 1992:450).

Loans provide an ideal way for local governments to provide and finance much-needed infrastructure development and improvement, and to direct the focus of limited central government grants to those municipalities that cannot afford to borrow (Oluwu 1992:15). However, loans remain a widely underutilized form of finance in the Third World, due to the prevalent restrictions enforced by the central level. A case in point is Colombia, where it was found that the process of local government borrowing required, on average, the approval of over 100 officials and at least one year for the approval to be granted (Bird 1995:41). A further problem is the tendency for the scale of funds needed to be unavailable (World Bank 1988:164).

However, regulations and monitoring are an important component of local governments' borrowing funds in these countries, and are felt necessary to avoid the macroeconomic instability created when local governments borrow beyond their means. The World Bank (1997:124) recommends central governments continue to use hard budget constraints on local governments.

The dearth of incentives in the intergovernmental grant system to improve local government performance is, and should be noted as, one of the most significant drawbacks to their use. Incentives that reinforce the continued tax revenue effort from local authorities need to be built into the transfer system. With the often-inadequate own-source revenues (discussed below) collected by local government, a well-designed transfer system has become a crucial aspect of supporting decentralized government.

In industrial countries, it is widely felt they can afford to rely more heavily on transfers because of the political influence exerted by the public, allowing a higher degree of local government autonomy. Thus, in industrial countries it is more possible to take advantage of the improved efficiency of centrally collected tax revenue, and still have relatively condition-free revenue with which to finance local services. In developing countries, this influence from the public is generally absent or underdeveloped, thus a local finance system that depends heavily on transfers will be more likely to be subject to restrictive central-level controls and requirements.

Own-Source Revenues

Along with expenditure responsibilities, local governments in developing countries each have some degree of access to revenue raising sources. In all cases, however, a greater degree of decentralization in terms of their expenditures exists than in terms of their revenue collections—in other words, locally-raised revenues are rarely sufficient to cover all local government spending. Nevertheless, the ability of local authorities to raise revenues is an important component of a functioning decentralized government system, particularly in terms of their autonomy over expenditure decisions. While the local collection of own-source revenue does not necessitate increased local autonomy due to the prevalence of central controls regardless of where the funds come from, there is a "...presumption that local authorities have more discretion in managing their local sources of finance than is the case for external revenues" (Bahl 1992:32).

The Bahl and Linn study (1992:34-35) concludes that usually 60 to 90 percent of local resources accrue from locally collected sources, with a median of approximately 78 percent. These figures declined throughout the 1980's, suggesting an increased reliance on grants, and likely also the associated increase in central involvement.

The Decentralization School advocates the increase in locally financed projects and services, allowing local authorities improved discretion in their decision-making process.

As a result, many decentralization programs are calling for the strengthening of local government revenue access. However, the benefits of improved autonomy come with drawbacks. These drawbacks were briefly introduced in Part III, and are further explored below in relation to the developing country context.

Collection

The most obvious obstacle to collecting sufficient local revenue is the inaccessibility of lucrative tax bases to local authorities. This a common factor in developing countries and will be further explored in a later subsection on the power of the central government in developing countries. Another important obstacle is when tax revenues remain below potential due to collection problems, and is an all-too-common ailment facing local authorities in the Third World.

Contributing factors include inappropriate exemptions. In Thailand, tax exemptions exist for owner-occupied housing, government owned properties, charitable and religious institutions and investments that are made in priority areas. This has resulted in grossly inefficient collection, epitomized in the cities of Chiang Mai, where less than 14 percent of houses are taxed, Had Yai, at 11 percent, and Songkhla, with only 26 percent of housing units being taxed (Kokpol 1996:157).

The absence of enforcement of collection is another dilemma, with the source of lacking motivation to enforce payment often deriving from the employees collecting the tax. In Tanzania, in the 1986/87 tax year, an estimated 50 percent of taxes were not collected. Sources noted that the largest contributing factor was the absence of performance-based incentives, noting that other countries, such as Bolivia, have achieved significantly improved results from installing non-salary incentives in their revenue departments (Therkildsen 1992:1106).

Tax information is also consistently incomplete and outdated. This is particularly relevant in developing countries, that rely heavily on property taxes, and that have been experiencing rapid urban growth and periods of sustained, and often excessive, inflation. A prime objective in the Brazilian Property Tax Reform was to improve the property information system. Within the first year of the program, municipalities were reporting revenue increases of up to 100 to 200 percent. These results have been mainly attributed to the discovery of missing parcels and the updating of property values (World Bank 1988:163).

In addition to generally improving collection of the tax sources that exist, local authorities must pay attention to the types of tax sources being utilized. Many potentially lucrative and efficient tax bases remain underutilized.

Property Tax

As is the case in many municipalities of industrial nations, the property tax is considered the most common, and often the most important, source of locally raised funds in developing countries. Yet, revenue generation from this source is failing to grow as fast as local expenditures in these countries. In a study of 37 cities from 21 developing countries, Bahl and Linn (1992:36-37) estimated that a median proportion of 42 percent of local revenue accrued from property taxes. A decline of its importance over the 15 years observed was also evident, correlating with the overall decline of local tax revenues in proportion to local expenditures. A more recent study by the World Bank (1997) found that property taxes accounted for only 5 to 25 percent of local revenue, and somewhat higher percentages in African cities indicating their higher dependence on the property tax as a source of revenue.

While local authorities in developing countries lack many suitable alternatives to the property tax, this tax source remains largely underutilized. There are considerable impediments to the efficient functioning of a property tax in these countries. Collection of revenue, as noted above, is a serious problem and is of particular concern in relation to property taxation. Serious efforts at tax reform have all included improvements in the property tax system. Reforms focus on methods of obtaining more comprehensive information and updates, enforcement of rates through penalties, incentives for collectors of revenue, incentives for timely payment, and easier methods of payment. Such reforms were pivotal in the 16 percent increase in 1986/87 in property tax collections in Delhi, India (World Bank 1988:162).

In Colombia, a Mission of Intergovernmental Finance was established in 1980, with the main conclusion of the mission that "local resources should be relied on more for local purposes" (World Bank 1988:158). This was felt best achieved by strengthening traditional tax sources, such as the property tax. Reforms saw the increase in revaluations and the indexing of property values. The previously fixed property tax rate was also removed and local authorities given the autonomy to choose their own rate (albeit from a centrally imposed range) (World Bank 1988:158).

Efficient administration of the tax is difficult, and is generally unpopular with the taxpayers, heightening the tendency towards incomplete coverage of all property units. Thus, significant obstacles to the reform of property tax exist. In Brazil, 80 percent of local government resources come from unconditional central grants. Little incentive thus exists for Brazilian local government to reform its property tax, as it is able to keep local taxes to a minimum while still receiving adequate financing (World Bank 1988:163).

A second impediment is the general pattern of ownership of real estate in developing countries. Bahl (1990:411) notes the work of Carl Shoup (1979) who sees the tax base divided between "the politically nontaxable mansions and luxury apartments in high-rise structures, on the one hand, and the shanties of the poor that are not worth trying to tax, on the other." Thus, the absence of a substantive middle class is a contributing factor to the insufficient revenue extracted from the property tax base. Important government officials and their families own a large proportion of commercial and residential real estate influencing the ability to tax property

Property taxes and user charges are the top two most recommended forms of revenue raising for local government according to the efficiency concerns outlined in the public finance theory. While difficulties continue to exist for the collection of property tax revenue in much of the Third World, with administrative reforms the property tax can move closer to fulfilling its revenue raising potential, generating a more adequate source of local funds and reducing the necessity of heavy reliance on central grants.

