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## **Decentralization and Local Government Performance**

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# DECENTRALIZATION AND LOCAL GOVERNMENT PERFORMANCE

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## I. Introduction

The latter half of the twentieth century has witnessed the sustained growth of central state apparatus throughout both the developing and developed world. Driven by the secular growth of the welfare state in the industrialized world, and in the developing world initially by the political imperative of creating national identities out of the ashes of colonialism, and subsequently by developmentalist attempts to guide the economy to growth and prosperity, central governments increased their authority and involvement in the political and economic lives of their electorates to degrees undreamt of by their 19th century forebears. In the wealthiest OECD countries, *central* government expenditures rose to between 40 and 50 percent of GDP,<sup>1</sup> and throughout the world governments nationalized large segments of their economies and circumscribed much of the remainder in a web of tariffs and regulations.

The effects of this increase in mandate were not entirely positive, however. With centralized policy control, regulation and production came high concentrations of political power and discretion over resource allocation, which in turn brought proportional incentives to corruption and clientelism. Electorates grew disenchanted with bureaucratic regimes which seemed distant, and which produced uniform outputs often unrelated to local needs and conditions. Local cultural and ethnic variation was quashed beneath the steamroller of national identity defined by the capital. And income in the developing and communist world did not converge with that of the richest countries, but mostly fell further behind, while the developed countries themselves grew more slowly than during the boom years of the 1950s and 1960s.

The modern debate about decentralization and the optimal size and structure of government begins with the perceptions of these and other failings of the modern state. Proponents of decentralization condemn the impotence and waste of centralized government, and seek to invigorate it and focus its efforts; the ills of corruption, clientelism and political alienation are often regarded as the natural by-products of a bureaucracy distant in space and rendered insensitive, inefficient, and inflexible by its size. Policy failure in the sense of sub-optimal choices is diagnosed as resulting from poor information and incentives that are skewed away from ideal outcomes. Reformers advocate the decentralization of political authority and public resources to sub-national levels of government as

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<sup>1</sup>World Development Report 1995

a general cure for these ills, operating through the reduction of government to more manageable dimensions, thereby making it responsive and accountable to the governed.

As the reader will surmise, the decentralization debate is both broad and often frustratingly imprecise. Arguments for and against decentralization frequently assume the character of sweeping, cross-disciplinary claims about the effects of administrative measures on the quality and efficiency of both government and social interaction. The lexicon in which discussion occurs is as varied as the backgrounds of those who participate (i.e. Economics, Political Science, Sociology, Anthropology, Public Administration, etc.), greatly impeding comparisons of proposed measures and of the effects they are designed to produce. Writers on decentralization, whose work more often than not consists of reports on past, or advocacy for future, reform, seldom specify the mechanisms by which favorable changes are meant to occur, and often fail to isolate the variables involved in a way which is both satisfactory and consistent.

## **II. An Unresolved Debate**

Partly as a result of this, the economic and political literature on decentralization is inconclusive. The debate – both theoretical and empirical – on whether decentralization increases or decreases social welfare and efficiency is still very much unresolved. As we shall see in more detail below, arguments in the political science literature in favor of decentralization rely on incomplete, often anecdotal reasoning which describes situations where decentralization may be beneficial, but with a loss of generality and without distinguishing the conditions (assumptions) which are strictly necessary for this conclusion to obtain from those which are not. Often this literature simply assumes away the central problem of decentralization by asserting that “it brings decision-making closer to the people”. That devolving power and resources to smaller administrative units will necessarily result in better decision-making and an accompanying increase in social welfare is, at least, highly contentious and unproven. Additionally, such an assertion directly contradicts the nation-building and developmentalist theories of the 1950’s and 1960’s, which made diametrically opposed claims that were equally unsubstantiated. Before boarding the decentralization train, it would seem prudent to establish stronger reasons for embracing it than the fact that it is the opposite of a previous, failed strategy.

The economic treatment of decentralization is similarly ambiguous. Notably, it is much easier to write an economic model which demonstrates that a highly centralized regime is more productively efficient than a decentralized regime (as is demonstrated below). The issue of allocative efficiency – a supply of goods and services that meet people’s needs and wants - is less straightforward, and involves questions of the formation and aggregation of preferences that economists have turned to only recently. But it is nonetheless fair to say that the advantage of decentralization in terms of allocative efficiency has not yet been established.

Empirical results reported from a wide variety of decentralization experiences throughout the world are also mixed. Rondinelli, et al. (1984) report that Indonesia, Morocco, Thailand and Pakistan showed perceptible, but small, improvements in resource distribution, local participation, the extension of public services to rural areas, project identification and implementation, and employment generation after implementing decentralizing reforms of the public sector. Studies of decentralization in Algeria, Libya and Tunisia show that the performance of decentralized

administrative units have been positive in some cases, but have not always met the goals of the original policy reformers. Devolution in Papua New Guinea increased popular participation in government, and has improved the planning, management and coordination capacity of provincial administrators. Reform there does seem to have made government more responsiveness to people's local needs, but has also added an additional layer to the state bureaucracy, thus weakening government's ability to attract foreign investment and stimulate long-term economic growth. Positive results from decentralization reported in this and other studies (notably Bennet 1993, Cheema and Rondinelli 1983, Rondinelli *et. al.* 1981, and Veira 1967) include, in general terms:

1. Decentralization has increased the access of people in previously neglected rural regions and local communities to central government resources, if only incrementally, in most of the LDCs where it has been tried.
2. Decentralization seems in some places to have improved participation and enlarged the capacity of local administration to put pressure on central government agencies, thus making available to them large quantities of national resources for local development.
3. The administrative and technical capacity of local organizations is said to be slowly improving, and new organizations have been established at the local level to plan and manage development.
4. National development strategy now increasingly takes account of regional and local level planning.

