Accountability and Coordination in a Decentralized Context: Institutional, Fiscal and Governance Issues

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Introduction

Poverty reduction strategies have primarily been developed within the context of centralized, national planning processes. Regional and local governments have largely played an informal role. For centralized governance systems, the informal nature of the participation of sub-national governments may be sufficient. However, in decentralized systems, direct and formal involvement of governments at the sub-national level is more critical to both the establishment of an effective strategy and its implementation. Some have suggested that decentralization is itself a poverty reduction strategy, with the implication that the form decentralization takes may be critical in determining the ultimate success. Certainly, with the increased local political, administrative and fiscal autonomy accompanying decentralization, the role and ability of local governments to directly formulate both explicit and implicit public sector responses to poverty and its reduction is greatly enhanced. Likewise, the ability of the national (or central) government to impose a national policy response is curtailed. To formulate and implement policy in a context of devolved responsibility and authority likely requires a different approached to policy development and coordination and different mechanisms to assure successful implementation of policies consistent with both national and local needs and priorities.

An important element of the promise of decentralization is the ability to tailor local public sector policy and service delivery to the needs of local populations, while at the same time providing incentives for an effective, efficient and locally accountable public sector. The conferring of local discretion in planning, budgeting and revenue mobilization, however, hampers the formulation of national responses. While it is recognized that national uniformity is not conducive to the most effective solution to a range of important public concerns, neither is ad hoc local unilateralism.

In decentralized contexts, mechanisms must be established to effectively link national and sub-national planning processes; to assure that national priorities are appropriately reflected in regional and local policies. Vehicles must also exist to assure that plans are realistically linked to resource constraints and that, once developed, plans are effectively incorporated into sub-national budgets. Doing so will likely require the development of a set of fiscal incentives to foster local acceptance and compliance with national elements and adequate levels of local resource capacity and autonomy to assure the ability to provide local functions. This may require a significant restructuring of current fiscal arrangements. Evaluation and feedback mechanisms must also be put in place to assess the effectiveness of
strategies adopted and assure local compliance in implementation with both national and local elements.

Both strategies and the mechanisms employed must be adjusted consistent with the distribution of existing governance authority. It also suggests that the wave of decentralization engaging the developing world has significant implications for effective poverty reduction strategies. Questions emerge as to whether centralized or decentralized structures are better suited for poverty reduction, identification of the tradeoffs implicit within structures and, within the variety of decentralized systems, which mechanisms and under what circumstances offer the likely best results.

Decentralization as a Heterogeneous Governance Construct

Dichotomous descriptions of nations as centralized or decentralized provide little relevant to the actual operations or implications of governance structures. Centralization / decentralization is a continuum with many intermediate positions. Even highly centralized nations normally have layers of decentralized administration. "Decentralization" is not synonymous with the effective restructuring of the public sector, for poverty reduction or otherwise. The basic issues involve the alignment of responsibilities and capacities across levels of government. At one level, at its core, this entails a division of expenditure responsibilities and assignment of revenue authority consistent with the spatial dynamics and various ranges of government provided goods and services and the spatial incentives and pricing characteristics implicit in mechanisms of public finance (Oates 1999). On another level, it requires consideration of the cultural and political environment and relative administrative, institutional and technical capacity (Shah 1998; Tanzi 1995; Dethier 2000). Both of these environments vary from nation to nation and between setting within nations.

Decentralization: Its Basic Forms.

Many have observed a "world-wide" trend toward decentralization. While decentralization is often associated with and even attributed to democratization, Dethier points out that decentralization and democracy are also not synonymous. "Decentralization has been carried out by democratic and authoritarian regimes from the left and right ...." and often out of a desire of these regimes to retain control (2000:3; Escobar-Lemmon 2001). Similarly, a federal structure in not a requisite. It has been occurring in both unitary and federal states (Escobar-Lemmon). Lindaman and Thurmaier (2002) Identify three waves of decentralization, each with different motivations and desired outcomes. The first wave (1950s - 1960's) was a political vehicle for increasing the popular support
of the state, individual politicians and ministers. Its focus was on decentralizing and deconcentrating administrative structures. The second wave (mid 1970s into the 1980s) was based on the presumed effectiveness of decentralized planning for implementing development programs. It included the rhetoric (if not the reality) of devolution of responsibilities. The third and current wave is argued to be ideologically driven by a preference for a "market-oriented" state. A large part of its focus is fiscal.

A uniform taxonomy of decentralization does not exist. Dethier identifies (but does not explain) three distinct forms: fiscal decentralization, political devolution and administrative deconcentration. Treisman identifies five basic forms of what he terms "political decentralization:" (i) structural decentralization, (ii) decision decentralization, (iii) resource decentralization, (iv) electoral decentralization and (v) institutional decentralization (2000: 2-3). Structural decentralization simply refers to the number of geographic tiers, with no distinction regarding range of autonomy within tiers. Decision decentralization encompasses the scope of autonomy. It refers to the range of issues for which subnational tiers have authority without being overturned by higher tier units. Resource decentralization focuses on the relative distribution of fiscal (revenue) or human (personnel) resources between central and subnational tiers. Electoral decentralization refers to the selection method of subnational officials. Local election, as opposed to central appointment, confers greater subnational authority. Institutional decentralization refers to the degree to which the subnational tier's representatives have shared authority or "rights" within the process of central government decisionmaking. Requirements of subnational legislative ratification of constitutional changes confers greater decentralization.

A consensus seems to be emerging around a three general forms of decentralization: (i) political decentralization, (ii) administrative decentralization and (iii) fiscal decentralization (Gurger and Shah 2000; Braun and Grote 2000; Rondinelli 1999; Tanzi 1995).\(^1\) None of these are precisely defined and Treisman's types could be subcategories in each. In a somewhat parsimonious taxonomy of a fairly complex political and economic process, Rondinelli (p. 2) defines decentralization as "the transfer of authority and responsibility for public functions from the central government to subordinate or quasi-independent government organizations or the private sector."

Political decentralization provides "... citizens and their elected representatives more power in public decisionmaking. ... It often requires constitutional or statutory reforms, development of pluralistic political parties, strengthening of legislatures, creation of local political units, and encouragement of effective public interest

\(^1\) A fourth form of decentralization is referred to as "economic or market decentralization" (Rondinelli). It entails a shift of responsibility from the public sector to the private sector via privatization of services or deregulation of private sector activities.
Effective and meaningful political decentralization and administrative devolution requires adequate revenue and expenditure authority. Fiscal decentralization entails access of subnational jurisdictions to revenue mechanisms necessary to exercise decentralized authority. This includes subnational taxes, fees and charges, intergovernmental transfers and debt. In a fiscally decentralized setting local jurisdictions have the ability to alter tax rates (and possibility bases) and charge structures to manage revenue availability consistent with expenditure responsibilities. This would include a system of fixed, objectively determined intergovernmental transfers.

The Case For and Against Decentralization

Decentralization is expected to convey a number of significant benefits resulting in improved governance, while at the same time posing potential risks. Their occurrence is dependent upon preexisting initial conditions, the form and design of decentralization and the level of institutional and resource support devoted to its implementation. These benefits and risks are detailed in Annex A and are only summarized here. Benefits include:

• Improved allocative efficiency;
• Greater technical / cost efficiency;
• Enhanced accountability;
• Democratization and heterogeneous representation; and

• Economic growth.

The primary economic justification for decentralization is allocative efficiency. It is associated with a more general argument that the proximity of government to its constituents improves the ability to gage public needs and desires and better match them in service delivery. It is predicated on the existence of participative mechanism to give voice to public desires. Also expected are improvements in technical efficiency due to competition among local jurisdictions for mobile citizen-consumers and investment and increased accountability for performance. Alternative jurisdictions function as a performance
standard, local discretion conveys focused responsibility. The result is greater accountability, as the empowerment of local officials to make autonomous decisions and deliver services places responsibility locally, within access of local populations. With this added responsibility and access, the public has a greater ability and incentive to act on their evaluation of performance either through the electoral processes or via formal and informal direct communication. Decentralization has also been pursued as a mechanism to counter secessionist pressures by providing greater autonomy and self determination to local populations. In doing so, it provides greater representation locally and regionally to populations which might lack the numerical strength to maintain adequate representation in national political institutions. In this regard, it may serve as a vehicle of increased democratization in heterogeneous populations. General improvements in the efficiency and effectiveness of public services are also expected to promote economic growth.

The arguments in support of the benefits of decentralization are largely derived from the experiences of Western democracies. Initial conditions in developing countries vary considerably. Obstacles to mobility, weak accountability mechanisms, poor technical capacities, and cultural characteristics may mitigate the expected effects and point a cautionary finger towards areas in need of particular attention to increase the likelihood of positive outcomes.

The postulated potential effects of decentralization are not, however, all positive. Decentralization may come with costs. The extent that these costs materialize is, however, often a function of the state of pre-existing institutional and governance conditions and political and cultural norms, and the details and appropriateness of design and implementation. Like the benefits, the costs are not given; however, they do reflect potential hazards of which to be wary. These include:

- Inadequate local reference information and under estimated central government responsiveness;
- Poor electoral accountability and corruption;
- Absence of local bureaucratic professionalism;
- Failures in geographic correspondence and inter-jurisdictional spillovers;
- Technical and demographic change;
- Fallacies of demand efficiency and mobility;
- Poor public expenditure management;
- Increased inter-regional disparities;
- Potentials for destructive competition and sub-optimal subnational spending;
- Problems in technical efficiency;
- Impaired macroeconomic stability and fiscal perversity.