User Charges

In line with the benefit principle of taxation, efficiency is optimized when individuals pay a tax charge equivalent to the benefits they have received. Thus the use of user charges for local services provided is seen as an appropriate method of improving the efficiency of service delivery. The types of services that are usually being provided at the local level tend to be more amenable to the charging of user fees.

The equity issues of user charges are a little more complex although, generally, if the good is an acute necessity (such as the provision of potable water), the charging of user fees are generally accompanied by central level subsidization, or another form of assistance, to facilitate adequate and equitable provision to all.

Local user charges in developing countries, however, despite the theoretical efficiency benefits and role as a potential revenue source, remain largely underutilized. The 1988 World Development Report provided figures approximating that in some localities one-third of locally raised revenue accrue from user charges, providing a viable supplement to local taxes in raising revenues, as well as encouraging "fiscal discipline among both service providers and service users" (Rondinelli 1990:45). Services particularly amenable to local charges include refuse collection, electricity, telephones, public housing, recreation, and water supply (although, again, additional or full central assistance is typical for services deemed to be essential, in particular, water supply). The charge should be sufficient to cover the operating costs of service, maintenance and replacement of the infrastructure.

Particularly encouraging have been the results of betterment levies, a form of user charge, in the improvement of infrastructure. Betterment levies are a tax usually collected by property owners, which approximate the improvement in property value brought about by a public action (like installing an improved sewerage removal system in a neighborhood). Betterment levies allow infrastructure improvements to be undertaken without sacrificing the financing of other services and create a direct link between the tax paid and services received.

An example of the successful use of betterment levies—although one that affected an area broader than usual—is in Tijuana, Mexico. Even before the floods that devastated the city, the transportation system and residential properties were in a state of disrepair. The flood only heightened the situation, causing 60 deaths and hundreds of millions of dollars in damage. The city's mayor held a referendum to approve the levy of a tax on gasoline to finance the repairs. The levy was indeed approved and provided much-needed funds to restore and improve substantial portions of the damaged infrastructure (Campbell 1995: m3).

As with all user charges the problems associated with such levies ensue from the administrative and collection constraints endemic to most local level governments in the Third World. In Jakarta, Indonesia, a betterment levy was impeded by administrative delays in the form of approval to the tax department, delays in informing and tracking down landowners, and the further incomplete and inaccurate data concerning the relevant property and land values (World Bank 1988:161).

User charges have also been introduced for primary education in Tanzania, where a fee is charged for all school children (although the payment is voluntary due to equity concerns). Yet, due to the fact that most of the funds are not used to improve the quality of schooling, and the associated lack of incentive for collectors (who are usually the school teachers) to actually collect the fee, in 1987/1988 less than 25 percent of pupils paid the fee (Therkildsen 1992:1106).

Clearly, accountability is the most crucial aspect of user charges—the direct, visible linkage between the tax and service is encouraging the efficient utilization of the services, the generation of sufficient revenues to finance a number of publicly desirable services and infrastructure improvements, and reducing dependence on central level grants. For reasons of equity, geographical spillovers and that of national interest, however, user chargers are not a desirable method of financing a number of services, which can account (along with collection problems) for the continued underutilization of this finance method.

Other taxes

While the property tax might be considered the most important own-source local revenue for developing countries in general, the local government (subject to central government approval) applies a variety of other taxes, each with considerable variation in both revenue generation and political importance within and between each country.

Automotive tax: One of the most promising taxes being implemented in urban areas of developing countries is the automobile tax. While lack of permission to utilize the tax base remains the most pervasive case for its disuse, for the cities that are able to, it has become a lucrative and equitable tax that also exhibits environmental benefits. With the number of automobiles growing rapidly, the tax base is particularly large, widespread and easy to track through licensing. In some particularly large cities automobile use has risen dramatically, revealed in Bahl and Linn's (1992:190) figures; in Thailand, while Bangkok has only 8 percent of the country's population, it has 83 percent of the nations cars. Similar figures in Seoul are 7 percent of the population and 57 percent of cars, and in Tunis, 15 percent of population and 65 percent of cars.

As automobile owners are among the better off, the tax adheres more to the ability-to-pay principle. A direct correlation can also be made between the tax revenue and government expenditure, as the increasing number of drivers (and thus the increase in tax revenue) are causing increased maintenance and construction expenses in terms of the transport infrastructure. Automobiles also impose the social costs of congestion and pollution on the environment, and the tax should be sufficient so as to form a crude method of recouping—and even discouraging—the environmental costs.

The two cities of Jakarta and Seoul are taking full advantage of this tax. In Jakarta, the automotive tax accounts for 37 percent of local revenue (in 1983/84). In Seoul, the use the tax increased local tax revenues by 64 percent between 1982 and 1986 (Bahl 1992:193). Despite the lucrative potential, most local governments have not utilized this tax, mainly for lack of central approval.

Income tax: The most potentially lucrative, elastic and progressive tax is the income tax. The main reason for its infrequent use at the local level in developing countries is the central government's desire to retain control over this source. Public finance theory outlines serious concerns over its use at the local level due to its imposition on mobile factors of production, and in the developing country context, additional concerns also arise with the necessity for a large number of formal sector employees and the tendency of workers to evade and under-report income. In countries that do allow local "income taxes", they tend to be more of a head tax or wage tax (World Bank 1988:163).

The central government level has a clear advantage over this field, thus supporting the continued central control over the tax. The piggy backing of a local income tax onto the national level is a more efficient method of raising local resources, however, the subsequent central-local transfer is rarely without the usual centrally imposed controls.

Taxes on Industry, Commerce and the Professions: With the rapid rates of urbanization being experienced in many Third World countries, a tax on economic activity would provide local governments with an income (in terms of economic activity) elastic revenue source. It is also argued that local governments should be able to tax economic activities, as it is not only individuals but also producers who derive benefits from the local services provided.

As with the income tax, however, the tax is distorting when applied at the local level, as economic activity is mobile. The tax is also conducive to tax exporting, as local authorities are able to shift the tax burden onto residents outside their jurisdiction (Bird 1995:8).

In the developing country context, additional concerns are the high delinquency rates of taxpayers. In Côte d'Ivoire, a 1984 World Bank study identified that 30 percent of revenues from businesses were not collected. Avoidance of the tax is hard to correct as many businesses operate without a valid business license (Bahl 1992:25). A few developing countries depend heavily on this source of revenue, particularly in Latin America. In Valencia, 67 percent of local taxes, and in LaPaz, 74 percent of local taxes are derived from this source (Bahl 1992:222).

Two particular forms of taxes on economic activity are the octroi and cess. Octroi is a tax that is placed on final consumption and intermediate goods entering the city, and is particularly prevalent in India and Pakistan. Cess is a tax on agricultural production and again felt by local authorities to be a justifiable charge on agricultural producers as they also draw benefits from local services. It is mostly applied in a few East African countries, for which the tax revenue accounts for a significant portion of local resources.

In Kenya, central authorities allowed the charging of cess in 1987, and today, in the Kenyan county of Murang'a, the cess provides by far the largest proportion of local revenue (Smoke 1994:149, Olowu 1992:9).

Other Taxes: Various other taxes, including sumptuary taxes (on beer, liquor and tobacco), entertainment taxes, excise taxes, license taxes, fees and various poll taxes are regularly charged. Individually, while the revenues for each may usually account for only an insignificant revenue share, as a whole, the combination of these various taxes can add to a respectable amount of revenue. In Indonesia, a similar hodgepodge of taxes accounts for over 20 percent of local revenue (World Bank 1988:162).