Negative results include:

1. Decentralization and privatization of state activities has a tendency to create greater inequities among communities and regions with different levels of organizational capacity.
2. This opens the door for local elites to play a disproportionate role in the planning and management of projects.
3. The absence of or weakness in supporting institutions (public or private) needed to complement the managerial capacity of local governments, as well as weaknesses in the linkages and interaction between local and central administrations, have led to disappointing results from decentralization in Africa and Asia.
4. Programs are usually justified on grounds of efficiency and administrative effectiveness, but then judged on their political results. Where political aims are important, considerable deviation from best practice is tolerated. Not surprisingly then, decentralization seldom lives up to expectations.

In general, these and other studies show that decentralization has achieved moderate success in some countries, moderate failure in others, and both in many. But the reasons for this are poorly understood. As the workings of decentralization remain largely a mystery, it is difficult to judge whether specific decentralization programs failed due to weakness in design or implementation, and more difficult still to recommend improvements.

### **III. Definitions of Decentralization**

Before entering into the substance of arguments for and against decentralization, it is important to review the various meanings which the word has been given by both authors and the governments that implement it. Because such a discussion becomes very quickly an exercise in taxonomy, it is useful to proceed as succinctly as is prudent. As alluded to above, the word "decentralization" is

more a semantic umbrella beneath which are gathered many and different concepts than it is an analytically precise term. This study will concentrate on the more representative academic usages given "decentralization" by both political scientists and economists.

Perhaps the best general definition of decentralization is by Rondinelli, et. al.:

the transfer of responsibility for planning, management, and resource-raising and allocation from the central government to (a) field units of central government ministries or agencies; (b) subordinate units or levels of government; (c) semi-autonomous public authorities or corporations; (d) area-wide regional or functional authorities; or (e) NGOs/PVOs.<sup>2</sup>

If we add "and private firms" to (e), then we have a good general definition with which we can approach most theoretical and empirical issues. Bennet (1990) highlights a useful distinction between two general decentralizing thrusts: *intergovernmental decentralization*, which involves transfers of authority, responsibility, power and resources downward among different levels of government, and *market-based decentralization*, where these are transferred from governments to the market and Non-Governmental Organizations (NGOs). Each category embraces numerous specific strategies for transferring functions. Wolman (in Bennet, 1990) delineates three types of decentralization: *political decentralization*, *administrative decentralization*, and *economic decentralization* (though admitting that there is no clear distinction between the first two).

An additional complicating factor is introduced by the question of the general class of regimes within which decentralization takes place. Aside from the issue of whether effective decentralization is more likely to occur under democratic, authoritarian, theocratic, or other regimes, the type of regime under which decentralization occurs is likely to have a great impact upon its effectiveness. For the sake of focus, this thesis will concentrate on decentralization under democratic regimes. We shall see that the presence and nature of democratic controls will play a large role in our ability to theorize about decentralization.

It is clear that the underlying concepts regarding the forms which decentralization takes are broadly similar, but also that the taxonomic exercise could continue through innumerable divisions, definitions and categorizations.<sup>3</sup> The reasonable course to take, then, is to choose one definition and proceed. This study elects the following:

**Decentralization** will be understood as the devolution by central (i.e. national) government of specific functions, with all of the administrative, political and economic attributes that these entail, to local (i.e. municipal) governments which are independent of the center and sovereign within a legally delimited geographic and functional domain.

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<sup>2</sup>"Government Decentralization in Comparative Perspective: Developing Countries", *International Review of Administrative Science*, 47(2), Rondinelli, et al. (1981)

<sup>3</sup>Some authors add a "Hybrid" category to the ones listed above. This would seem to be a futile gesture, as any categorization involves idealized forms abstracted from reality, and therefore most unlikely to be detected in their pure form, but which exist in order to facilitate exposition and understanding.

It will be useful to keep in mind the definition of Rondinelli, et. al. during the theoretical discussion, as most authors have adopted a more general approach to the question of decentralization than that proposed above. The empirical work and theoretical proposals, however, will stick closely to the latter definition. The two reasons for choosing this usage are both powerful and fortuitous. First, the clarity of the proposition greatly simplifies analysis, allowing it to focus on discrete, well-defined decentralizing measures and exogenous variables in order to gauge the empirical effects of each on policy outputs. Second, the empirical case which will be used to test these relationships involves precisely this form of decentralization (see below), implemented uniquely and vigorously.

#### **IV. The Political Economy of Decentralization**

The intellectual case for decentralization originates in the most basic arguments concerning democratic government and the effective representation of citizens' interests, to which economic arguments based on efficiency have been added more recently. Political philosophers from the 17th and 18th centuries, including Rousseau, Mill, de Tocqueville, Montesquieu, and Madison distrusted autocratic central government and held that small, democratic units could like ancient Athens preserve the liberties of free men. In several of the Federalist Papers, Madison theorized about the prevention of tyranny via a balance of powers not only among the branches of central government, but between central and regional and local governments as well.

The modern case for decentralized government is well represented by Wolman (in Bennet, 1990), to whom we now turn. Wolman groups his arguments concerning decentralization under two main headings: Efficiency Values and Governance Values. *Efficiency Values* comprise the public choice justification for decentralization, where efficiency is understood as the maximization of social welfare. Wolman contrasts the provision of public goods with the market for private goods. Within the private economy, individual preferences are expressed through a market mechanism which facilitates continuous signaling between supply and demand via prices. The nature of public goods, however, is such that competitive markets will not provide them.