While Annex A details each, these potential obstacles are highlighted here to underscore their relevance to effective planning and budgeting in a decentralized context. The first potential hazard is really a suggestion that the benefits of decentralization in a developing context might be overstated if local officials lack more accurate information (or an ability to...
It also cautions against a naïve assumption that the provision of services by a centralized government precludes local variation and responsiveness. Mechanisms exist for local responsiveness even in centralized contexts, so the relevant comparison of outcome is not as polar as suggested. The second mitigating factor cautions that an opportunity for increased local responsiveness is not likely to be consummated absent mechanisms of electoral accountability and considering opportunities for corruption. Similarly, inadequate local governance and bureaucratic capacity may siphon away the allocative and technical efficiency benefits of decentralization. Haphazard definitions of jurisdictional service boundaries and spillovers of benefits and costs between jurisdictions may also function to create failures in coordination or increase costs, again impairing allocative and technical efficiency.²

Should a local competitive environment be engendered through decentralization, the result are not universally desirable. It is possible for unbridled competition between jurisdictions to result in a degradation of the revenue base and an inability to provide an efficient level of local public services. Inter-local competition can potentially result in sub-optimal subnational spending. The reverse is also true. Absent competition as an efficiency motivator and in the face of problematic fiscal incentives (often associated with inadequate subnational revenue responsibility, gap filling transfers and soft budget constraints), subnational governments may be motivated toward fiscal perversity and excessive spending. This can hamper macroeconomic stability.

If providing for “basic needs” is the consuming function of government, then spatial variations in services based on differential preferences loses relevancy. Further, absent population mobility, the potential effect of competition and choice is muted. In addition, significant local and regional variation in income and economic activity can result in dramatic differences in fiscal capacity. Absent an appropriate intergovernmental fiscal system, increased local responsibility for service delivery can seriously heightened disparities in the availability of services to local populations. This can reach a level which severely threatens basic adequacy in poorer locations and likely reinforces existing disparities. Such are situations for which its is often difficult to explicitly compensate, particularly with a diminished central government role in service provision and the implicit redistribution which it entails.

Changes in technology and demographics also suggest the existence of a moving target for effective service delivery. While local jurisdictions would be expected to be better able to recalibrate for these changes, local capacity difficulties, resistance to change and the absence of vehicles to promote coordination across jurisdictions horizontally and vertically may accentuate these effects. Local management capacity is a particularly important issue for effective service delivery, planning and budgeting. With the

²This suggests the importance of coordinating mechanisms for service delivery both between and within levels.
general state of expenditure management systems being particularly poor at the local level in developing nations, the ability to effectively plan and execute local authority may be problematic. Embedded with this are the increased difficulties which emanate from augmented service delivery responsibilities and the importance of corresponding fiscal arrangements for financing these responsibilities. Adequate public expenditure management systems are critical to effectively exercising these responsibilities. It is questionable whether these systems (planning, forecasting, budgetary classification, accounting, treasury management, etc.) are capable to the task. This is particularly the case when implicit accountability mechanisms are weak and are magnified in the face of potential decentralized corruption.

The above litany of potential hazards in decentralization is not intended as an aggressive argument against its pursuit. It does, however, suggest rather vividly the need to for a purposeful design of decentralization to mitigate the likely occurrence of such effects. This purposeful design should hold the possible pitfalls as markers of the need for caution and balance in the pursuit of poverty reduction strategies in decentralized environments. Experiences of decentralization in practice should provide insight into the promising elements to be emulated (or pitfalls and consequences to be avoided) in pursuit of effective decentralization. From these experiences, lessons emerge.

**Affect of Decentralization**

The case for decentralization suggests positive effects for poverty reduction through public involvement in governance and the provision of more efficient and effective public services targeted at the needs of local populations with less waste and more effectively supporting private economic activities and development, democratization and nation building. The case against suggests the possibility of an opposite set of effects. The result that emerges appears to be determined by the pre-existing existing conditions, the form and mode of decentralization undertaken and the level of development of supporting institutional frameworks and capacities, such as local administrative and civil service reforms and political participation.

Unfortunately, most research has neglected a focus on determining the existence of necessary pre-conditions and institutions and has instead focused on specifying the structure of decentralization (usually with a focus on fiscal decentralization) and on the assessment of some measure of outcome. Little systematic empirical work has been done comparing relative preconditions and institutions, however, studies focused on more specific issues of service delivery, accountability and meeting the needs of the poor together.

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3Vito Tanzi has assembled an essay of necessary conditions (Tanzi 2000).
4This line tends to focus on prescriptions for revenue assignment, expenditure assignment and intergovernmental transfer systems.
allow us to construct a composite view of more successful approaches (see Annex B for a summary of a full sampling of the relevant research).

Accountability and responsiveness.

There are at least two levels of accountability in intergovernmental systems. At one level, there is accountability between institutions. Between, for example, bureaucratic agencies and executives and legislative bodies and accountability between governmental levels (local to regional to national and visa versa). At a more basic level, concern is for accountability between the public (however defined) and institutions of governance. The general thrust of decentralization is the latter, however, in an effective governance system the former is no less critical.

The appropriate balance of upward accountability (through regulation) and downward accountability (to constituents) is critical and situational. Effective decentralization does not mean an absence of central oversight. Regulation is surely appropriate when local government action might affect national monetary, trade or fiscal policy or where local governments are conducting functions on behalf of the central government. The form taken is quite critical. Where the effect of local behavior/policy is localized and requires detailed knowledge of local conditions, the justification for central regulation is more difficult. Effective service delivery must, however, include “a system of accountability that encompasses both regulation by central government and incentives for responsiveness to local constituents.” (Dillinger 1994)

Greater relative local (as opposed to central) accountability should not be taken as a given. Evidence suggests it is the existence of democratic institutions, rule of law and bureaucratic culture that is important to accountability and reduced corruption rather than the level of centralization/decentralization (Gurgur and Shah 2000). Decentralization is not likely to be successful at reducing corruption if not supported by community participation in policy making and functioning democratic institutions.

Accountability failures exist because of (i) political capture or (ii) bureaucratic corruption (Bardhan and Mookherjee 2000). The assumption in the literature is that local governments are more prone to capture. Whether or not this is the case is context specific and dependent upon the degree of voter awareness, cohesion of special interests, district heterogeneity and the national electoral system, including its competitiveness. (Bardhan and Mookherjee 2002)

Evidence dose exist suggesting that local officials do more accurately perceive

5Political capture generally results from low voter political awareness and special interest access. Bureaucratic corruption is a result of "... an agency problem between elected politicians and central bureaucrats, arising from poor communication and information systems that prevent effective monitoring and performance evaluation of bureaucrats." (p. 5) Agency problems are assumed to be reduced at the local level because elected local officials either personally manage or can closely monitor service delivery systems.
the preferences of local populations. Household opinion surveys in Uganda and the Philippines showed a closer correspondence between the preferences expressed by local populations and those perceived by subregional officials. (Azfar et al. 2001, p. 27-28). However, acting on these perceptions may be a different matter, particularly in situations absent democratic accountability mechanisms.

Local political accountability is undermined by poorly developed local democracy. Alternative and supplementary means exist to promote accountability and revolve around, organizational rules and defined organizational outputs, local fiscal responsibility and demonstrations of willingness to pay, minimizing transaction cost in articulating voice, appointed vs. elected office holding, forms of access, and sub-municipal administrative branch offices. "Yardstick competition" in which performance of public officials in one jurisdiction is us as a standard for evaluating others is also suggested as a vehicle for holding local officials accountable for outcomes (Bardhan 2002).

Supportive formal and informal institutions are necessary. Participation of citizens and transparency in decisionmaking is quite critical. Even barriers to decentralization in the form of immature budgeting, auditing and accounting systems can be overcome by "...institutions and mechanisms for citizen voice and exit, [and] norms and networks of civic engagement ...." (Shah 1998) To achieve "direct citizen participation requires that citizens have clear information regarding the municipal budget and service costs, and that they participate in actual budget choices." (Peterson 1997) Formal structures identifying the role of community organizations and citizens are also important.

Service Delivery: Intergovernmental Relationships and Outcomes.

The 1994 World Bank Infrastructure for Development report (World Development Report) identifies numerous examples of "the potential for improving service delivery by decentralizing government authority to independent sub national governments." (p. 74) Included is Mexico’s experience in decentralizing roads, bridges and water supply systems, where costs totaled only one-half to two-thirds of those of centrally administered projects. "A review of forty-two developing countries found that, where road maintenance was decentralized, backlogs were lower and the conditions of roads were better." (p. 75). Decentralization of water and sanitation was found to also produce improved maintenance and performance. "...[P]er capita water production costs are four times higher in centralized than fully decentralized systems and are lowest when decentralization is combined with central coordination."
Failures in decentralized service delivery exist, and in addition to problems in technical knowledge, are a function of "constraints and perverse incentives confronting local personnel and their political leadership, and ... these, in turn, are often the inadvertent result of problems in the relationship between central and local government" (Dillinger 1994). Decentralization could help alleviate some of these problems, however, as it has been pursued it is often not effectively designed for these tasks. In misaligned systems, perverse incentives in service delivery create technical inefficiency, allocative inefficiency, and inequity.