Volunteer Services

One of the expectations of increased local government autonomy, as mentioned in Part IV, was the rise in volunteerism put towards improving local services and infrastructure. There is certainly considerable support for this belief and its expected benefits for the economy. Although, it is discouraging to learn that one of the prime motivations behind the proliferation of self-help and community groups is the inadequate level of services being provided by the local government (Therkildsen 1992:1101).

There are a few good examples of how volunteer services have contributed to the economy. An example from Bogota is in the town of Tabio, where the mayor of the town has been successful in raising public awareness and generating a sense of identity. The results have been the pooling of effort, particularly by young people, to improve the streetscape and public spaces. This has generated a renewed tourism interest in the town and brought associated economic activity (Londono 1995:1).

A second case study comes from Karachi, Pakistan and provides an example of "grassroots" development.

> Over the last decade, a community development project in the Orangi district of Karachi—a crowded low-income area with no effective public services—has installed a sewerage system in much of this district, in addition to building many schools, health-care posts and other facilities. In total, the poor residents of this district have invested a considerable sum in these facilities, including doing much of the work themselves. One result has been to lower costs: manholes for underground sewerage lines, for instance, cost 500 Rupees compared to 2300 Rupees in a similar, nearby UNICEF-financed project. Another, more important, result is that the infrastructure work is wanted by the people served. All these activities have been carried out with no support from any government agency. In fact, the main problem encountered by this successful example of "informal" local government has been the failure of the formal city government to adequately maintain the central sewerage system.
>
> —Bird 1995:43

In Tanzania, averages of 4 to 8 community activities are constantly underway in each village, with an average of 10 to 15 days a year being donated by households for road work alone. Most volunteer services are directed towards schools, roads, tree planting, shops, vegetable production and the like (Therkildsen 1992:1105).

Yet, in most localities, volunteer services are not being integrated into the local budgets despite providing a significant contribution to infrastructure and service provision (Therkildsen 1992:1103).

There is little argument that own-source revenues are essential—in both developed and developing economies—in enabling autonomous local government. From the analysis into the various forms of local taxing, however, several problems are evident in generating local revenue. First, as with industrial countries, concerns arise with the application of most taxes at the local level versus central collection. The property tax, due to its application on land, an immobile factor of production, and user charges, with their clear connection between tax price and benefit received, remain the most efficient and effective local level taxes. Yet, efficiency concerns still exist with both, with additional concerns impeding the use of these two taxes when applied in developing countries, including collection and administration problems with both, and the heightened equity concerns related to user charges. Such concerns have resulted in local revenue collection from these two sources rarely reaching potential.

While in some cases other tax sources have contributed to significant revenue shares, they have typically not been consistently important in most countries. The automobile tax is a promising source of revenue, although mostly limited to urban centers, and in particular, the mega-cities of the Third World, and is often not permitted to be applied at the local level.

There is little support for the use of the income tax at the local level, except as a piggyback tax on the central level, denying local levels an important lucrative revenue source. Taxes on business activity seem appropriate, but, as they are a tax on a mobile factor of production, they must be applied with care at the local level—the harmonization of the rate between localities is advisable if applied at all.

In taking an overall picture of revenue generation at the local level, the inefficiencies introduced and the limited capacity in administering the tax at this level provide a strong justification for centralized revenue generation. However, the capability of local government can be improved through local training of personnel and the introduction of incentives. Once approved, the remaining inefficiencies of the tax may be an acceptable sacrifice in fostering strengthened and autonomous local government. Again, central government involvement and support is required—in granting permission to utilize certain taxes, providing training and appropriate incentives, and monitoring the progress and results.

Sequencing

In addition to concerns over the administration of taxes at the local level and the types of taxes being utilized, the sequencing over the transfer of responsibilities and financing mechanisms can effect local capabilities to efficiently finance provided services.

The pitfalls related to unconditional funding, while they may simultaneously foster an environment of autonomous decision-making, are considerable, as explored previously. Such unconditional funds provide local governments with little incentive to be fiscally responsible with the transferred revenue, have no clear accountability mechanism (either to the local taxpayers or to the central government), and encourage lax local revenue efforts. Yet, in some countries, the design of the decentralization program is encouraging such behavior through the transfer of large amounts of unconditional funds. To make matters worse, and to convey a completely opposite scenario to traditional decentralization programs in developing countries, such programs are often not automatically transferring the service provision responsibilities to match these funds.

This sequencing has resulted in a system of functions chasing finance. This has led, in Ecuador, to a fiscal crisis of the municipalities. While they had been previously receiving sufficient, and in fact abundant, funds for the limited services they had been responsible for, their tax effort and generation had been neglected. They were subsequently transferred responsibilities for urban development, providing potable water, sewerage, road construction and maintenance and so forth. The state shortly thereafter experienced a financial crisis, which was accompanied by the dramatic reduction of central transfers to the municipalities, and thus resulted in an exaggerated vertical fiscal imbalance—with local governments unable to fund their responsibilities (Carrión 1996:264).

In Colombia the grant distribution formula was also reformed, significantly increasing and entrenching the transfer of funds to localities. The transfer of responsibilities, however, was not simultaneously reformed creating an opposite fiscal imbalance (World Bank 1988:158).

The recommended sequencing of decentralization sees functions following the capacity of the local level, and the finance then following the transferred functions. Local functions should ideally be financed, when possible, through user charges, encouraging accountability and visibility. When user charges are not appropriate, due to equity concerns or the inability to exclude (such as common property goods or pure public goods), then general local taxes should be utilized. If significant externalities, or spillovers, exist then central grants are recommended to finance provision.

Resource Constraints: Personnel

As was made apparent in the three case studies in Part IV, on Uganda, Thailand, and Mexico, the quality of personnel at the local level is of critical concern in developing countries. With little historical importance of local authority in the Third World, the neglect of capacity building in terms of personnel development has been a crippling factor to the later transfer of responsibilities to the local level. Without the continued support of the central government in investing in local officials and staff, decentralization will not live up to even its most basic expectations. This central support is rarely in place, and the attempts that have been made are inadequate at best and detrimental at worst.

The central level has the comparative advantage over local levels of government in attracting and retaining skilled personnel. Central government positions offer greater prestige, higher advancement possibilities and, frequently, a higher and more secure remuneration package.

To enhance personnel quality at the local level, the central governments in developing countries have usually installed one of the two (or both) following programs, both of which have had limited success. The first is the devolution of central personnel to local units, on both a temporary and permanent basis, to supplement their local capacity. In the Philippines, attempts were made to transfer 99 percent of the central field personnel from four agencies to local levels. Problems have arisen, however, with the resistance from the local level in accepting these transfers for a variety of reasons, including the higher salaries they would be required to pay for these transferred staff (which would also create a biased and likely demoralizing differential between local and centrally-transferred personnel). Local authorities also tend to prefer hiring their own staff rather than accepting national transfers (Tapales 1996:212-16).

Retraining existing local staff and officials is the second of the personnel-strengthening programs being utilized, and is being viewed as essential in the successful reform or implementation of decentralization programs. In Kenya, training programs were implemented in the 1980's, including a mobile technical assistance unit that would travel to localities and assist with the identification of training requirements in terms of managerial and fiscal functions. The Local Authority Development Program was also installed by the central government, which dealt with local government training in the planning and financing of long-term capital investment. However, the programs remained under central discretion and were removed for political reasons later in the decade (Smoke 1993:910-11).