When public goods are provided, tax and service packages should reflect as accurately as possible the aggregated preferences of community members. However, because individual preferences for public goods differ, there will be some divergence between the preferences of individual community members and the tax and service packages reflecting the aggregated community preferences. It is likely that the average divergence of individual preferences from the tax and service package adopted by the community through its government will be less in small communities of relatively like-minded individuals than it will be in larger, more heterogeneous areas. [...Allocative] efficiency and social welfare are thus likely to be maximized under highly decentralized political structures.<sup>4</sup>

One counter argument to this rationale highlighted by Wolman is that decentralization will complement, or even exacerbate, disparities among communities with different economic means. In principle, however, this objection is easily addressed through grants administered centrally, designed to equalize localities' resources. Similarly, decentralization to low levels of government may reduce efficiency by inhibiting the achievement of economies of scale in the provision of some services, though this too is easily solved via different levels of government providing these services according

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<sup>4</sup> Wolman in Bennet, p.27.

to their technical characteristics. A more serious objection is posed by the existence of externalities<sup>5</sup> in the provision of local public goods, which reduce overall efficiency for society. These can be solved by reverting to higher levels of government, which internalize the externalities in their taxing and spending decisions.

But the fundamental objection to such efficiency arguments, and one which is generalizable for this literature, is that it simply *assumes* that central government will produce more standardized, less-differentiated outputs less suited to local preferences than local government. Although this is intuitively appealing, the lack of an explanation for how this comes about amounts to assuming away the problem. We can easily draw up a model where central government installs agents in each community to gather information and detect local needs and preferences, which data is then relayed at low cost back to the center (see Annex 1). All outputs are produced centrally, and then distributed in the desired amounts and qualities to all localities. If we assume economies of scale in at least some outputs, and transportation costs low enough that these gains are not canceled out (neither unreasonable), then it is easy to see that such a system would dominate the decentralized solution on (productive) efficiency grounds.<sup>6</sup> This could form the basis of an argument for the centralization of government which, in purely logical terms, is every bit the equal of its opposite.

Some authors have sought refuge in the position that the competing claims are a metric question, and therefore resolvable through empirical research. But this response is also highly unsatisfactory. The issue in question - whether central government is likely to produce outputs that are more or less similar to individual's preferences - is intimately tied to the structure of governmental institutions and to the incentives that these produce. As such it is tractable to theorizing about cause-effect relationships concerning structure, product and aggregate outcomes. It is, in fact, a question *unsuited* for empirical study, as attempts to measure the allocational efficiency of "central" versus "decentralized" government, in ignorance of plausible mechanisms, are likely to omit important explanatory variables and result in models which conflate causes and produce meaningless estimates. It is therefore important to provide a mechanism which adequately explains the central feature of the standard efficiency argument.

*Governance Values* comprise Wolman's second grouping, in which he includes: (i) responsiveness and accountability, (ii) diversity, and (iii) political participation. The first values, responsiveness and accountability, are easily the most important of these and comprise the political parallel to the argument about efficiency detailed above.

Decentralization, by placing government closer to the people, fosters greater responsiveness of policy-makers to the will of the citizenry and, it is argued, results in a closer congruence between public preferences and public policy. This is not only because decision-makers in decentralized units are likely to be more knowledgeable about and attuned to the needs of their area than are

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<sup>5</sup>Uncompensated costs or benefits imposed by one unit on others - e.g. downstream water pollution from waste treatment.

<sup>6</sup>Additionally, such a system of public goods-production would arguably have lower staffing requirements/running costs, as reproduction in local democratic government structures could be replaced by a smaller number of agents.

centralized national-government decision-makers, but also because decentralization permits these decision-makers to be held directly accountable to the local citizenry through local elections.<sup>7</sup>

However this argument, as presented by the political science literature, is also *a priori*. Politics in decentralized governments may be more closed than national politics, and more susceptible to interest-group capture or manipulation by powerful agents. Alternately, local elections may be contested on non-local issues, such as the popularity of the national government (as occurs in the UK). Wolman asserts that the question of whether responsiveness and accountability increase or decrease with decentralization is an empirical one.

Diversity in public policy is another argument in favor of decentralization. Diversity is valued because (i) it offers citizens a greater choice in public services options when they are deciding where to reside (see the Tiebout model below); and (ii) it is thought to encourage experimentation and innovation in public policy. Decentralization will thus result in a variety of policy approaches at the local level, some of which will be more successful than others. Once given policies have been shown to work, they can be taken up by other decentralized units as well as central government. This argument obviously depends critically upon the empirical question of whether decentralized structures really do foster greater policy diversity than central government. Limited research suggests that it does, but the question cannot yet be considered closed. The question of the diffusion of successful policy experiments to other units and levels of government is also an open, empirical one. We note, however, that the organizational literature stresses that decentralized structures promote innovation, while centralized structures promote adoption.

The devolution of real power to localities is also thought to enhance political participation amongst the people, because of the increased levels of interest and involvement in local government which it brings about. This process, it is argued, enhances democratic values and performs a systems-maintenance function, thus promoting political stability. Similarly, decentralization provides the opportunity for citizens to debate and decide upon those local issues which matter most to them, thus promoting political education. Lastly, local politics provides a training-ground for local leaders, who can then progress to become national leaders. These claims are also subject to empirical investigation; initial results are inconclusive, but not favorable. Participation levels measured by turnout at elections in the United States, a country considered decentralized, are notoriously low, especially for local elections (typically around 30%). It is also low in the UK (around 40%), but much higher in countries considered more centralized, such as France (70%) and Italy (85%).<sup>8</sup> Nor is the educational function of decentralization evident in the level of political discourse in the US and UK. This last point is probably related to the importance of mass media in the modern political discourse. When most political debate is mediated by a technology that displays extremely centralizing characteristics, the electorate is likely to be better informed about the intricacies of the national and international politics that fill the airwaves than they are about the state of the municipal sewerage system, or the performance of local police.