In exploring the experiences of Hungary and Slovakia, effectiveness in service delivery (defined as promoting efficiency, ensuring accountability and encouraging participation), is found to hinge on three central factors: (i) "appropriate expenditure and tax assignment," (ii) "governance mechanisms to strengthen accountability and fiduciary responsibility," and (iii) "incentive mechanisms to ensure that agents deliver services of an acceptable quality at least cost." (Dethier 2000). Information asymmetries between central and local governments require that compliance be induced either by monitoring and reporting or through incentive mechanisms to align the utility maximizing behavior of both actors. The key is to establish a framework (for example, financial management and accounting), reporting requirements, and monitor compliance directly and through public accountability requirements. This requires that a great deal of attention be focused on the intergovernmental finance structure. Proper management of funds and functions is also required and this is served by transparency (of budget documents and processes and annual financial statements) and enforcement of standards such as audit of local jurisdictions.

Based on the Latin American experience, Peterson (1997) cautions that strengthening municipal capacity requires professionalization of staff, mechanisms of citizen feedback and control, increased output expectations of local public employees, and workforce stability. Citizen participation, public and market accountability and own source and intergovernmental fiscal instruments promoting appropriate incentives are also found to be important. Findings in the Philippines and Uganda, suggest a number of problematic preconditions affecting service delivery: (i) local officials must (but often do not) have the authority to adjust service levels accordingly; (ii) technical efficiency is mitigated by local corruption of a scale sufficient to produce a problematic leakage of funds and resources; (iii) effectively eliciting accountability through citizen participation and voting requires information, and information dissemination regarding local issues and polices is inadequate; (iv) exit as a motivation for public service improvement is quite weak due to limited mobility across jurisdictions; (v) less than adequate levels of local government capacity (regarding personnel, and materials and equipment constraints); and coordination difficulties regarding services with significant interjurisdictional spillovers. (PREM 2001; Azfar et al. 2000)
Participation is also recognized as a key contributor to effective service delivery. In reviewing the five to ten year history of 25 agriculture and rural development projects, the participation of "beneficiaries and grass-roots institutions" was found to be critical in long term success. A review of 121 rural water supply projects found that those with "... high participation in project selection and design were much more likely to have the water supply maintained in good condition...." (World Development Report 1994, p. 76) The three keys to effective participation are: (i) directly involving beneficiaries; (ii) developing early project consensus; and (iii) acquiring beneficiary in-kind or cash contributions.8

"The primary problem with the decentralized delivery mode is the proneness of local governments to pressure from local elites to divert supplies to them. These [sic] reflect weaknesses in the functioning of a fair electoral process at the local level, lower levels of political awareness among the poor, and the tendency for wealthier groups to form special interest groups that contribute to campaign finance of political parties. The anti-poor bias, and hence targeting failures ..., tend to be more severe in regions with high poverty rates." (p. 35)

von Braun and Grote (2000) in cross country comparisons examine the effect of decentralization in advancing the needs of the poor. They suggest that effective decentralization may be expected to lead to both improved technocratic responses (improved targeting of limited resources) and institutional voice (through enhanced political participation). However, if unsuccessful, decentralization can have negative outcomes. "...[T]hose in power have few incentives to allow participatory institutions to develop." Corruption is an important element, as its effects are quite regressive and it increases income inequality. To improve the conditions of the poor, improved intra-regional targeting is required. Without this, significant inter-regional transfers (such as in India or Indonesia) will have limited effect.

Decentralization can be linked to aggregate positive outcomes. Casual observation reveals that countries scoring

8Korean village road building projects are cited as an example of consensus building. The experience of the Brazilian water sanitation project (PROSANEAR) highlights the importance of tailoring participation to local population conditions. The importance of blending centralized and decentralized infrastructure planning is highlighted in Malaysia. The participatory municipal budgeting model used in Porto Alegre Brazil is also considered illustrative of the potential for positive results (Bardhan 2002).
low on the UNPD Human Development Index tend to be politically centralized (von Braun and Grote). Cross-sectional regression of the UNDP index on measures of expenditure and revenue decentralization have also shown a relationship between fiscal decentralization and satisfaction of basic needs (Lindaman and Thurmaier 2002). When decentralization serves as a catalyst for dampening secessionist pressures, it tends to promote the maintenance redistributive policies and stability needed to provide for basic needs. Decentralization can, however, also escalate inter-regional tension were regional income differences are extreme.

Decentralization is not a certain cure, it has often widened education performance gaps between wealthy and poor jurisdictions, such as in Burkina Faso and Chile. However, in other nations (coupled with appropriate financing structures) gaps have closed. In New Zealand, Mexico and Argentina inequalities have declined (Fiske 1996).

von Braun and Grote consider the effects of decentralization on inequality and income distribution across several countries. They find that political decentralization often benefits the poor due to the involvement of civil society. There is less evidence for similar effects of administrative decentralization or fiscal decentralization. A minimum threshold of subnational expenditure responsibility appears to be a precondition for poverty reduction, but the reduction appears to plateau, such that high subnational shares are not associated with high levels of poverty reduction. Expenditure decentralization can also impair the delivery of critical social services (such as education and health) due to problems in institutional and/or managerial capacity and local political power of the poor.

Evidence of the importance of representation in determining the distribution of policy outcomes also exists. India's mandated representation of women in leadership positions at the local level is associated with increased female public participation and increased investment in infrastructure (such as water, fuel and roads) which provides for rural women's needs. (Chattopadhyay and Duflo 2001; see Bardhan 2002). Relatedly, Foster and Rosenzweig (2001) find that fiscal decentralization and democratization increases the political representation of landless households. (see Bardhan 2002)

Altered governance structures are also expected to be associated with increased economic output and growth.

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9In China, they report an increase in economic inequality and significant rural poverty. They attribute this outcome to governance factors such as "...distorted incentive structure, existence of powerful elite, or inoperative legal systems." India's decentralization allows the poor to exercise voting rights at three levels of local government. However, patron-client relationships sometime require the poor to vote based on preferences of their landlords. "India combines consistently high poverty rates, illiteracy, and poor social indicators with democracy." Only limited improvements have been made in the living conditions of impoverished populations. Ghana's district assemblies establish a framework for implementing participatory, pro-poor focused projects. Still, while the general poverty rate has declined, the benefits of growth have not accrued significantly to the poor.
But, in spite of economic improvements, the poor are often excluded due to capture and corruption. Mechanisms are required to assure adequate participation and targeting. To mitigate local capture effects, sectors relevant to poverty reduction should have shared local / central responsibility. For education, for example “some parts of the system (setting the curriculum, organizing examinations at the secondary school level, monitoring the quality of instruction, etc.) are best provided by central authorities with democratic control and oversight ....” (Dither 2000: 12)

Lessons

Complexity and Conflict

Altered central-regional-local arrangements are not just a phenomena of the developing world. In an extensive review of intergovernmental management in OECD nations, intergovernmental transition appears to be the norm. Here, both “supra- and sub-national bodies are becoming more important ... and semi-public and private sector bodies are becoming more widely and deeply involved.” (OECD 1997). The result is greater complexity in intergovernmental relationships. Subnational jurisdictions are becoming more important partners and within this shift the center is struggling “... to retain some overall control of expenditures and revenues, while local resistance mounts and calls for greater freedom of action grow stronger.” Experience across 26 OECD countries highlights a variety of tensions in intergovernmental relation. These tensions entail establishing an appropriate balance between: (i) increased local autonomy, while maintaining overall direction; (ii) providing for local differentiation and flexibility, while assuring “some minimum degree of uniformity,” and (iii) promoting greater responsiveness to local desires, while maintaining economy and efficiency in service delivery. These tensions have required important alterations in “central government management vis-à-vis sub-national levels.” These include:

- adjusting financial and administrative controls away from detailed, top-down requirements and toward broadly-agreed frameworks and ex-post, results oriented instruments;
- developing co-ordination and consultation mechanisms for a more comprehensive and coherent approach to target-based governance and which fit the cultural context and the “style of relationship” in each sector;
- promoting accountability procedures which combine managerial responsibility for financial results with political accountability to the public which are in accordance with the shift towards greater participation by citizens. (OECD 1997: 70)
These conflicts are often accentuated through suspicion and a lack of confidence between levels of government. “The problem of mistrust ... is mutual in that it operates in both directions.” While these general issues appear uniform across nations and across the developed / developing world, there is no one best way for for dealing with them. Unique economic, cultural, political and capacity issues determine what is possible and desirable. Still, improved transparency and communication in intergovernmental relations appear as universally desirable features.

Unfortunately, decentralization initiatives have often not lived up to their expectations, particularly in the developing context. This often is the result of weak local governments and hastily developed programs stimulated by political or economic crisis. The main factors hindering success include: (i) an inadequate institutional framework to oversee and facilitate decentralization, (ii) conflicting central government political and bureaucratic incentives, (iii) limited local managerial and technical capacity, and (iv) inadequacies in local government accountability to local constituencies (Smoke 2000).