In Thailand, the Rural Employment Generation Program proved to be successful, not only in generating employment, its prime aim, but also in training local leaders in the process of planning, designing and implementing local level projects, all under close central assistance. Previous local projects were planned and designed at the central level, with the implementation contracted out to the private sector, leaving the local government with a minimal role to play. Rondinelli (1984:35-36), however, does note that not all local leaders were able to rise to the challenge, often with negligible efforts or interest from the local level impeding the results achieved in many localities. Projects that required complex technical skills and input also failed to achieve desirable results.

Personnel training, as was explored in the section on own-source revenues, is also required for the collection of tax revenues. Most training programs include training in tax collection procedures, as well as financial analysis techniques and current and capital budgeting (World Bank 1988:166).

The inadequate local personnel resources that exist in most developing countries, combined with the skill levels that are necessary to efficiently deliver local services provide a strong justification for centralization in this aspect.

> Without vigorous and continuing central government initiatives, personnel management at the local level is unlikely to improve. Although increased local autonomy tends to be needed in fiscal affairs, the reverse is true for personnel management.
>
> —Cochrane 1983:39

Although, the importance of *some* degree of local level input or control is evident. In Thailand, conflicts frequently occur between the mayor and key personnel due to the existence of strong central involvement. This is because the appointment of all senior officials and personnel is made by the central government, leaving the mayor with little control over the hiring of key staff (Kokpol 1996:155-56).

What emerges from the analysis of the personnel situation in developing countries is the clear need for strong central involvement in the short-term. Capacity levels are currently inadequate and hamper the successful management of increased local government functions. This does not, however, imply the necessity for long-term central control over local level staff and officials. As with the case of revenue capacity building, personnel improvements require central support and training, along with the initiation of incentives and progress monitoring. As capacity levels rise at the local level, fewer distortions and inefficiencies should result from devolving functions and the revenue capabilities to finance them.

Clearly, however, this all rests on the willingness and desire of the central governments to strengthen their local governments.

Resource Constraints: Organizational Skills

One of the most frequently cited organizational concerns at the local level is corruption. Decentralized authority cannot guarantee to bring the state closer to the people, and may only see the transfer of power from the central level elite to the local elite, thus public accountability of government actions can remain minimal or non-existent. Inadequate regulations and enforcement, and the decline of real wages, also contribute to the prevalence of corruption, with embezzlement felt to be particularly extensive (OECD 1995:29, Therkildsen 1992:1103).

There also exists considerable chronic confusion over the division of responsibilities between government levels. In Tanzania, the current local government system combines aspects of the pre-1972 system (which included a certain degree of local autonomy) and the 1972 to 1984 system, a period which saw the abolishion of local government. The result has been considerable confusion between the ministries, regional administration and local government in terms of their responsibilities and resource distributions (Therkildsen 1992:1103). In addition, there is a tendency towards joint responsibility of services in developing countries. For more complex functions, such as education and healthcare, such combined responsibility is widely felt justifiable and unavoidable. But for services that are obviously local in nature, such as roads and traffic management (where they happen to be of joint responsibility in Thailand), a single level of administration would be more efficient.

According to public finance theory, the division of functions between government levels should be clear and simple, and provided by the lowest level that can efficiently deliver the service. In addition, due to the capacity constraints of local government, functions should only be transferred when the local level has attained the ability to adequately provide the good. The heightened capacity constraints in developing countries, however, often see higher levels of government remaining more efficient in providing services that can be provided most efficiently at the local level in industrial economies.

A third concern, and one that relates to the training of personnel and the public support of local institutions, is the manner in which government officials relate to the general public.

Rondinelli (1984:52) noted the inclination for both central and local officials to assume a patronizing manner when in contact with the general public. This is generally seen as an attitude—that citizens exist to serve the state—reinforced or introduced by the colonial period and incompatible with the ideals of decentralization.

Just as simplicity and clarity are preferable in the division of responsibilities between government levels, it is also a desirable feature of the government structures themselves and one that is regularly not adhered to.

> In one small Latin American country there existed in the early 1970's—outside the control of the 138 municipalities—16 rural health areas, 4 roads and bridges districts with 18 subdistricts, 6 regional public building authorities, 125 primary education districts in 15 regional departments, 34 sub-administrations of the post office with 5 full administrations, 9 police departments, 4 national planning zones, 29 local labour control districts, 38 island revenue collectorates with 63 sub-agencies, 19 local income tax agencies—and further divisions and subdivisions for forestry, community development, agriculture, customs and excise, electricity supply, water distribution and so forth! Many of these entities were established with the active encouragement of international technical assistance organizations and may possibly be optimal in scale for each particular service's requirements. But in such circumstances any attempt by the local authorities to make rational and coherent development plans is doomed to failure.
>
> —Allen 1985:20

A last desirable organizational feature that is, again, typically not followed, is the establishment of vertical linkages. With the inherent weakness of local government in developing countries, central-local government linkages are a convenient method of providing local authorities with the necessary support and assistance in creating and maintaining an efficient government process. Linkages can be useful for providing central personnel, technical, and managerial assistance—which had been recommended for both capacity building of personnel and resource generation techniques, and now for local level institutions. The obvious shortcoming in the developing country context is the propensity for any central government involvement with the local level to develop into intrusive control, thus many attempts at central-local integration are, in fact, merely central attempts to encroach upon local autonomy (Rondinelli 1984:61).

Central Government

One of the most pervasive and effective factors for the historically and currently limited presence of local government in the Third World is the continued central control over local government functions and the structures which reinforce this control.

In the last decade considerable efforts have been undertaken to strengthen the role of local government in providing public services. This effort has, in some cases, grown out of grassroots public support. In the majority of cases, however, the effort to decentralize government structures has been initiated from outside forces. While both forces have been successful in pushing through decentralization reform, the latter will tend to lack the continued pressure, more likely to be associated with the former, necessary to maintain interest and support for decentralization. Such long-term interest is essential for successful decentralization, as the structural reforms required are extensive and the short-term dislocation costs will tend to outweigh the short-term benefits of the program. Rondinelli (1984:47) notes that in East Africa decentralization of government has shown limited impact. In Tanzania and the Sudan, he observes, this is due to the continued weak support it receives from the central bureaucracy and political parties despite its initial implementation and enthusiasm by their respective presidents.

In most cases, the problem lies in the fact that power is simply not decentralized at all, which is attributed to the continued unwillingness of the central government to relinquish its considerable powers and influence. Even with both outside and grassroots pressure being exerted on the central government to devolve powers, without the central government's wish to do so, the programs implemented will tend to be merely the illusion of real power transfer. A high degree of central power being maintained over local authorities can disable any formal "powers" they have been assigned. The fear of real participation and strengthened local institutions encroaching on their traditional power base often lie at the heart of the central government's lack of support for decentralization programs (Allen 1985:60).

Justifications usually put forth for continued central control and intervention are based on either grounds of efficiency or of paternalistic concerns. There is little dispute among economists that the arguments for centralization are stronger in developing countries than their industrial counterparts—particularly in terms of the stabilization and distributive functions of government. In terms of the stabilization function, the economies of developing countries are felt to be more open and thus prone to worldwide fluctuations, natural disasters and war. The centralization of limited resources is also felt necessary to optimize investment and economic development opportunities. The regional disparities found in western economies are also believed to more pronounced in developing countries. By retaining the central distribution of incomes, the exaggeration of these disparities, which could be damaging to national and local development, can be avoided (Bahl 994:3).