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<sup>7</sup>Wolman in Bennet, p.32

<sup>8</sup>Wolman in Bennet, p.34.

In conclusion, and in the wake of a wide variety of arguments, it is important to note that the intellectual core of the case in favor of decentralization is composed of a combination of the allocational efficiency argument with that concerning the responsiveness and accountability of local government. Other arguments regarding diversity, education and leadership development may bolster this reasoning, but are of secondary importance. The possibility that local government can be designed in such a way that it accurately perceives the needs of its electorate and faces clear incentives to attend to them, both to greater degrees than central government, constitutes a powerful hypothesis in its favor.

## V. What is the mechanism?

But the above discussion, though it would seem to point us in the direction of a theory of decentralization, does not explain in rigorous terms how decentralization achieves these results. Much of the argument is *a priori*, counterclaims are not adequately examined before being dismissed, and the conditions necessary for decentralization to succeed are not clearly delineated. What is the mechanism by which decentralization of the public economy brings about improvements in allocative efficiency? Is local government accountability an input or an output? Are local elections the only necessary legal/institutional prerequisites, or are other conditions necessary? It is to these issues that we now turn.

We begin by examining the economic literature. The most influential economic model of the local public sector is Tiebout's (1956) *A Pure Theory of Local Expenditures*. This paper imagines a world where efficient local governments compete to lure perfectly informed individuals, who move costlessly between localities and choose the one which offers their optimal bundle of public services and taxes. This revelation of preferences through migration brings about a competitive equilibrium in locational decisions which ensures that no individual can make himself better off without making someone else worse off: a Pareto-efficient result. But the mechanism which Tiebout posits – individual mobility in a context of fixed public service supply – amounts to moving voters around while holding politicians constant. This directly contradicts our experience of the world, where – save for extreme cases<sup>9</sup> – it is individuals who are largely fixed and governments which, via elections, change. Even in a highly mobile country such as the United States, during any given electoral cycle the overwhelming majority of the population is geographically static, and it is their governments and politicians (local, state and national) that change. Thus we must conclude that this model is fundamentally flawed: it posits a relationship which does not by and large exist in the world, and ignores a series of others (amongst voters, between voters and governors, amongst politicians vying for power) which do and may very well be important to the question of decentralization and social welfare.

Another way in which decentralization might improve public service provision involves information. Although the economics of information is a relatively new and still-developing field, the basic argument is that information about local preferences, along with technical data concerning the production and provision of public services, is so voluminous and complex that central governments are incapable of gathering it all and processing it adequately. Thus, important information will not be reported, or will be lost in transit, or will be interpreted incorrectly at the center, or some other sort of informational obstacle will arise which prevents the center from knowing what services the

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<sup>9</sup> Rwanda is one recent example.

periphery most needs and how best to provide them. These models' inability to explain why this is so in a precise and convincing fashion, however, amounts to an assumption that it is true. Though admittedly more elegant, this is not far removed from the operative element of the political arguments examined above. Perhaps more importantly, it is not clear in the closing years of the 20<sup>th</sup> century that distance poses a significant obstacle for the fluid transmission of information. In an age when CNN and MTV reach most corners of the globe, it is simply not credible that data on local preferences and other relevant conditions, once accurately gathered, somehow cannot be transmitted to the center without significant distortion or cost. Indeed, the modernization of communications systems would seem to have the opposite effect; as bandwidth increases and unit costs fall, central government becomes more viable, not less.

And yet we should not dismiss this line of thinking entirely. There is intuitively some sense in which local people have easier access to better local knowledge than non-locals. But to call this an information problem is to conflate distinct concepts. For the problem does not lie in the information *per se*, but rather in the agent who collects it. With proper incentives and local cooperation, a non-local agent could easily gather the relevant information necessary to provide a routine public service. And indeed, a local in the same position would require comparable conditions to succeed. But the local has obvious advantages on both counts. As a local, it is she, her family, friends and community who benefit from the efficient provision of that service. Thus she has natural incentives to perform her job accurately and honestly which her colleague does not. For similar reasons, she may find obtaining cooperation less costly. And she will have obvious, though not necessarily large, advantages of familiarity with local conditions, which it would cost an outsider to learn.

This argument is completely independent of the character, quantity or quality of the information involved, and concerns instead the performance incentives which agents face. As such, it is easily generalizable to a large number of tasks incumbent upon government agents, whether central or local, and therefore to the question of central vs. local government generally. Indeed, this insight lights the way to a deeper understanding of the efficiency implications of local government. As discussed above, where economies of scale dominate, central government will enjoy productive efficiencies in the supply of public services. Local government will enjoy advantages in allocative efficiency, however, to the degree in which local officials' professional incentives are more in line with the interests of the local population than the incentives of central government officials. This condition will obtain where local officials are fully accountable and responsible to the local population, and where electoral representation is sufficient to ensure that all groups have a voice in local affairs. Compared to such an environment, the incentives faced by national public servants, with a much broader and probably more diverse constituency, would by definition be less propitious to satisfying the needs of a given local population.

Such an argument constitutes the kernel of a theory of institutions, incentives and accountability in the provision of local public services. It comprises the heart of a political-economy model of decentralization, local government and optimal local-service provision which I am developing elsewhere, in a larger theoretical and empirical study of decentralization. I will not present a formal, fully specified version of this model here, but will instead limit myself to saying that such a model relies explicitly on local government autonomy in a context of real local power and resources, open and transparent local democracy, good (though not necessarily perfect) information on the part of voters, and some form of countervailing power or safeguard, institutional or otherwise,

to protect against abuses of power by local leaders. It can be shown with this model, and in a systematic and rigorous way, that decentralization changes the incentives which public officials face by making local government accountable to its electorate. Local officials will tend to respond to their voters' needs more than their central government peers, in the knowledge that their jobs depend on doing so. Local government will in this way produce outcomes (i.e. public services) which are more allocatively efficient than central government. The theory also predicts the possibility, given certain conditions, that decentralized governments can be more cost-effective (i.e. more outputs for a given budget) than central government as well. We now turn to the empirics of decentralization, where we shall see that both of these predictions are confirmed by data from a recent, radical decentralization reform.