Based on a review of the motivations for and effects of education decentralization, Fiske (1996) suggests several general conclusions. One is the that: “Political objectives alone can be used to justify a decentralization program.” (see panel 1) When this is the case, concern for other outcome become quite secondary. For any purpose, building a consensus is critical to success.
### Panel 1: Underlying Reasons for Decentralization: The Case of Education

<table>
<thead>
<tr>
<th>Country</th>
<th>Reasons</th>
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<tr>
<td>Columbia, 1991</td>
<td>A means to a political goal of &quot;stability and legitimacy for the central government&quot;.</td>
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<td>Hungary, 1985</td>
<td>School autonomy &quot;as a reward for the fight for political freedom&quot; in an attempt to fill a political vacuum. The result has been fragmentation, manipulated funding formulas, inefficiency and deficient local capacity such that the decentralized system has had to &quot;struggle for legitimacy.&quot;</td>
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<tr>
<td>Spain, beginning 1970</td>
<td>To placate centrifugal forces and neutralize threats of regional secession. A &quot;critical&quot; element in a peaceful and orderly transition from authoritarian to democratic government that has been described as the miracle of Spain.</td>
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<td>Brazil, early 1990's</td>
<td>A policy position that &quot;the road to quality education lay in giving local communities a greater say in running their schools.&quot; Financial, administrative and curricular autonomy was granted to elected school boards. It was intended to break the tradition of patronage and has increases operational efficiency.</td>
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<tr>
<td>New Zealand, 1989</td>
<td>Effort to reduce centralized administrative bureaucracy. Eliminate regional level of administration to localize decisionmaking and streamline administration.</td>
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<td>Mexico, beginning 1978</td>
<td>Administrative and bureaucratic difficulties and notorious delays in centralized pay system. At tempted to devolve responsibility to states resisted by teacher unions and concerns about salaries and pay. Fourteen years to achieve decentralization due to concerns of teacher’s union in negotiating with 31 states.</td>
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<td>Zimbabwe, 1980</td>
<td>Desire of universal, but decentralized unitary system of education spurred by socialistic political ideal of &quot;popular participation, self-reliance, and democratic decisionmaking&quot;. Later political impasses over control spurred by central attempts to centralize teacher pay and appointment as a result of quality problems and delays in teacher compensation.</td>
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<tr>
<td>Argentina, 1975</td>
<td>To stimulate local revenue mobilization and off-load fiscal responsibility to the provincial level and below. Education policy remained centralized, including regulations setting wage bill.</td>
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<td>Chile, 1980</td>
<td>Stimulated by military government’s view that &quot;teachers as a group were an enemy of progress.” Sought to lessen their influence by fragmenting and devolving decision on hiring, firing and wages. Teachers were removed from civil service status. However, curriculum remained centralized and participation in school policy making was not significantly opened to parents and teachers. In 1990 a new democratic government was elected and began a new round of decentralization focused on democratic reforms. Teachers, backing the change in government, regained civil servant standing and lobbied for a return to centralization. However, additional local discretion in education decisionmaking regarding curricula was granted and a more democratic form of organization was adopted.</td>
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<tr>
<td>India, 1992</td>
<td>State responsibility for education was further decentralized to local jurisdictions with a constitutional amendment establishing a three-tiered structure of locally elected governance bodies. Inefficiencies have been exchanged for the prospects of community control, however, signs of elite capture exist.</td>
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<tr>
<td>Venezuela, 1969</td>
<td>Education reform as a basis for economic development. Education responsibility was decentralized to regional administrative territories. The political appeal of decentralization created an environment of perpetual change in personnel and policies as electorally victorious parties sought to demonstrate their commitment. In 1991, an attempt was made to shift responsibility for schools to state governors. Governors have only been willing to accept responsibility for those in good physical condition with education programs that meet minimum quality standards.</td>
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The impetus of reform (how problems are defined and solutions proposed) appears to be as important an element to success as is its actual content. Studies indicate that it is the executive rather than legislature, parties, interest groups or think tanks that initiate institutional or policy change (possibly because in developing countries these other actors lack staff and resources to design change proposals). How political leaders became concerned and how they responded, how the content of reform is developed, and the structure of design teams and their function are important factors in determining the content of reform initiatives and the conflicts that will envelope the introduction of new policies and initiatives. (Merilee 2000).

This suggests that initial planning may set the stage for overall outcomes. Successful decentralization programs have almost always included clear statements of the reform objectives (World Bank 2000: 41). Using Indonesia as an example and pointing to potential deficiencies in its reform program, the World Bank highlights the need for a coordinated definition of expenditure and revenue assignment, clearly established objectives guiding the design of intergovernmental transfer systems, clearly articulated implementing regulations which include consultation with civil society in their development, standards for evaluating success, and a strategy for appropriately adjusting structure and policy. These are all dependent on a clear, up-front statement of objectives to guide decentralization.

Tanzi (2000) reinforces the importance of appropriate initial conditions, but more broadly. He stresses eleven "issues to worry about", but provides little prescription for dealing with them. These issues include: (i) geographic scale and the inherent disadvantage of large countries, (ii) privatization as an alternative to decentralization, (iii) excessive regulation accompanying multiple layers of government, (iv) excessive internal market fragmentation due to differing regional regulatory and tax policies, (v) decentralized corruption, (vi) the importance of revenue and expenditure assignment and intergovernmental transfers, (vii) impediments to tax reform caused by decentralized fiscal structures, (viii) difficulties in coordinating fiscal policy to achieve macroeconomic objectives, (ix) impediments to fiscal transparency created by fiscally important and independently operating subnational jurisdictions, (x) centrifugal forces caused by regional disparities in resources, and (xi) tendencies for duplicative administrative employment and inability to take advantage of economies of scale. Tanzi concludes that "...the conditions for successful decentralization are often not present. When this is the case, more decentralization means the the country pays a price in terms of efficiency and/or stability." For Tanzi, the key is institutions, "... especially institutions that allow the central government to transfer resources to local government with some assurance that the resources will be used effectively and for the purpose for which they are passed on ...."

Comprehensive Reform vs. Evolutionary Processes.
A balance is needed between “unworkably comprehensive” attempts at decentralization and limited technically oriented adjustments divorced from broader reform efforts. While decentralization generally entails a demand-side (citizen participation) focus, supply-side (governance) capabilities are critical to success. Decentralization reform programs should also recognize capacity differences between local jurisdictions and vary treatment accordingly. This suggests potential problems for highly standardized reform programs. Asymmetric decentralization can, however, be a difficult field to traverse. Variation must be objectively based on capacity and appropriate range, to assure that local variation does not develop into individual local negotiation for fiscal advantage. (Smoke 2000)

While this suggest potential obstacles, it also engender numerous prescriptions for success and promotion of best practices for realizing the potential of decentralization. The appropriate scope for decentralization is a critical determination and is dependent on the local situation. Local government capacity, resource availability and accountability mechanism are central to improved government performance (Smoke 2000: 17). Decentralization should be viewed as a gradual, continuing process rather than an immediate response to current conditions producing a normatively desired outcome. Process is important and the road to desired outcomes is often long and arduous. Established processes and institutions are the rails that keep the pursuit of outcomes on track. Establishing consensus from important institutional actors on how to initiate reforms is likely more critical to ultimate success than the detailed design of the reforms themselves. Process and consensus are precursors to establishing an appropriate enabling environment and framework for a sustainable local government structure.

Augmented and Shifting Roles Across All Levels.

Effective decentralization actually requires an increased role of central and regional governments in promoting the development of local jurisdictions as effective governance institutions. Higher level jurisdictions are critical in establishing procedures and standards for improved local operations and transparency, and for promoting the accountability of local officials to local constituencies. (Smoke 2000) “New skills are needed to manage multi-tiered systems with diverse, fragmented and interdependent components.” (OECD 1997: 15) Central governments must conduct analytic studies to monitor and evaluate the decentralized system, determine tax effort, track subnational budgets, evaluate fiscal alternatives, establish and administer transfer systems, regulate local borrowing, establish fiscal information systems, establish audit procedures, establish personnel and environmental regulations, qualifications for public employees, minimum service standards, mechanisms to resolve intergovernmental disputes, and establish sanctions (World Bank 2000). Reforms in Kenya, Cambodia and Brazil have included central and provincial
facilitation as a major element in local capacity building. (Smoke 2000)

Coordination of Multiple Institutions and Actors.

Administration of decentralization is, itself, often centralized. Because decentralization necessarily involves the devolution of fiscal and sectoral responsibilities, a wide range of central government agencies and officials are implicitly involved. Effective decentralization, while possibly coordinated by a local government, planning or finance ministry, must include sectoral ministries to assure harmonization of policies across levels of government. Beyond this, non-governmental organizations, civic groups and private organizations should be effectively involved. With such a broad array of actors, coordination becomes a special challenge.

The benefits of decentralization emerge through local adaptation, but require more elaborate (and sometimes, informal) means of coordination. It is possible for a single agency to effectively function in a coordinative role, however, the fact that usually several agencies are involved with different aspects of decentralization requires that a neutral or higher level entity (such as the office of the president or prime minister) take charge to formalize responsibilities, and monitor and assure individual entities fulfill their responsibilities. (Smoke 2000)

General Principals of Effectiveness.