In terms of the allocative function of government, one argument recommends the continued centralization on the basis that local governments have inadequate financial, administrative and decision-making abilities necessary for service delivery. However, such an argument tends to simply explain and reinforce the continued weakened state of local authorities in developing countries (Bahl 1994:4).

The second justification is the paternalistic attitude that central governments assume in relation to the lower levels of government—which is often reinforced by the opinion and traditional beliefs of the public themselves (which will be discussed further under the cultural section) and results in the lack of central level trust in the capabilities of local governments.

> It is difficult to determine whether the [lack of trust in local officials] is a product of what has been referred to as the centrist mentality of national officials or is a well founded concern over the shortage of highly skilled and trained officials in the regions. But the result is a widespread reluctance on the part of the central government officials to delegate power to regional and sub-regional levels. This has resulted in a "yo-yo" process of delegation and withdrawal of delegation, depending upon whether the central officials are satisfied or not with the decisions and action taken by officials in the region.
>
> —Rondinelli 1984:53

Such withdrawal is common, even going to the point where local elected officials are subsequently replaced by central appointees (Smith 1985:188).

The case frequently cited of central level impedance to real devolution is that of the decentralized process being implemented simply as a tool to reinforce central control. Under the pressure from other forces (internal and external) the central government may agree to devolve powers to local government, only to retain the necessary resources (financial, managerial and technical), thus weakening the position of local authorities and increasing their dependence on the central level (Rondinelli 1984:63, Olowu 1990:72).

In Ghana, a coup d'état saw the military rule throughout the 1980's. In 1992, under donor pressure, the military powers were forced to hold a national multiparty election. In the hopes of generating public legitimacy the Provisional National Defense Council (the military government) had previously revitalized decentralization in Ghana. No real powers had been devolved and localities remained fully dependent on the central level, but the illusion was sufficient. After the election, once the military party and its leaders were elected to power (albeit, in an unopposed election due to the boycott by opposition parties), the government immediately suspended the "decentralization" program (Mohan 1996:89).

Yet, national-level support and assistance remain a crucial factor in the endeavor to successfully strengthen local government institutions. The central role in creating technical advisory services, municipal credit banks, planning bureaus and so forth, has been pivotal. In Latin American, Allen (1987:29) notes that such centrally supported structures—in the form of municipal development institutions—have led to strengthened local units through financial, managerial and technical support.

It is the central government that controls the transfer of funds, that sets the rules and regulations of the transfer and the ability of local government to access tax bases. While local governments remain in a state of underdeveloped capacity, the cycle of underdevelopment will be perpetuated (as they lack the capacity to adequately raise their own revenues) until the central government intervenes and shifts their role from that of intervention to a more supportive and monitoring role.

The containment of central encroachment is thought best achieved through the constitutional entrenching of the rights and responsibilities of each government level (Olowu 1992:15, Allen 1985:22). Yet, if such rights are not supported and the public does not challenge the abuse then constitutional entrenchment will not be infallible, as was revealed in the Mexican case study.

While justification for centralized control may exist in terms of efficiency and capacity concerns with the local governments in developing countries, what lies at the heart of the matter is the lack of political, and unfortunately, often personal, will to devolve powers away from the central government. Until such will is in place, reforms will be regularly impeded by central level intrusion. It is believed that the pressure to reform the central attitude to decentralization will and should ideally be exerted from the grassroots level.

In Zimbabwe, the central government is dominated by the Zimbabwe African National Union (ZANU-PF). The party has also retained significant powers over the "autonomous" local governments. An example of the extent of the party's control over local affairs is the mayoral elections. All mayoral candidates must be approved by the president who relies on the council of the Politburo (the party's decision-making body). Thus although candidates must be voted in through a primary election, the elected candidates must still be approved by the Politburo. In the last elections,

> [o]f the appointed candidates, all but one won. The only post that ZANU-PF lost (in the town of Mutare) was won by the candidate who had won the primary elections and who had been rejected by the Politburo. The candidate resolved—with the encouragement of the electorate and in defiance of party rules (which state that standing as an independent risks expulsion from the Party)—to stand as an independent. The situation described above, however, shows that resistance to the Politburo is still very minimal.
>
> —Masuko 1996:47

What the example also shows is the significance of public support.

Legitimacy

The Zimbabwe mayoral elections example quoted above also provides a perfect example of the legitimacy concerns of local governments in developing countries and introduces the third major obstacle to creating autonomous and effective local institutions in these nations. The central appointment of local officials and decision-makers is widely practiced and results in the reduced public legitimacy of local authority.

Legitimacy, in this context, translates into the responsive representation of public preferences for public goods by local government. This does not require that local officials are elected, for even appointed officials may still make their decisions based on public needs and wants. However, there tends to be a stronger correlation of accountability between elected officials to their constituents and between centrally appointed officials to the national government. This distinction is felt to be important for it is this local accountability to—or responsiveness to the needs and demands of—the public that is considered the key to improving local performance. "Participation is far more important to increasing production and productive capacity than are expertise and technology" (Samoff (1979) in Smith 1985:187).

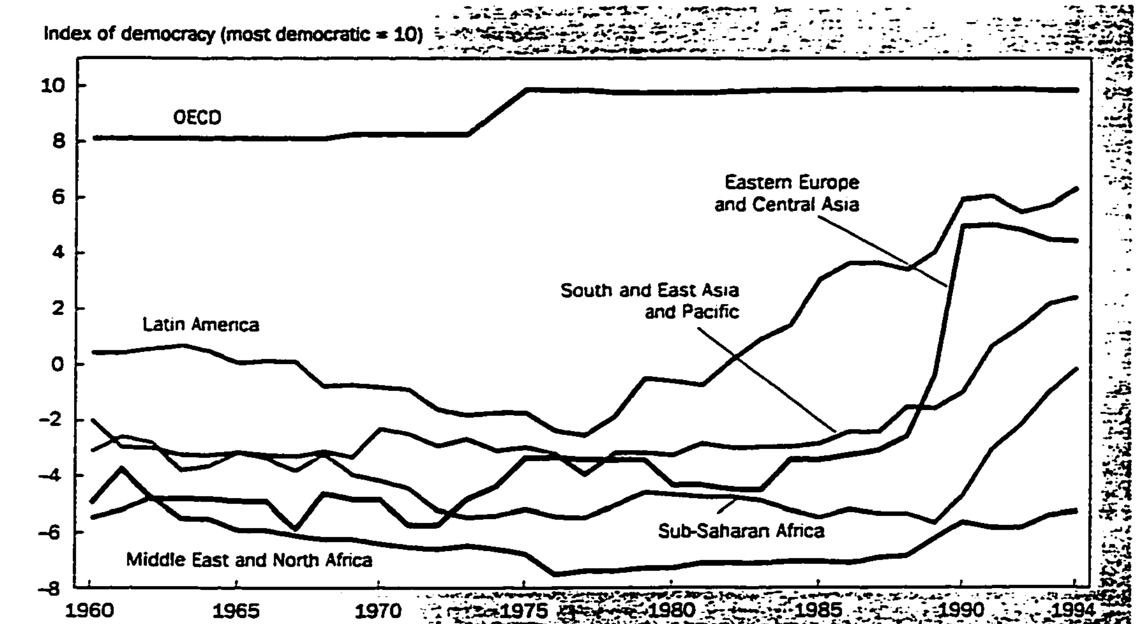
However, even with elected officials, the extensive use of grants from central government has created a tendency for local government to feel responsible to the central level rather than its constituents (Campbell 1992:7). With elected officials, voting is a crude mechanism for determining the tax and expenditure package. Without some form of public participation, officials must approximate the right "price" for services, and will further have no mechanism for choosing what public services are desired.