## VI. New Evidence

We are fortunate to have an extraordinarily suitable case-study of the transition from highly centralized public service provision to one that is highly decentralized, including large amounts of data concerning not only budgeting and real expenditures, but local *preferences* as well. This is the case of Bolivia, since 1953 one of the most highly centralized countries in Latin America, which underwent an extremely rapid, nearly overnight process of decentralization in 1994. Because the process was accomplished so quickly, and because the degrees of centralization/decentralization were so great, the Bolivian case comprises a sort of social experiment which we can use to test the ideas developed above.

The Popular Participation Law promulgated by the Bolivian government in April, 1994, and implemented as of July of the same year, brought about an enormous change in the balance of power between local and central government. The legal context in which decentralization took place was that of a unitary (as opposed to federal) state where municipal governments are independent, freely elected, and report to no one other than their constituencies. The core of the decentralization reform consists of four points: **First**, the share of all national tax revenues devolved from central government to the municipalities was raised from 10 percent to 20 percent. More importantly, whereas before these funds were apportioned according to ad hoc, highly political criteria, after decentralization they are allocated strictly on a per capita basis.<sup>10</sup> **Second**, title to all local infrastructure related to health, education, culture, sports, local roads and irrigation was transferred to municipalities free of charge, along with the responsibility to administer, maintain and stock this with the necessary supplies, materials and equipment, as well as invest in new infrastructure. **Thirdly**, Vigilance Committees were established to oversee municipal spending of Popular Participation funds, and propose new projects. These are composed of representatives from local, grass-root groups within each municipality, and are legally distinct from municipal governments. Their power lies in the ability to suspend all disbursements from the central government to their respective municipal governments if they judge that such funds are being misused or stolen, as well as the natural moral authority which they command. When suspension occurs, the center undertakes no arbitration, but simply waits for the two sides to resolve their dispute, relying on economic incentives to speed their agreement. **Fourthly**, municipalities were expanded to include suburbs and surrounding rural areas, to the point where the 311 municipalities exhaustively comprise the entire national territory.

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<sup>10</sup> Whereas before reform the three main cities in the country received 84 percent of all devolved funds, and the majority of communities received nothing, after reform the three cities' share fell to 29 percent and that of provincial and rural increased between 42 percent and over 3000 percent.

In anticipation of decentralization, communities throughout Bolivia took part in a series of Participative Planning Exercises (PPEs) held at the provincial level (i.e. sub-departmental; Bolivia has nine departments), which led to the drawing up of Municipal Development Plans for some 150 municipalities so far. These seminars were convoked for three days each by facilitators from La Paz, included representatives from all sectors and strata of society, and were designed to discuss local problems and needs, suggest solutions, and eventually produce a list of projects for each municipality drawn up by consensus. While it is true that this methodology presents opportunities for the manipulation of opinion by the wealthy, educated, etc., there is no practical method for ascertaining information on needs other than asking the needy. Having observed one such complete exercise, I have every reason to believe that reasonable precautions were taken to ensure objectivity, and no reason to think that repeating the exercise would produce superior results.

In a year-long study of decentralization in Bolivia, I seek to combine the standard econometric analysis of a large, municipal-level database which I am building with more qualitative, deeper analysis of the social and institutional dynamics of municipal governments and municipal societies, which affect institutional performance but are not captured in the objective data. The large database includes substantial and very detailed data on the sources and uses of municipal funds, local preferences and priorities captured by the PPEs, a large amount of social, institutional and demographic data from the most recent census and integrated household surveys, and electoral data from the last two elections, among others. Most of this data has only become available during the past three years, as many of the types of information I am working with were not produced until quite recently, and financial and demographic data were not compiled at the municipal level before 1994. It is an additional stroke of luck that a national census was carried out in 1992, supported technically and financially by various aid donors. The main previous source of such demographic and social information were estimates based on the 1976 census, which by 1992 were woefully inaccurate. The qualitative research, by contrast, was carried out during 6 months of work in the field, most of which was spent in 9<sup>11</sup> municipalities spread throughout the far reaches of Bolivia, selected to control for size, region, economic base, rural vs. urban setting, and cultural and ethnic makeup. This research involved extensive interviews with grass-roots representatives, elected and appointed government officials, and a variety of other business, labor, religious, and indigenous/ethnic leaders, as well as gathering planning, budgetary, and geographic data from local sources.

### *Does Decentralization Make A Difference?*

The lessons which we can draw from this research are not yet final, as much work remains to be done. But a large portion of the data has been carefully analyzed and there are already a number of robust conclusions which we can discuss. To begin with, aggregate public spending patterns *do* change when resources and power are devolved to lower levels of government. And they do so in ways which this researcher at least finds positive and heartening, although we do not wish to make too much of this as we will examine spending in the light of objective needs below. A comparison of annexes 2 and 3 shows that the share of Education, Civil Works, and Water & Sanitation in total national investment rose dramatically after decentralization, whereas investment in Multisectoral, Industry & Tourism, and Communications fell. And if we disaggregate local from central government figures, we see that municipal spending in these first three categories was proportionally much higher

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<sup>11</sup> Annex 8 lists 10 municipalities: 9 case studies and 1 pilot. The annexes which follow include graphs with only 8 observations. This is due to incomplete information when they were made, which will soon be remedied.