In reviewing the effectiveness of fiscal decentralization in transitional settings of Russia, Ukraine and Kazakhstan, Norris, Martinez-Vazquez and Norregaard (2001) offer “three basic principles” to guide decentralization in establishing incentive mechanisms to ensure the overall objective of “accountability and transparency at all levels of government.” These principles are:

- “The need for clarity of roles between levels of government.” Roles should be stable and transparent. Overlapping responsibilities often lead to “expenditure dumping or unfunded mandates.” Clarity is defined via legal and institutional structures, expenditure and revenue assignment and an objective non-negotiated transfer system.
- “A measure of autonomy for subnational governments on both the revenue and expenditure side is crucial ....” This entails flexibility to establish and budget for priorities, desired service levels and production modes. On the revenue side it entails access to meaningful revenue sources accompanied with the ability to establish tax rates and / or base. Meaningful autonomy also requires minimal access to resources by all jurisdictions. Because of differences in capacity, this requires the establishment of equalizing transfers.
- “Institution building ....” Sufficient administrative capacity is necessary to fulfill decentralized responsibilities. This requires adequate staffing, materials and equipment. Beyond this, democratic institutions and participation, appropriate budget
processes and procedures, and institutions to assure cooperation and coordination between levels of government are required.

Reviewing progress in Hungary, Ebel, Varfalavi, and Varga (2000) identify what they consider to be a relatively effective model for movement toward fiscal decentralization. The importance of a comprehensive legal framework (which incorporates the independence of local governments as public service entities with assigned tasks and taxing power, discretion regarding the range of responsibilities undertaken, and accountable to local citizenry) is stressed. But the limitations of such a framework are also recognized, as is the need for a continued sorting of relationships. Lingering issues "... include the strengthening of local revenue systems (and, here, local officials must start taking more responsibility), reconsideration of the assignment of functions and authorities among different types of subnational (e.g., local and county or other regional) governments, and a continued experimentation with the system of central-to-local fiscal transfers."

Cohen and Peterson (1997) focus on an administrative framework they refer to as "institutional pluralism" as a vehicle for strengthening local governance through pluralist rather than monopolistic administrative design.

Planning is shared and participation maximized (see panel 2). Anwar Shah (1998) also offers a general prescription for successful fiscal decentralization. It is rather comprehensive in its view of decentralization and highlights the need for an environment conducive to citizen participation, appropriate societal norms, threshold administrative capacities, the value of asymmetric decentralization, and proper revenue, spending and fiscal structures (see panel 3).

Comment: Dillinger identifies four critical areas: (i) linking services to levels of governments, and suggested mechanisms (p.24); (ii) geographic specificity; (iii) linking revenues to expenditures (finance following function ... user charges, benefit taxes, transfers, etc.); and (iv) Balancing regulation w/ political accountability (p. 33).
Panel 2: An Integrated Conceptual Approach: Institutional Pluralism

Institutional pluralism is an "administrative design framework" to assist designing and implementing administrative decentralization. The attempt is to simultaneously "strengthen local-level governance, increase transparency and accountability, and improve governmental performance...." Its focus is on organizational and institutional roles and is based on the principle that "...providing allocative tasks through a pluralist, rather than a monopolist, administrative design promotes accountability, ... the most important part of administrative design." (p. 2)

Institutional pluralism is a form of administrative decentralization / deconcentration in which roles related to financing, regulation and implementation are shared by at least two institutions or organizations. This may include private firms and organizations. It attempts to leverage public with private resources "by promoting role pluralism among task-related actors." Public institutions become network brokers. (p. 9)

Institutional monopoly is too be avoided and is not a function of centralization or decentralization. Decentralization is conventionally the displacement of a central institutional monopoly with one which is more localized. "Institutional Monopoly, be it held by a central governmental unit or distributed to non-central or private levels, is an administrative strategy that does not promote accountability." (p. 7) Decentralization in the form of distributed institutional monopolies are largely unsuccessful, "they [generally] have neither the legal basis nor the technical capacity of the center ... nor do they have legitimacy to leverage local private resources for public goods and services." (p. 8)

Objectives and goals are organized around the public sector roles of stabilization (solvency, openness, and competitiveness), distribution (side-payments, political support, economic growth, and equity) and allocation (adequate human, fiscal and political resources). In carrying out administrative reform, national leadership is essential including strong political commitment. It is important that a defined strategy regarding preferred outcomes be centrally defined and that the process be regulated. Oversight should typically be shared as should financing.

Planning should also be a shared function, with initial overall strategies developed centrally and centrally sponsored transition to greater local involvement and capacity development. The brokerage role (of using the market and civil society for the provision of collective services) is also a properly centrally / locally shared function, with market and civil development both local and central functions in spawning private sector roles in service delivery.

Effective administrative decentralization requires a strong center to provide an effective enabling environment for role decentralization and decentralized service delivery. Obstacles to institutional pluralism include the coordination costs associated with management of task-related roles, imperfections in markets and weakness in private partner institutions and organizations, and inadequate personnel and financial resources to accomplish task-related roles.

Panel 3: Lessons for Successful Fiscal Decentralization

- Enabling environment for decentralization, i.e., institutions of citizen participation and accountability must be addressed in any serious reform of fiscal systems.
- Societal norms and consensus on roles of various levels of government and limits to their authorities are vital for the success of decentralized decisionmaking.
- Civil service reform is critical to the success of a decentralization program.
- Evaluation capacity development is of fundamental importance in public sector reform in developing countries.
- Traditional administrative capacity matters but should not be considered as an impediment to decentralization.
- Asymmetric decentralization as provided under the Indonesian Decentralization Program and under provincial local government ordinances in Pakistan offers a thoughtful approach to decentralization.
- A major separation of spending and taxing decisions leads to a lack of accountability in the public sector.
- Sharing revenues on a tax by tax basis distorts incentives for efficient tax collection.
- Successful decentralization cannot be achieved in the absence of a well designed fiscal transfers program.
- The role of fiscal transfers in enhancing competition for the supply of public goods should not be overlooked.
- Finally, contrary to a common misconception, a developing country institutional environment calls for a greater degree of decentralization than needed for an industrialized country. ... A more primitive public sector environment is more suited to a decentralized form of government.

Integrating Priorities and Planning\textsuperscript{11}

\textsuperscript{11}See Annex C for additional treatment of issues and practices of coordination in the context of decentralized regional/local planning.
Coordination Through Incentives, Norms and Regulation.

In their review of fiscal federalism in industrial countries, Boadway, Roberts and Shaw (1994) conclude that decentralization is *not incompatible* with the fulfillment of national objectives. However, it requires the establishment of mechanisms of coordination, regulation and fiscal inducement to be successful. Also required are hierarchical accountability structures. Regulatory models are varied. In some OECD countries, regulatory responsibilities are shared across levels of government (at each level involving multiple bodies). In others, authority is centralized. The trend is toward a middle position “... as decentralized countries attempt to reduce duplication and regulatory costs by creating national standards, and centralised countries move towards power-sharing arrangements and a shift of responsibility away from the central government.” (OECD 1997: 48)

One presumed effect of decentralization is increased difficulty in macroeconomic stabilization, due to uncoordinated and possibly undisciplined activities of more autonomous subnational jurisdictions. Transfer systems can, however, incorporate stabilizing provisions. Such provisions prevent excess expansion of cyclically inflexible subnational expenditures commitments during periods of economic prosperity and provide protection against disruption of needed resources to subnational levels during economic downturns. They might do this by establishing a moving average of several years experience in central revenue collections to determine the size of the pool to be distributed subnationally in each particular year, smoothing fluctuations, or by limiting the nature of spending of some cyclical increments of the transfer, such as precluding its use for operating purposes. The first would limit spending in growth years by building surpluses in the transfer account. In years of downturn, additional transfers would be provided from this surplus or financed via central government issued debt. A similar outcome might be achieved by establishing a maximum ceiling and minimum floor for transfers. Argentina and Columbia employ such stabilizing rules. However, compared to the experiences of Mexico and Brazil, there is no evidence to suggest that these mechanisms have resulted in improved macroeconomic performance. (Gonzalez et al. 2002)

To further assess the macroeconomic effects of decentralization, a cross-sectional time-series analysis of fiscal and monetary policies of nine major federations in the developing world was conducted. Countries studies included Argentina, Brazil, Mexico, Venezuela, Columbia, India, Nigeria, Pakistan and Malaysia. The affects of revenue and expenditure decentralization on budget balance, inflation and debt were assessed to determine the degree to which subnational autonomy influences intergovernmental interaction (see Wibbels 2001). Findings suggest the importance of both revenue and expenditure decentralization for macroeconomic outcomes. Expenditure decentralization without revenue authority is more likely to result in adverse outcomes, as a form of "fiscal illusion" is created between the apparent local benefits and
more diffused costs of revenue burdens for subnational spending. Where subnational jurisdictions (provinces) have substantial revenue authority (including access to credit markets) in conjunction with expenditure authority, policy divergence between levels of government declines. This effect is increased in instances of higher levels of party centralization across tiers of government. Maintaining national government political support at the subnational level also becomes an important element of economic reform strategies.

**Representation of National Interests.**

The root of coordinating plans and priorities is information exchange and mutual understanding of the relative purview and legitimate interests of each level of government in a multi-tiered governance system. Two basic models of demarcating responsibilities exist and can be summarized as one based on “legal tradition” and the other based on a “managerial culture” rooted in a search for efficiency (see OECD 1997: 28). Irrespective of the foundation, integration is highly dependent on the representation of national policy and priorities at local levels in a manner which maintains higher level “steering capacity” to assure that national objectives are not hopelessly compromised by lower level actions. This occurs in all nations through structures of central representation at subnational levels. Again, two main forms exist: (i) ‘deconcentrated administrations’ and (ii) ‘prefect systems.’