The connection between decentralization and democratic representation stems from the public finance theory of fiscal federalism, as discussed in Part III. The theory was developed using the industrial model of democratic government decision-making, in which voter preferences directly influence the expenditure and tax decisions of local government, and are felt to approximate the preference revelation model of private goods. With often only the façade of local legitimacy and accountability in a considerable number of developing countries, this mechanism is absent (Bahl 1994:4-5).

In turn, often this lack of legitimacy further impairs the ability of local government to raise taxes from a disillusioned and dissatisfied public. In Nairobi, Kenya, the Association of Manufacturers was considering transferring its service charges into an escrow account rather than payment to the local government, challenging the government to improve the services provided (Smoke 1993:911).

Currently, legitimacy in local government is calling for public participation beyond the periodic revelation of preferences in the form of elections, as mentioned by Conyers (1983). While nearly two-thirds of all countries worldwide use elections to choose their government leaders (versus one-quarter in 1974, see Figure V-2), elections do not always translate into a more effective and responsive government (World Bank 1997:10). The participation of the public is felt important in the formulation of budgets by representative local councils, in the form of demonstrations against undesirable policies and regulations, and the like. It is hoped that with a more direct participation, the public will obtain a better understanding of the decision-making process and contribute to its effectiveness in providing a socially preferable tax and expenditure package.

Figure V-2
Index of Democracy



Note: This particular index of democracy is calculated for 177 countries from scores on five component indicators: competitiveness of political participation, regulation of political participation, competitiveness of executive recruitment, openness of executive recruitment, and constraints on the chief executive. The World Bank does not endorse any particular democracy index. See the Technical Note for details. Source: Jaggers and Gurr 1996.

Source: World Bank 1997:112

Different ideas of how to improve local legitimacy have emerged. Two main methods will be discussed here. The first is the use of formal reporting and evaluation systems to improve local government accountability to—depending on the finance source—the service users, the local taxpayer, or the central government. Bird (1995:20) observes the advantage of collecting information to assist in evaluating public sector performance, which would be used in encouraging informed public participation and assisting central government monitoring of local activity.

In the Philippines, the active participation of non-governmental organizations (NGOs) and people's organizations (POs) has led to successful levels of public participation in the village, municipal and provincial planning processes, through their representation on local councils. The Local Development Councils of all subcentral levels also have at least 25 percent representation from NGOs. Other forums for public participation (through the NGOs and POs) include the Health Boards, the School Boards, the Prequalification, Bids and Awards Committees and the Peace and Order Councils. These organizations have been formally included in the local political and administrative structures and processes (Tapales 1996:217).

While, on the downside, increased public participation can lead to increased demands on the state, or to political gridlock, participation remains intimately related to the decentralization process. This relationship is somewhat confused, however, with much of the public finance literature requiring a functioning democratic system to exist for effective local government to operate. Decentralization in developing countries, on the other hand, while recognizing that an accountable, visible and participatory process would be desirable, advocates that democracy will develop out of a decentralized government environment.

Analysis of the literature seems to indicate that both are accurate, although with some degree of organization of the public being a prerequisite to decentralization.

Cultural

In addition to the three major obstacles (of inadequate resources, central domination, and the lack of local government legitimacy) three minor obstacles have been identified and will be briefly outlined here. The first, the cultural and traditional practices found in developing countries, will often deviate from the expected practices of western societies and thus will affect the translation of western-created decentralization practices.

To begin, the concept of individual preferences is often alien to traditional lifestyles, and is restricted by complex social structures based on caste, gender, religion and ethnicity. Mobility can also be restricted, based on similar roots (Smoke 1994:38-39). Yet, both of these two concepts, individual preferences and consumer mobility, are integral aspects of the fiscal federalism theory. Jurisdictions that cross cultural boundaries may also create difficulties for local authorities in meeting possibly significantly distinct preferences based on these ethnic or religious divides.

Developing countries also tend to have traditional political and societal structures that do not blend well with the western form of local government. The reliance on traditional leaders in rural areas still often remains and will create difficulties when the central level tries to impose local institutions that do not incorporate existing leadership structures. Modern local government may also face resistance through its tendency to disrupt the pattern of traditional landowners and local elite. On the other hand, the influence such groups tend to have over the political mechanisms will often see the implementation of local government simply reinforce the current inequal distribution of income and power (Smith 1985:193). There is also a tendency towards and resigned acceptance of paternalistic leadership. Citizens often continue to look to the central government for their needs rather than the local levels, and the communication process is strictly one-way—from the government down to the people (Rondinelli 1984:56).

There is a startling diversity of practices and lifestyles in the region known as the Third World. The ability to accommodate such differences can impact significantly on the success of decentralization. In Madura, great lengths were taken to accommodate traditional behavior in one small village. The beliefs of the local religion forbade the payment of interest. Thus when attempting to set up a village credit program, the officials worked closely with the religious leaders throughout. The credit program was successfully implemented, assisted by the replacement of a "management fee" for the interest payments (Rondinelli 1984:55). While, in East Africa, the implementation of decentralization has been

> hampered by the rural population's distrust of government officials and their unwillingness to believe the government promises. This mutual distrust often led local staff to identify and select projects without consulting rural people. That behavior encouraged local residents to sabotage, undermine, or simply ignore development projects that they did not want or understand, or that they felt were not in their interests.
> —Rondinelli 1984:55-6

Economy

Some development economists have put forth that a minimum level of economic development is required for the decentralization of government powers—which is expected will foster further economic and political development (Rondinelli 1981:142). Some economic obstacles prevalent in developing economies, which affect their ability to reach this minimum, follow.

The Underdevelopment of the Private Sector which Reinforces Centralization: In Tanzania, and other African countries, the private sector is often unable to undertake the provision of basic services that are almost universally provided by the public sector in industrial countries, but for which the public sector regularly fails to provide in these impoverished economies (Therkildsen 1992:1111). Such services include education, health care, transportation infrastructure and environmental protection.

Unique Externalities: Smoke (1994:35) uses the example of the containment of infectious diseases among both humans and livestock. Clearly, in such cases extensive and often centrally coordinated government effort is required.

Demand Differences: As with the case of consumer preferences and mobility, the concept of demand and willingness to pay might not be directly transferable to much of the Third World context. Demand is likely to be for a minimum package of services to satisfy basic needs—varying mainly with the geographical environment. With the limited use of the cash economy, particularly in rural areas, the concept of willingness to pay for public goods and taxation is often irrelevant (Smoke 1994:35, Mawhood 1987:16).

Market Imperfections: The market tends to work imperfectly in developing economies justifying the reliance on central planning and intervention (Rondinelli 1984:1).

> Resource mobilization has complex dimensions because it is based on mutually supportive interaction between the local government and the private sector. On the one hand, the success of the private sector often depends on the provision of basic services by a well managed local government. At the same time, the more successful the private sector, the greater the revenue base—commercial, industrial, residential—from which the local authority can draw to operate and improve existing services and facilities.
>
> —Olowu 1992:8

Excessive Expectations

Part IV of this study presented the range of expectations that are being placed on decentralization programs in developing countries. The excessive nature of these expectations has often caused the premature dismantling and "failure" of many programs. Decentralization programs can be effective in *alleviating* poverty through improved efficiency in service delivery, but these expectations must be based on realistic achievements (Allen 1985:59-60).