than that by the center. This is further bolstered by examining *average* municipal investments (Annex 3),<sup>12</sup> where we see that in both percent and per-capita terms it is the smaller municipalities which place a higher priority on Education and Health. A much coarser measure – the number of municipalities which spend (any amount) in each sector (Annex 4) – reveals a similar picture. We must conclude that decentralization is not a policy-neutral measure, and does indeed have significant implications for the structure of public spending and investment. As the theory above predicts, local priorities are different from those at the center, and shifting power and money into the hands of the community<sup>13</sup> produces different outcomes. Whereas the national government prioritized investment in Hydrocarbons and Transport, local governments prefer to invest in human capital and social services. The latter, public goods with significant externalities, appear – to this researcher at least – to be preferable to items such as Hydrocarbons, or Industry & Tourism, sectors from which local governments should almost certainly stay away. But we do not wish to emphasize subjective assessments. We turn now to demographic data to investigate whether or not municipalities spend according to objective needs.

Allocative efficiency, a theme so central to any discussion of decentralization, can be investigated quite carefully for Bolivia by comparing public spending patterns before and after decentralization to (a) the demand for public investment, for which we can use the results of the PPEs, and (b) health and educational indicators, and other demographic data which indicates objective need for given services. Part (a) of the analysis is unfortunately not ready, as data on the results of the PPEs have only recently become available. Once we have these results, however, they will by their nature be an especially powerful indicator of whether or not local governments respond to demand. Part (b), on the other hand, is far advanced, and rewards scrutiny. The tables of Annex 5 list t-statistics<sup>14</sup> from a series of regressions on different measures of educational budgeting (*ex-ante*) and investment (*ex-post*) from 1994-5, for all 311 of Bolivia's municipalities. They tell a provocative story of how these decisions are made. We see from these results that positive educational attainment levels are significant and negative terms in the models, whereas no attainment (no schooling) and literacy are significant and positive. This holds for both budgeting and real expenditures, and across different measures of spending (percent of budget, per capita, and per student enrolled).<sup>15</sup> School attendance rates and the number of classrooms per student are also negative and significant. These results indicate that municipalities effectively treat their education budgets as investments in human *capital*, with familiar characteristics of decreasing returns, and not only as simple service provision. While education is a widely favored investment, and those who are literate prefer it more than those who are not, the surprising result, controlling for this effect, is that education spending rises as educational attainment *falls*. As the stock of educational capital decreases, and thus the return to education rises, municipalities choose to invest more in education. As their never-schooled population rises they spend more as well. Education spending also rises

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<sup>12</sup> Here we calculate sectoral shares of each municipality's budget and then average over 311 municipalities, in effect treating all municipalities as equals. This is as opposed to aggregate spending totals, which emphasize the priorities of larger municipalities which invest more.

<sup>13</sup> How power is exercised locally – i.e. whether local government is run in the interests of the community or against them – is one of the more important issues of decentralization. We examine it further below.

<sup>14</sup> Due to the types of variables used (i.e. rates, percentages, indices and dummies), the coefficients from these regressions are not easily interpretable, so I exclude them for now.

<sup>15</sup> Educational indicators are from the 1992 census, whereas budgetary data are from 1994-1995. Thus there is no endogeneity problem between education budgets and enrolment rates. Also, educational attainment rates and literacy are measured amongst the adult population, whereas enrolment rates are of children of school age.

with the Unsatisfied Basic Needs indicator (which rises with greater levels of deprivation), and falls with increased values of the Human Development Index (which falls as human development improves), supporting the human capital model of investment decisions.

The story for Water & Sanitation and Transport, though so far less detailed, is similar (Annexes 6 & 7), though with an interesting twist. Investment in Sanitation rises as fewer households have private sewerage service. This agrees with the above interpretation. As more households have public standpipe service, however, water investments increase, and the “no service” term for Water & Sanitation is not significant. This implies that in the water sector a logic similar to that in Education is at work, but only among those with some level of existing service. Hence investment is greatest where there exists a low level of service and decreases as service improves, but the poorest of the poor are ignored. By this interpretation, attention is skewed toward the “bourgeois poor”. Another explanation is that those who do not have water service may not realize its value and not demand it, whereas those who have tasted the benefits of a low level of service want more, and in this case get it. The Transportation equations suffer from a lack of viable indicators of need. The notable term here is peasant communities, which is positive and (barely) significant. Thus, where a given municipality has more peasant communities,<sup>16</sup> which tend to be dispersed across rural areas, transportation spending is higher.

These results point consistently to a highly rational model of local decision-making where the fundamental criterion is need, and governmental outputs are conceived of as the equivalent of productive capital, with the marginal investment going to those municipalities where the return is highest. This finding is both robust and surprising, especially when we consider that most of the municipalities which account for it suffer high degrees of deprivation, with poor, badly educated voters and governing officials generally unprepared for their posts. And yet the decisions they make are not only rational, but more rational – the evidence above suggests – and more in line with local needs than decisions made at the center. Powerful supporting evidence comes from comprehensive interviews from the municipal case studies. Out of over 200 interviews, a mere 4 responded being less satisfied with local government than with government from the center; another 41 opined that the two were roughly similar; and the remaining 167 reported significant or dramatic improvements in public sector responsiveness. It is true that these were subjective interviews, with some risk of insinuating responses or misinterpreting answers.<sup>17</sup> But the magnitude of this trend cannot be ignored. We must conclude that allocative efficiency, public service provision, and indeed popular satisfaction with government have all improved with decentralization.

This directly contradicts claims that local government is too poor, too ignorant, or too prone to interest-group capture to operate efficiently, necessitating the guiding hand of national government which is technocratic, capable, and generally knows what to do. Here we begin to see evidence of the opposite: local government has a deep understanding of its task, and has the capability and the incentive structure to produce the public outputs that people want. It is worth reiterating that these results are not final, and there is much (very) new data that must still be incorporated into the analysis. But we also note that the results so far are quite robust, all point in the same direction, and are most unlikely to be overturned by new data.