All twenty-six OEDC nations studied employ deconcentrated administration and most also have a prefect system. The first represents central policies through a deconcentrated placement of central government agencies at the subnational level. These agencies are subject to central directive, even though working at the local level. The range of responsibility, local impact and discretion of these field offices varies considerably. Federal countries (such as Germany, Australia, Canada, United States and Ireland) also employ significant representation of regional levels locally. Unitary nations, (particularly those without central representatives at the local level, such as the United Kingdom and New Zealand) rely heavily on the legal status of central agencies. The local discretion of agencies has been on the rise.

Under the prefect system, an official representative of the central government is charged with representing its interests at the subnational level. Central representatives usually have two principle responsibilities: (i) oversight or administrative supervision of subnational governments, and (ii) acting as an intermediary between levels. These structures are typified by the “Napoleonic” model first employed by the unitary states of continental Europe (they are foreign to the United Kingdom, Ireland, New Zealand, Canada, Australia, and the United States). Prefect systems have been retained even within moves for greater decentralization. Administrative supervision involves oversight of the legality and advisability of local actions and policies. Sometime the role is constrained to activities involving joint projects in areas of shared responsibility. While in most countries the prefect system has been retained, in many
systems it has lost its coercive powers. In any regard, the prefect acts as a communication conduit between levels.

*Coordination, Consultation and Collaboration.*

In either structure, coordination rather than vertical direction is the intended result. Coordination requires consultation and entails both vertical and horizontal collaboration. The more complicated the intergovernmental distribution of responsibilities, the more important and difficult become coordinating tasks. (Annex C provides a review of coordination issues and practices in a decentralized local / regional planning context. The need for vertical methods has increased, as has the tension between coercive and cooperative approaches.) Traditional mechanisms are no-longer sufficient in producing a coherent whole. Subnational perspectives must be considered to produce responsiveness and relevance, but coordination is necessary to (i) clarify national policy goals, (ii) establish agreement (if not consensus) regarding the contribution of individual programs and levels, and (iii) communicate and learn from local experiences and progress toward objectives. Coordination and consultation has the added benefits of allowing the identification and elimination of overlapping, duplicating or competing program activities. This is highly relevant in structures such as France’s, in which subnational jurisdictions are responsible for education capital and maintenance expenditures and education policy is established from the center. In Australia, the Audit Commission has studies the level of duplication between levels of government.

Several OECD nations have attempted to augment consultation through both formal and informal mechanisms. However, consultation can have negative effects on the speed of decisionmaking and may provide greater access for self-interested parties, possibly detracting from the general interest. Not all models are highly collaborative. Consultation ranges from the “co-operative” to the “adversarial.” Cooperative approaches seek consensus and collaboration (such as Japan), while the adversarial approach, associated with bipartisan politics, favors more decisive decision-making, sometimes in a manner which sacrifices consultation and involving legal procedures. These mechanisms are not as well attuned to the growing complexity of intergovernmental arrangements.

Forms coordination and consultation take include:

- horizontal and/or vertical;
- more or less formal (based on informal practices or more formal “understandings” or conventions);
- structural or procedural (using special co-ordinating bodies or achieved through procedural means);
- institutional versus ad hoc (in principle either open-ended or limited in duration);
- mandatory (legal requirements) or voluntary;
- binding or non-binding;
- primary or subsidiary (inter-institutional co-operation may be the primary mode of policy-making or
only come into play under certain conditions). (OECD 1997)

These forms are obviously not mutually exclusive and different forms are simultaneously operating both across and within policy areas.

Dithier (2000) identifies the importance of incentives and norms which facilitate cooperation and stresses the effect of participation in promoting stakeholding which improves quality of life and facilitates organizational effectiveness. Goodpaster and Ray emphasize that to assure that local interests do not “trump” national interests “… the central government must retain the authority to control or revise the actions of the periphery.” They suggest legal provisions which prohibit local action in areas relating to economic policy, citizen rights, internal and international trade, citizen mobility and residency, or reserve a central government right to invalidate local laws in such areas. “[T]he central government should reserve to itself the authority to undo local actions whenever they demonstrably injure clear national interests.” (Goodpaster and Ray c.2001: 2) Focusing on the Indonesian system, they suggest the possibility of “serious problems” associated with Law No. 22 and Law No. 25 relating to these issues. Regarding Law No. 22, while it does contain provisions outlining central / regional authority, requirements for regional authorities to carryout national government general governance policies, and reserves authority in certain areas to the national government, Goodpaster and Ray argue that it is too non-specific. They point to subnational actions, such as the closing of the Newmount mine due to a local tax dispute and Semarang officials refusal to allow the unloading of a shipment of sugar, as inappropriate economic interference and contrary to national policy.

Importance of Social Capital.

Participation is a function of both formal institution and informal elements of social capital. It has been suggested that social capital is comprised of trust, norms and networks “… that foster mutually beneficial cooperation in society.” (de Mello 2000: 3) It is essential to the functioning of society and economic progress. It also functions as a civil society coordinating mechanism promoting governance, performance and accountability and its development is expected to improve the outcomes of government. Social capital is related to social status, educational attainment, religion and income distribution. It has also been suggested to be related to the structure of governance. The characteristics of decentralization (closer, more committed government, democratic institutional development, greater government and civil servant trust) are expected to be catalysts for increased social capital formation and are, therefore, expected to reinforce (and be reinforced by) its positive effects. Pooled cross-sectional analysis of the relationship between national measures of fiscal decentralization and confidence in government, civic cooperation and civic association, suggests that decentralization positively affects social capital formation. In this regard, decentralization, itself, may be its most effective coordinating mechanism; however, issues of causality remain unresolved. (de Mello 2000)
Experiences in local planning in the United States also highlights the importance of participation. A review of 60 planning processes in Florida and Washington suggests broad scale stakeholder involvement in participatory planning processes are necessary if the results of the process are to have an impact on local government decisionmaking. Broad involvement contributes to the establishment of consensus, limits the effectiveness of latent opposition groups and produces stronger plans with a greater likelihood of implementation. (Burby 2003).

A recurring concern in this review is that improperly structured decentralization can result in a direction of resources "... away from the poor, needy and powerless to the rich, replete, and dominant." A review of experience with World Bank supported social funds provides some insight into the integration of local planning and accountability. "Social funds aim to empower communities by enabling them to participate in the selection, implementation and operation and maintenance of development projects." (PREM 2001b) These funds directly support "community projects" intended to reduce poverty and improve basic services and shift decisions away from central bureaucracies toward communities which have had little previous influence. However, local planning is quite limited; it requires a community to select projects only from a menu supported by the fund and is, therefore, restricted in its participatory nature. It is not truly a "local" planning process. A completely local planning process is much more involved and requires transferring both service responsibilities and responsibility for annually producing development plans covering all basic services in an integrated and strategic manner. In countries with stronger local governments (such as Honduras, Bolivia and Zimbabwe), the social fund planning process has, however, become a stepping stone to more comprehensive, participatory local planning. Lesser success has been experienced in countries with weak local government's (such as Cambodia, Malawi and Zambia).

It is the model of decentralization which emerges which appears important. True devolution (or "democratic decentralization" complete with substantial powers, resources and accountability mechanisms) has been offered as an important element in a Comprehensive Development Framework established by the World Bank in 1999 and as supportive of a variety of structural, social and human development concerns. The role of civil society is critical and is generally excluded from political and policy processes above the local level. This reinforces the importance of responsible, participatory local government and decentralization as a vehicle for building civil society. "When significant powers and resources are devolved to lower levels, especially to elected bodies at or near the village level, existing associations become more attractive and engage more with government agents and institutions." (Crook and Manor 2000) Civil society organizations improve the effectiveness of government, and democratic decentralization allows civil
society to exercise influence in a more orderly and focused manner.\textsuperscript{12}

Linkage Between National and Subnational Budgets.

The extreme of linkage between national and subnational budgets occurs in centralized governance systems in which subnational units function as administrative divisions of the central government. In such structures, priorities are set by central ministries and often actual subnational budgets are confirmed centrally. In decentralized structures, the reasonable range of coordination is reflected by the United States' complete absence of formal coordination and Germany's establishment of an integrated budgetary framework across levels. In the United States, while the national government does use fiscal incentives (in the amount of approximately $300 billion annually) to entice states and localities into policy conformance and while constitutional guarantees and national legislation provide additional bounding of budgetary purview, mechanisms of direct budgetary coordination are absent.

Germany's 1969 Law on Budgetary Principles, on the other hand, has established a framework for coordinating budgetary process and the establishment of uniform budgetary principles across levels of government. General provisions establish requirements for providing gross estimates, a comprehensive and complete budget, fiscal year, requirements for spending authorizations, priority of efficiency, and cost effectiveness. Specific provisions establish the means of budget preparation, accounting structure, budget classification, auditing, execution and reporting, and the role of special funds. The legislation also requires multi-year financial planning and the exchange of budget information between levels of government. (World Bank Institute 2001) The law's premise is that "... uniform national policy goals can only be realized if public budgets of central and subcentral governments can be monitored effectively and in a standardized fashion." This requires uniform budget classification in categories related to the National Accounts. Revenues and expenditures are comprehensively accounted for in gross, full-cost (rather than net) terms and are subject to national consolidation.\textsuperscript{13} Special and off-budget funds are highly controlled. Annual budgets are required to be reflected within the context of a medium term financial plan established cooperatively by all three levels of government and a Financial Planning Council. This financial plan and compliance with its implications is, however, only advisory.