Patience is also required for the strategically planned establishment of a decentralization program, and for the results to be felt.

> It takes time for a new institution to find its feet, to be tested for its response to the needs of the situation, and to be intelligently modified. Too often—...not only in the less developed countries—local government structures have been "planted and hastily uprooted because they were not producing instant results."
>
> —Allen 1985:60

The lesson taken from these three minor obstacles, dealing with the cultural and economic differences and the excessive expectations being placed on decentralization reform, should be that decentralization cannot be applied directly from industrial examples. Smoke (1993:916) has been particularly clear on this point: the unique characteristics of each country will impact upon the ability to transfer real power to local government and to achieve favorable results. In his analysis of decentralization in the Kenyan context, he concludes that while the economic principles, as outlined in Part III, should be used as a starting point (although, this is often not the case), a more comprehensive analysis of the country's political, social and institutional climate is necessary in developing an appropriate decentralization program. This also applies to comparisons between countries in the Third World, for while many common elements may be shared, the programs that may work in one developing country will not necessarily apply well in another.

Part VI
Conclusion

Whether a First or Third World nation, there are potential benefits to be gained from the decentralization of government decision-making and service delivery. These benefits were outlined in Part III and based on the efficiency gains and increased consumer welfare from devolving government services. In that section benefits were also noted to be heightened when there is a greater variation of preferences between communities and when the similarities within each community is greater. And when consumers are able to move between these communities, choosing their community based on their preferences for, among other things, local government tax and expenditure packages (or the process of, as Tiebout would phrase it, voting with one's feet).

In Part IV, the potential benefits expected from decentralization in developing countries were outlined. These benefits tended to expand beyond the traditional efficiency and equity related benefits, outlined in Part III, and into the potential political and social benefits that decentralization can bring. Benefits include not only the improved knowledge of and responsiveness to public needs (in not only local service provision but also in national level policies), but they also focus on the enhanced interaction between governments (vertically and horizontally), reduced bureaucratic inertia and corruption, the rise of voluntary services, the possible increase in central control, improved resource mobilization, and in creating an environment which fosters public participation in the government process, to name but a few. These benefits are expected to be enhanced when the central government provides a supporting and monitoring role, when clear and simplified organizational structures are in place, and if a true democratic, grassroots participation environment is operating.

However, there are many centralizing forces that restrict the success, or extent, of decentralization being achieved. In Part III, these forces where in the provision of the services (or good) itself, such as interjurisdictional spillovers, economies of scale, and the inexperience of local administrations. By far, the most centralizing forces came from the problem of financing these decentralized services. Taxation, the largest source of local revenue in industrial countries, generates additional welfare losses (in terms of efficiency and equity concerns) when applied at the local versus central government level. Grants evolved as part of the solution to allow decentralization in service provision while retaining the more efficient finance generation at the central level. However, even grants raise their own concerns for efficiency, and thus are not able to completely alleviate the centralizing force of government finance.

In Part V, one of the main lessons to learn is that of the stronger centralizing forces that exist in developing countries versus their industrial neighbors. For each additional obstacle that developing countries encounter when attempting to decentralize, the centralizing force is enhanced. And this has been revealed in and reinforced by the status of government systems today: in developing countries, as a whole, there has been a much stronger trend, historically and in the present, towards centralized systems than in industrial countries.

The obstacles, or centralizing forces, have come in a variety of forms, one being the dominance of the central government and its unwillingness to devolve power. Few reforms can be implemented while central governments retain a vested interest in keeping the status quo or an interest in further increasing their status and power, and while the institutions that are present reinforce this dominance. It is felt that only through strong and organized grassroots movements (which for many developing countries is unlikely given the current social and political mechanisms hindering the organization of citizen groups) and the financial incentives of donor countries and development agencies, will central governments shift their function in relation to local government from an intrusive, paternalistic position to a more supportive and monitoring role.

The second obstacle is the lack of resources available to local governments. Funds, personnel and organizational skills are, practically without exception, in short supply and inadequate to fulfil the responsibilities local governments have been assigned (whether these be devolved or merely deconcentrated responsibilities). The pattern evident here, in terms of alleviating resource constraints, is the missing support (in the form of financial, training and technical assistance) from the central government, which is considered to be one of the most essential components to strengthening local government capacity.

The financing of services at the local level encounters additional concerns in the Third World, providing a particularly strong centralizing force. Collection inefficiencies, administrative inexperience and lack of incentives, inadequate and/or missing tax bases, inelastic tax sources and chronic tax avoidance are enduring conditions at the local level that further impede local revenue generation. The grant system in developing countries, while avoiding many of these deficiencies, does little to enhance the decentralization of public services due to the tendency to introduce extensive centrally imposed conditions on the revenue transferred. The finance, personnel and organizational issues all create a strong case for centralized government provision, far greater than that encountered in the industrial country context.

The established channels for public participation in First World countries are often the prime decentralizing forces. Unfortunately, such mechanisms are regularly absent in developing countries, creating a further centralizing factor. Efficiency in service delivery is unlikely to improve if local governments have no incentive to respond to the public's needs and demands, thus also removing the prime traditional motivation for decentralizing services.

The unique social and economic characteristics of this society can also create obstacles. Unfortunately, unlike the resource constraints of local government, when such obstacles emerge, they tend not to have an apparent or obvious solution, for traditional beliefs and customs inherent to the peoples of these nations usually cannot simply be replaced or removed. One particular example is the traditional reliance on village elders to represent and lead communities, which can cause problems when attempting to impose western style government structures which has no place for traditional leaders. The development of the economy is also an issue—one that has both a cause and an effect relationship with decentralization—and is unlikely to be solved without long term commitment. In particular, the differences in demand and regular absence of market mechanisms, upon which responsive local government service provision is based, can significantly undermine local government operations in these countries.

The message that is being sent is that of the necessity of retaining some degree of centralization of government before implementing local government reform. In this prelude to decentralization reform, the capacity building process of local government should first be undertaken.

To achieve or smoothen the progress towards the successful decentralization of decision-making responsibilities to lower levels of government in developing countries, the centralizing obstacles must be incrementally removed. While the literature provides sufficient information on what problems developing countries are facing, there is a paucity of advice on how to solve these problems. However, there are four main suggestions for dealing with these obstacles which frequently are alluded to throughout this paper (particularly in Part V) and are regularly part of recommended reforms from the World Bank.

Accountability through Regulation: There is no assurance that devolving responsibilities to the local level will create a government process subject to the necessary scrutiny of and accountability to the general public. Absence of controls over local government accountability in developing countries is particularly prevalent. As such, devolving responsibilities and finances in such an environment will only encourage corruption, inefficient provision and revenue collection, and arbitrary decision-making. This became apparent in the use of resources at the local level, as explored in the financial, personnel and organizational resource constraints in Part V.

As such, the central government has a particularly important role to play in providing the appropriate framework for decentralization. Strong monitoring mechanisms over local government activity and performance measurements of their results are being recognized as necessary to the building process of efficient and effective local governments.

Accountability through Incentives: The second suggestion concerns the improvement in accountability through implementation of performance incentives for public officials. Officials at the local level currently, for the most part, are undertrained, underpaid and are rarely accountable to the general public. With increased autonomy at the local level, little to no incentives exist for them to use the additional finances wisely, or even to collect local revenues, as was also revealed in Part V. The implementation of incentives, particularly in the revenue department, has been widely advocated to improve revenue generation performance and responsive service provision. Complimenting the improved accountability (through regulations and incentives) are the reforms to civil service, including pay rises, cutting back on discretionary authority, and installing a system of checks and balances.