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<sup>16</sup> Bolivian municipalities – including cities – include large rural catchment areas.

<sup>17</sup> Equal numbers of well and badly-performing municipalities were chosen for the case studies. Thus, there should be no bias in favor of municipalities where respondents are happier.

### *Local Government Effectiveness*

Having established that decentralization does work, we turn to the question of how, and to the ultimately similar question of where, it works. And we begin noting that regression analysis obscures the existence of enormous diversity in municipal performance and local responses to the challenges of decentralization. From huge, urban, complex La Paz strung off the edge of the altiplano to tiny Baures deep in the bowels of the Amazon, the 311 Bolivian municipalities vary immensely in their levels of human capital, institutional capacity, natural resources, size, populations, and many other factors that affect in differing ways the quality of government they achieve. Close inspection of their spending patterns, action plans, and results obtained thus far reveals a similarly broad range of local-government effectiveness and efficiencies. What variables explain this variation? Why does local government succeed in some localities and fail in others? Are the determining factors mainly economic, geographic, social or institutional? Are they susceptible to policy interventions, or are some municipalities simply destined to corruption and failure?

Additional econometric work will undoubtedly shed much light on this question. But we turn now to qualitative research from the case studies, which offers insights with a richness of depth and detail that econometric approaches cannot match. Annex 8 shows descriptive and selected administrative data on the municipalities chosen. We see here how these cases varied in size, region, language and culture, environmental and social diversity, and economic base;<sup>18</sup> insofar as possible, we tried to control for local government success to date as well. The following results come from over 350 hours worth of semi-structured and unstructured interviews carried out at all levels of society, in several different languages, and under startlingly different conditions. The semi-structured interviews began with investment projects currently in execution, focusing on how they were planned and executed, and if they responded to real local needs. The interviews then broadened to include a range of questions concerning local government performance, interest-group capture and representation, and satisfaction with municipal outputs, trying always to establish *why* subjects responded as they did. Unstructured interviews were much more far-ranging, according to subjects' interests and willingness, but were mainly concerned with social and political conflict and their effects on the quality of local government. The results from these interviews were characterized and systematized into a series of discrete variables ranging in value from 1 to 100. These were then classed as dependent and independent variables, and used to create the graphs in Annex 9, which explore the causes of local government effectiveness. The following is not the only, or even the main, way in which findings from the cases will be ultimately used; but it is a very efficient way in which to present a vast amount of information.

We see in the first two scatter plots that Mayor's Effectiveness tracks Local Government Effectiveness<sup>19</sup> (LGE) very well, whereas Municipal Council Effectiveness seems to have less of an effect. This resonates with the general impression that strong mayors have a large effect – for good or ill – on the municipalities over which they preside, and might be explained by the persistence of patriarchy and paternalism in large parts of Bolivian society. But as a theoretical explanation and

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<sup>18</sup> This would seem a large number of variables for which to control in a “sample” of 9, but in Bolivia region, language, culture, and diversity largely track each other.

<sup>19</sup> Local Government Effectiveness combines measures of distributional equity, citizens' prioritization of services provided, and their satisfaction with outcomes with an indicator of local political transparency to calculate this index.

policy prescription it is not very helpful: “To have good local government we need good mayors”. We must look deeper.

The next two graphs reject prominent tenets of the conventional wisdom on decentralization. Defenders of centralism claim that poor, rural, distant locales lack the human, technical and economic resources for successful local government, and that ignorance and poverty mix with tradition to create a dangerous brew of domination and oppression. If this is true, we would expect LGE to fall as the index of Unsatisfied Basic Needs rises (where 1.0 is maximum deprivation) along the diagonal line. Likewise, this view holds that government will be more effective in large, urban populations than in small, rural ones. But our evidence indicates the opposite. Those populations where unsatisfied needs are greatest achieve the highest LGE values; if there is a systematic relationship, it is upward, not downward, sloping. And LGE shows no strong relationship with municipal urban-ness, although, again, if there is a relationship it is the opposite of what conventional wisdom suggests.

The last three graphs also contradict the centralist thesis, and offer reasons for why it is wrong. We see in the first that LGE decreases with employees per municipal population, whereas one might expect government to be better where it is more fully staffed. Likewise, as local tax revenues increase a municipality has more resources to work with, and so might fairly be expected to offer better services.<sup>20</sup> But the opposite is true: LGE increases as the local tax base shrinks, rising quite quickly as taxes approach zero. This is a surprising conclusion – municipalities which have fewer employees per capita and less money provide better local government. More careful examination of the data reveals that it is the smaller, poorer municipalities farther removed from urban centers which produce better government and higher levels of citizen satisfaction, whereas cities score low on distributional equity and popular satisfaction with outcomes. Data on aggregate spending totals discussed above confirm this result: average municipal spending patterns, which favor the many smaller, rural municipalities in Bolivia, are skewed much more towards primary needs and the social sectors than national totals, in which large cities are overrepresented. The last graph in Annex 9 offers the beginning of an explanation: it shows a decreasing quadratic relationship between Mayor’s Effectiveness and total local taxes. Thus, as local taxes fall to zero, and especially in the region near zero, mayoral ability increases dramatically. This suggests – as per above – that the best mayors are in the smallest, poorest locales, and the worst are ensconced in the cities.