Multi-tiered budget coordination requires more than a comprehensive...

\textsuperscript{12}A caution is also provided in that holistic development requires coordination and reinforcement among the policies and programs of line ministries. This is best supported by the devolution of responsibilities and resources to intermediate level elected bodies (i.e., districts or counties). "Decentralization to the local level seldom fosters holistic development because villages and towns lack elected councils." (Crook and Manor 2000: 7)

\textsuperscript{13}Debt financing is an exception. Debt is shown in net terms. Net levels are more appropriate for assessing the effect of budget policy on monetary policy and capital markets.
presentation of the use of current resources. Also important is an ability to identify accrued liabilities and assets, intergenerational implications of present policies, monitor efficiency and effectiveness of service performance, and identify net asset position of individual governments at all levels (World Bank Institute 2001).\textsuperscript{14} "... [D]ecentralization must proceed through wider and better information in order to allow effective control and to build reliable new institutions for governmental cooperation."

Expenditure Management.

\textit{Fiscal Discipline: Revenue Responsibility and Hard Budget Constraints.}

A benefit of decentralization is an ability to locally develop more cost effective methods of delivering public services and calibrating service levels to the needs of local populations. It is often argued that this will lead to a reduction in the cost of providing a package of benefits to local populations. However, lack of fiscal discipline (often typified by a soft budget constraint) is a serious inhibitor of effective expenditure management. Tremendous local pressures exist to increase spending to address legitimate local social concerns in addition to providing specific benefits to elites. Soft budget constraints are more prevalent the larger the state sector, the greater the sphere of bureaucratic action and closer the link between politics and business. They are linked to "perverse central government intervention in economic activity and ... state paternalism, which leads individuals to demand welfare benefits or compensation for welfare losses from the state" and "... fiscal pressure resulting from the economic transformation process...." (Dethier 2000) The nature of fiscal transfer systems have also contributed to soft budget constraints. When local or regional officials must shoulder the burden of financing benefits conferred from local revenue sources, the calculation equating marginal local benefit to marginal local cost is altered toward one which promotes restraint.

\textit{Budgetary Institutions, Procedures and Rules.}

Budgetary institutions and procedures are also deemed important to fiscal discipline. While much of the writing is devoted to national budgeting, it is also applicable to subnational. It is also often the cases that the adoption of procedures requires an implicit choice between conflicting public sector objectives. Hierarchical and centralized procedures, which heighten the authority of the executive and fiscal institutions, promote fiscal discipline and a greater linkage between planning and execution. More legislative influence emphasizes democratic control, checks and balances and collegial relationships, but less discipline. Within the process, open rules invite a more equitable distribution of outcomes (and likely less capture), at the expense of possible delay and expansion of spending. Closed rules limit spending prerogatives, and when they provide ceilings for expenditures or floors for revenues, or restriction on amendments, favor executive authority. Voting on aggregate revenue and expenditure totals

\textsuperscript{14}New Zealand and Australia have been viewed as innovators in incorporating accrual accounting in financial reporting.
before considering specific spending proposals is considered to enhance discipline, as does transparent practices. However, political actors often oppose transparency on budgetary matters to obscure difficult decisions, often in favor of fiscal illusion. Fiscal illusion may be promoted through use of optimistic revenue and expenditure (cost) projections, off-budget accounts and multi-year budgets which postpone difficult choices. Legal requirements for balance may foster quicker responses to fiscal shocks and promote fiscal responsibility, although they may ultimately work against transparency. Hierarchical procedures may enhance discipline, but reduce democratic access. Still, requiring budget balance at the subnational level promotes discipline. Hierarchical procedures are preferred when faced with the prospects of several years of fiscal austerity. Transparency should also be heightened. The executive should present a single, comprehensive budget document and the budget adopted should be inclusive of all activities. The role of multi-year plans should be limited and discussion should focus on current actions and forecasts and projections should be verified.

**Technical Capacity.**

"The increasing complexity of decentralized programs may raise the potential of improved delivery, but it also increases the chances for misallocation of funds at different nodes of the system" (Dethier 2000). Capacity shortcomings, as highlighted above, also suggest the possibility of inefficiencies and ineffectiveness however well intentioned local activity. Proper absorption of "... personnel management, data processing, procurement, and contracting” are critical to success and require time for complete absorption. (World Bank 2000: 42) Interviews of Indonesian subnational officials suggested that only 10 to 20 percent of local districts were in a position to absorb these new responsibilities. Basic issues included: (i) the quality of local human capital and the possible absorption of central government employees as a transition solution, (ii) the establishment of local management structures, (iii) the capacity of local computing systems, budget structures and accountability mechanisms, and (iv) the legal framework and reporting systems for budgeting decisions and personnel management and their costs.

**Fiscal Structure.**

Fiscal issues appear to permeate each category of lessons and in themselves forms a basic element of appropriate decentralization design. In reviewing the Latin American experience, Peterson (1997) offers several prescriptions for fiscal structure. The first is recognition that compromises is necessary. The most appropriate framework for macroeconomic management is not the same as that for local or provincial management. He cautions that decentralization also encompasses the greatest fiscal risks in situations of significant windfall gains and losses created through unbalanced financing. He also advises control over subnational debt, encourages the acceleration of local fiscal control through the development of local own-source revenues and less reliance on shared revenues and urges that "finance ... follow function" (p.11-12). The role of a
benefit based financing structure is highlighted as a vehicle for stimulating technical efficiency and accountability. The intergovernmental fiscal framework is felt particularly important in establishing appropriate incentives. Overall, an objective (non-negotiated) and stable transfer structure, absent any provisions for ad hoc gap filling, was found to be important in Latin America. Recommended elements include categorical / specific grants for financing nationally important devolved functions, and matching grants for capital projects with spillover benefits. Similar general recommendations are made by others (Shah 1998; Bird, Freund and Wallich 1994; Bahl 1999 & 2000). Issues of tax coordination may also be important particularly related to concurrent taxation of the same base by multiple levels of government and the existence of vertical tax externalities (Keen 1998).

**Critical Role of Transfers.**

Because of the absence of mature subnational fiscal instruments and due to tremendous variations in regional fiscal capacity, intergovernmental transfers must play a critical role in the decentralization process. Generally, transfers are needed to perform one of four basic functions (Bahl 2000). The first, vertical balance, requires a shift of fiscal resources between levels (national to subnational) to correspond with increased subnational expenditure responsibilities. The second function is equalization, to compensate for the inter-regional / inter-local differences in capacity to raise resources locally and match resource need to availability, by transferring resources among jurisdictions. Third, intergovernmental transfers can promote allocative efficiency by providing a mechanism for internalizing service externalities. That is, grants are necessary to compensate jurisdictions for the level of benefit from locally supplied public service which spills over boundaries to neighboring jurisdictions or to fulfill broader regional/national objectives. Without such compensation, the level of the service provided locally would be less than desirable. The fourth justification is administrative. It suggests that the superior tax administration ability of the central government lends to that level's role as a collection entity, with transfers used to distribute proceeds to subnational levels. See Annex D for an overview of intergovernmental revenue system issues and elements.

The critical importance of explicitly incorporating an equalization framework into the intergovernmental structure has been reinforced, along with the creation of a grants body or commission to establish and monitor the allocation mechanics (Searle 2000). To be effective, recipient and granting governments must have confidence in the efficacy of the grant structure. This requires a participatory approach to establishing the principles and objectives of the system, composition of the commission, and processes of establishing relative fiscal needs and implementation.

A compilation of experience derived from a wide cross section of nations has yielded a set of twelve "implementation rules for fiscal decentralization:"

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15R. J. (Bob) Searle is Secretary, Commonwealth Grants Commission, Australia.
"Fiscal Decentralization Should be Viewed as A Comprehensive System"

"Finance Follows Function"

"There Must Be A Strong Central Ability To Monitor and evaluate decentralization"

"One intergovernmental system does not fit the urban and the rural sector"

"Fiscal decentralization requires significant local government taxing power"

"Central governments must keep the fiscal decentralization rules that they make"

"Keep it simple"

"The design of the intergovernmental transfer system should match the objectives of the decentralization reform"

"Fiscal decentralization should consider all three levels of government"

"Impose a hard budget constraint"

"Recognize that intergovernmental systems are always in transition and plan for this"

"There must be a champion for fiscal decentralization" (Bahl 1999).

Fiscal transfers form a pivotal role in coordinating activities across levels of government. Central governments are able to leverage their policy authority at the local level through subnational fiscal dependence and conditions of aid. These conditions can serve to promote adherence to central government policies and regulations, even in circumstances in which the national government has no direct authority over a local service or policy space. It is interesting to note that fiscal stress and retrenchment has been as great a stimulus to reform of transfer systems as has desires for decentralization. However, in these cases, central conditions have often been relaxed in exchange for an off-loading of responsibilities to subnational jurisdictions. Central governments have also attempted to replace aid conditions with regulations and mandates for ensuring compliance with central policy without drawing on central resources.