Participation: Encouraging public participation in the local government decision-making, at various stages of the process, should be a longer term goal and, for the most part, should begin to replace the accountability mechanisms provided by the central level incentives and regulations. Local governments need to become accountable to local service users and local taxpayers—the clients in the relationship. Their ability to directly participate should be incorporated into local government structures and is expected to provide local authorities with information on local needs and wants and to create mechanisms for public feedback and the regulation of government performance.

Devolving Power, Carefully: The last recommendation is the obvious need for the careful planning by central government over the sequencing of decentralization. Clearly, the first step is to transfer functions based on the capacity and capabilities of local government. Finance generation, through grants and access to tax bases and user charges, must follow and must correspond to the functions transferred. From there, the process should be to build upon local level capacity to allow further devolution.

In addition to these four recommendations there are two further factors that are useful to successful and effective decentralization in developing countries. The first is the central government relationship with local government. Traditionally central governments have viewed local governments as mere branches of the central level and thus as subordinate. The need to rethink central-local relations has been clearly demonstrated—a less intrusive and more supportive role is required. Central governments must thus start to view local governments as their partners in providing services to citizens. Clearly, this also indicates that the government-public relationship must also be rethought, with the state servicing the citizens rather than the reverse, which has traditionally been the case. The central government must also accept the transfer of central resources to a local level. In industrial countries, the efficiency and effectiveness of decentralization is enhanced, as local governments are able to take greater advantage of central transfers, thereby reducing the inefficiencies of decentralized finance.

Second, patience is required—in first establishing the foundation for effective local government, and in allowing the subsequent reforms to reap their long-term rewards (rather than hastily abolishing reforms when short-term results are less than expected).

The last aspect of this paper should tie together the relationship between (1) decentralization as developed in the public finance literature and closely associated with decentralization in industrial countries, and (2) decentralization as it is being practiced in developing countries. It has been pointed out that the literature on decentralization in developing countries has, without exception, extended beyond the economic realm. The rationales for, the obstacles to, and the requirements for reform, have all focussed on issues mainly of a political or social/cultural nature.

What can largely account for the minimal role of economic concerns in the practice of decentralization in developing countries is the missing mechanisms for public participation and government accountability. The public finance literature calls for the different needs and tastes of communities to be identified and catered to, thus optimizing the welfare benefits of decentralization. This is considered the main justification for decentralization. Yet, in most developing countries the form of decentralization implemented is merely the transfer of administrative power, rather than decision-making power—thus decisions over local service levels remain in the hands of central authorities. While, as mentioned, this may still create an environment where local needs are detected and satisfied, it is less likely. Thus, the lack of public feedback mechanisms and accountability of local officials to the consumers of local services are considered the most crucial missing elements explaining the divergence of decentralization in the First and Third Worlds.

Thus, most of the literature on decentralization in the developing world has dealt with not only how to improve the resource capacity of local governments, but also the political and cultural aspects of improving government accountability to the public and their participation in the service delivery process.

This does not imply, however, that decentralization should not be applied in developing countries. What it does imply is that realistic expectations of government relations in these countries are required. From the analysis into the history, benefits and obstacles of decentralization, what does emerge is that governments in developing countries will remain more centralized than their industrial neighbors. Yet, there is a role for empowered local government, which must be developed carefully. Powers over local services should be transferred, based on the capacities of local government, and need to incorporate public feedback and accountability mechanisms. This should achieve not only some of the extraneous benefits associated with decentralization in the Third World, but also the traditional motivation of decentralization—the detection and satisfaction of community level preferences for local public goods.

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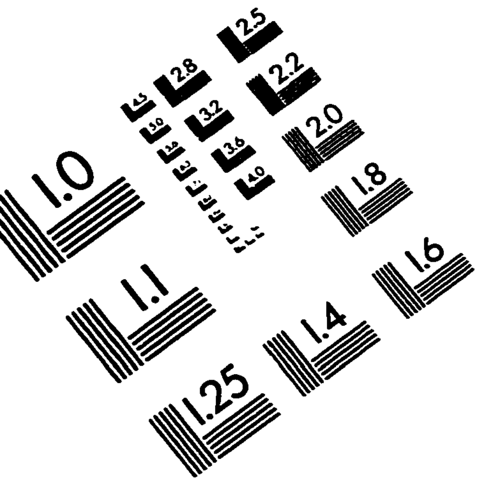

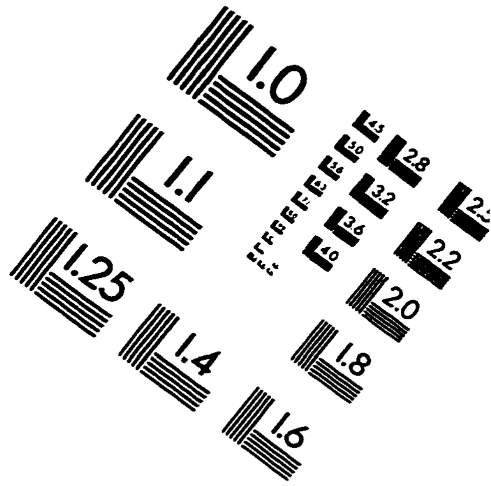

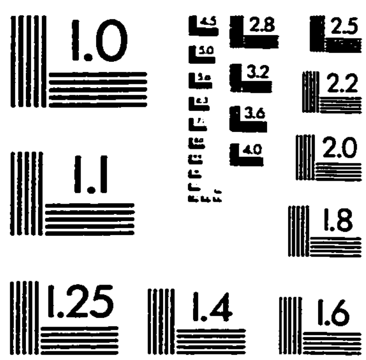

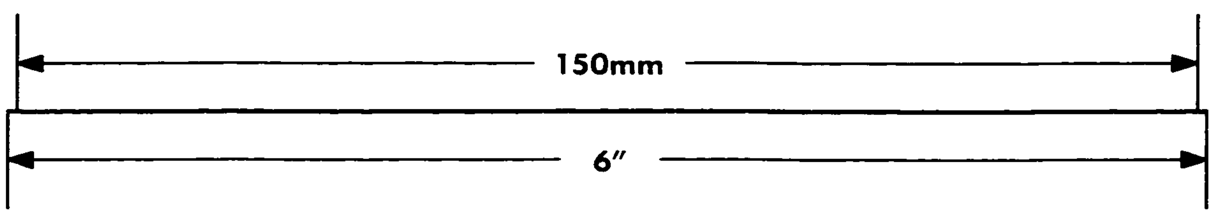

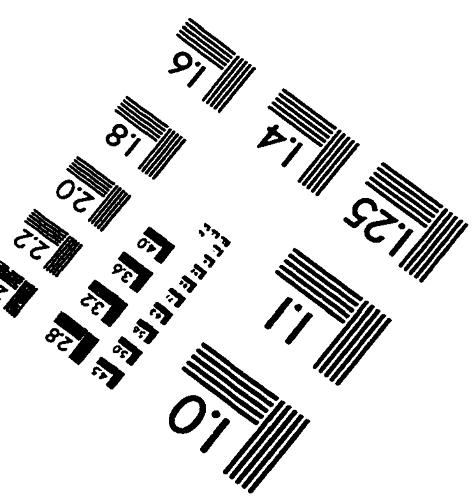

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