To understand this result, we must consider that the Bolivian decentralization reform was launched with much fanfare and a publicity assault which attempted to communicate to everyone the simple per-capita formula of revenue sharing, and urged communities to demand of local government their rightful share. My research indicates that this campaign was largely successful, and throughout the country the pressure on mayors to deliver is significant. Own resources and the local tax base, on the other hand, are mysterious topics in municipalities that have them. Interviews in such municipalities consistently showed that only the Mayor and his Financial Officer had information on local revenues. Vigilance Committee members, grass-roots leaders, business executives, and even Municipal Council members were typically ignorant of how much was raised, let alone who paid it and – most importantly – how it was used.

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<sup>20</sup> Because central revenue-sharing to municipalities is on a strict per-capita basis, municipalities looking to invest more must turn to local taxes.

This leads us to propose the following, incentives-based theory of local leadership, which is consistent with the political economy model of local government discussed above. In a context of many municipalities of varying size and resources, and many political entrepreneurs who are mobile, corrupt politicians will seek office in large, complex, relatively resource-rich localities, and not in small, rural municipalities with no tax base. Thus, government of the latter will be left to relatively virtuous politicians with a public service ethic, or those who are cajoled into office. This is because: (a) small municipalities with no tax base are financed entirely by revenue-sharing, which is effectively watched over by the entire community as a result of the initial public relations campaign; (b) local, spontaneous forms of supervision and control are much stronger in small, rural places where anonymity is rare and word-of-mouth suffices to disseminate information throughout the community<sup>21</sup>; and (c) the social fabric is stronger, and the costs to social organization and mobilization lower, thus facilitating corrective action at the grass-roots when politicians go astray.

In cities, by contrast: (a) local resources are treated as a municipal secret, providing politicians with numerous opportunities for corruption; (b) spontaneous forms of social control are much weaker due to the high degrees of anonymity and complexity which characterize social relations in urban areas; (c) the fabric of city society is much weaker, as multilayered forms of organization based on activity or purpose, and not simple geographic location, prevail; and (d) urban anonymity and complexity significantly raise the costs of grass-roots mobilization against bad politicians. The burden of supervision and review thus falls upon the legal system, which in many countries like Bolivia is too weak to serve as an effective counterweight to abuses of municipal power. Thus, political entrepreneurs looking for opportunities to capture rents will naturally drift toward cities, and will actively avoid rural municipalities, which by default will be left to politicians who may be ignorant or hapless, but at least are honest.

## **VII. Conclusions and Policy Recommendations**

This analysis points to an ordinal ranking of the most important problems facing local government. Both the evidence set out above, and the theoretical framework which it supports, identify effective democratic representation and corruption as the most urgent challenges to good municipal government. Before these first-order issues, local capacity shrinks to the status of a second-order concern. But the usual priorities of local-government programs, including those financed by the international aid community, focus precisely on capacity building measures – implementing information and budgeting systems, accompanied less often with instruction in the rules of parliamentary procedure. These activities concern the mechanics of running a municipal government, but ignore the deeper problems that go to the heart of public accountability and legitimacy. If we ignore these problems we risk not merely wasting money and efforts in the wrong battle, but actually worsening the state of local governance by putting resources and knowledge in the hands of those bent on subverting local government.

Instead, efforts must concentrate on building a regime where the systemic incentives promote accountability and public responsiveness to local needs and demands. The point must be not to stop corruption at a given moment, but rather to install a system where politicians are held fully

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<sup>21</sup> “Quitarle el saludo”, literally to deny someone a greeting (i.e. as one crosses the central plaza), is a common saying in Bolivia, and expresses the sort of spontaneous ostracism which communities inflict upon politicians fallen out of favor.

responsible for their actions; where they receive full credit for their successes, and the full weight of public opprobrium is brought to bear when they transgress the bounds of legal and ethical conduct, through the media, the normal and spontaneous channels which arise in any social setting, *and through regular, fair elections*. In such a system, politicians interested in turning popular demands into municipal outputs will thrive, not only for the duration of a program, but sustainably over the long run.

Such a regime does not come about spontaneously, but depends crucially upon a number of minimum political and social conditions. The first is **an open, fair political system** – open to all parties and individuals, and with free and fair elections. The underlying rules of the game must be well-established, clear, and must be enforced if the system is to be legitimate and binding. Anything less risks corroding popular faith in the regime, erecting barriers to accountability, and may tempt extra-systemic behavior which can ultimately undermine local democracy, at least in substance. The second is **transparency in local political and economic affairs** – good information widely disseminated on the political and economic dealings of government. As per the case of local tax revenues discussed above, anything that serves as a barrier to transparency in the business of government allows rent-seeking to flourish. Thirdly, **social cohesion and organization** – where the fabric of society is strong, private – sometimes informal – methods of supervision and control can substitute for the legal safeguards which in many developing countries are too weak to ensure that high standards of public conduct are met. Lastly comes **central government as neutral administrator and referee**. Although this paper has dealt little with the role of central government, there can be no doubt that it is very important to the success of any decentralization program. Because most such schemes will include some element of central-local grants, and because the power of central government will extend to the local level even in a highly decentralized framework, its behavior will do much to define the context in which local government operates and the possibilities that are open to it. It is thus very important that the center resist the temptation to intervene in local affairs, so perverting the incentives inherent to the local system. A significant degree of local autonomy is crucial if local democratic incentives and controls are to have any meaning, and if voters are to take an interest in municipal affairs. Excessive meddling from the center risks downgrading local officials from administrators and decision-makers to lobbyists seeking national favor in the capital.

These, then, are the conditions under which decentralization – with good will, careful planning, and luck – can thrive. And with it the increased governmental effectiveness, distributive equity, and popular satisfaction which comprise decentralization's bright promise. We end this paper with a hopeful note from the field.

*Bolivia is the poorest, most backward country in South America. It has dozens of spoken languages, a ruinous geography, and almost no infrastructure. If we can make decentralization work here, it can work anywhere.*

*– Armando Godinez, anthropologist and social researcher*

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