Monitoring and Evaluation.

Monitoring and evaluation is a function of (and not meaningful without) accountability. Effective government is monitored for results by and accountable to citizens, markets, and superior level jurisdictions (Peterson 1997). This requires establishing missions and goals, and developing and publishing measures of service quality (Chile / Columbia). Market principles can also be incorporated as monitoring incentives by linking revenue sources (citizen payments) to service levels received. Shah (1998) suggests that evaluation and accountability should be "... embedded in the public sector organizational culture .... by building institutional capacity for evaluation." This is viewed as critical to citizen participation and vertical oversight and requires "... a simple and reasonably objective evaluation methodology and .... mechanisms in place for self, higher level and independent evaluation." (p. 17) A change in incentive structures is required. For example, transfers should be conditional on service standards and access. Performance should be linked to budgeting and citizens should
be educated on their rights. For accountable and responsive service delivery, central planning needs to be relaxed to allow local innovation and adaptation. At the same time, control functions such as audit and inspection should be strengthened to assure, as Peterson suggests, “freedom and responsibility within boundaries”¹⁶ (p. 19).

Accountability Requires Balanced Local Discretion.

Accountability is a function of design. Adequate fiscal resources are a necessary component of meaningful local accountability. Without control over resources, it is difficult to hold local officials accountable for outcomes. Resource inadequacy and forced fiscal dependency on the central government promotes central control and regulation, limiting local autonomy and local accountability (World Bank 2000). Still, it must be recognized that at the local level, many services provided have implications beyond local boundaries. Because of this, local officials must be accountable to central and regional institutions as well as local institutions. This necessitates limitations on local discretion. An effective balance is needed to allow appropriate local discretion while maintaining responsiveness to broader objectives. Central regulation, minimum service standards and conditional transfers are vehicle often used to maintain and promote these broader objectives in decentralized contexts (see annex D). Ministries, however, often resist the transfer of service delivery authority to subnational jurisdictions and attempt to retain de facto policy and delivery control through administrative regulation. It is important, however, that direct central responsibility not be replaced by ministerial regulatory directive, if the benefits of decentralization are to be achieved. It has been suggested that key to true local accountability is local capacity and discretion, and political systems for holding local officials electorally responsible for outcomes. This is argued to be superior to centralized, hierarchical administrative controls. Also, structures which disperse authority over local services to both locally and non-locally elected or appointed officials interfere with local accountability. When non-local officials have responsibility for decisions affecting local service delivery the linkage between citizen and relevant public official is severed. (Edmiston 2000)

The Appropriate Range of Central Control.

Still, central monitoring is required. To effectively gage fulfillment of public objectives and maintain control over aggregate public sector expenditures, new reporting and steering systems are required. “This challenge to redesign the information and accountability systems is the key factor in contemporary inter-governmental management ....” (OECD 1997: 54) A range of central “control” is still required and its establishment is dependent upon the ability to monitor and evaluate performance. Two basic forms of control exist: (i) “performance-based”, and (ii) “administration- or rule-based”. Traditional forms of control are based on institutional oversight mechanisms emphasizing the legality, regularity and appropriateness of subnational actions.

¹⁶Peterson also suggests Four pillars of “governance quality:” “citizen participation,” “social development,” “government orientation” and (iv) “economic management.”
These institutions involve: (i) establishment of action frameworks and investigative authority of parliaments, (ii) central oversight administrative bodies, such as ministries of finance or interior, (iii) and a variety of “independent bodies charged with jurisdictional control.” (OECD 1997:59)

Modes of administrative control, or “vertical monitoring,” have ranged from a independent local Audit Commissions in the United Kingdom (establishing financial integrity and value-for-money) to prefect style forms of guardianship in Spain and Belgium. The evolution is toward a broader policy orientation and away from “detailed interference in local affairs.” (OECD 1997: 59) Prefect style monitoring is increasingly being challenged and being replaced by a focus on results. Blurring of tasks between levels in intergovernmental structures has also led to “less hierarchical forms of monitoring.” Some of these are quite informal and use “joint financing” as a vehicle for vertical coordination (such as in Denmark, Sweden, Switzerland, Canada and the United States).

Control Based on Performance.

Performance-based controls are increasing in usage. They reflect a further movement away from financial control and detailed regulation toward control based on results. Their focus is on process and outputs/outcomes. General intergovernmental grants are displacing specific grants in these systems to allow more intergovernmental consultation on minimum standards and guidelines, however, information and monitoring requirements are high. These structures are often based on benchmarking and consultation, but require clear lines of accountability for performance to be effective. Significant movements in this direction have occurred in Australia, Canada, Ireland, Denmark, the Netherlands, Norway, Finland, Iceland, Italy, Sweden, the United Kingdom and the United States.

Distinctions should also be made between “… the public accountability of elected officials and that of managers who are hierarchically accountable for results.” (Oecd 1997: 66) Accountability for managerial performance is salient to intergovernmental relationships. Decentralization has implications for monitoring resource usage. Two differing models are used. For example, in Australia and the United States, states establish their own audit requirements and have their own auditors. In France, decentralization reforms included the establishment of regional chambers of accounts to verify local finances and report to the national Court of Accounts.

Role of Citizen Participation and Civil Society.

Citizen participation and accountability are reinforcing (World Bank 2000). To be effective, this requires local governments to have power, resources and accountability mechanisms, such as vehicles to register citizen complaint, provisions for recall of elected officials, third party critical thought and evaluation, judicial independence, and free press. Participatory budgeting processes (providing civil society in-put into budget decisionmaking) can serve as additional catalysts for
accountability. Citizen participation requires strong local institutions and a "class-less" society. Participation requires "political stability" and "political freedom." (Shah 1998: 21) As much as requiring these conditions, decentralization can promote them. Effective outcomes also require a public sector oriented toward serving its citizens. Command and control mentalities must be replaced with a service provider role. Fiscal decentralization also appears correlated with social development, measured based on general human development and income inequality, and the quality of economic management.

Public accountability is often seen as the most critical element in decentralization. Free election of local leaders is essential but must be augmented by reform of local governance which holds public officials accountable for performance. Required elements include: (i) "performance measurement," which includes records of the output of all agencies and measures of efficiency; (ii) "independent and objective audits" of performance and financial management, (iii) "performance contracts" (iv) "decentralization of responsibilities within government" providing lower level officials discretion in determining how to achieve targets; (v) "customer orientation and access", including publishing operating plans and performance reports; and (vi) "establishing a competitive mode of service provision", including contracting and use of NGO's. The most important feature is, however, "building a strong civil society to both make local governments more accountable and to help carry out the broader functions of governance." (Kingsley 1996: 421-422)

Impressive actions have come from "visionary" mayors. These include the 1988 establishment of committees in each of Cote D'Ivoire 19 neighborhoods charged with providing their own services; Tijuana, Mexico's integrated plan for priority infrastructure, requiring contributions from beneficiaries and the community, with project ratification through public referenda, and its Hands-On-Work program, requiring community cost sharing (or work sharing) for community improvements; and representative councils in Accra, Ghana, in the form of "unit committees", "town councils" and "subdistricts."

Development Alternatives Incorporated (2003) stresses the importance of civil society for accountability. They advocate organizational development, citizen audits of government performance, and sustainable mechanisms of citizen participation as vehicles for enhanced community monitoring. Also important is improvements in general public administration, such as civil service reform and participatory development planning, and legislative strengthening to enhance budget oversight and performance monitoring.

Accountability in Cooperative Partnerships.

In devolved structures, accountability takes on different meanings in partnership arrangements between levels of government. These partnerships include horizontal cooperation between jurisdictions at the same level and vertical cooperation between governments at different levels. They include “joint production partnerships” focusing on
technical service production and lending themselves to performance contracts and periodic evaluations of partner activities; “common resource partnerships” focusing on joint management of common resources such as natural resources and land with movement away from compliance-oriented to outcome based management and performance contracts; and “joint investment partnerships” focused on investment projects largely in the nature of infrastructure (such as transportation or water projects) which require risk analysis, performance goal specification and evaluation mechanisms. The dominant focus of joint production tends to be service/good output, while that for common resources tends toward process and joint investment toward financial resources. In each case accountability is shared, complicating its attribution. It exists as accountability among partners, accountability of each partner to its governing body and accountability to the public. (OECD 1999) Partnership agreements must be capable of satisfying control oriented hierarchical and/or legal accountability relationships, internal professional accountability relationships, and external political accountability relationships. In these partnership arrangements, agreement on “results-oriented performance is critical to assuring accountability across all dimensions. This requires:

- clarity of roles and responsibilities, including identification of risks [and liabilities];
- joint specification of performance expectations, including balancing expectations and capacities [and

common understanding of objectives without unilateral setting of performance targets by a “stronger” partner];
- reporting of valid and reliable information on what was achieved among the partners, to the public and to respective governing bodies [without creating a monitoring process which overshadows primary partnership goals];
- joint evaluations on how far predetermined overall objectives have been met; and
- feedback on the performance achieved and adjustments [in a publicly transparent process]. (OECD 1999: 6, 18)
Conclusions

Decentralization offers potential to improved governance and service delivery at the location where it is most effective and in a manner which advances both development and the needs of dependent populations. However, these outcomes are not assured. Decentralization entails a complex web of interrelated levels of government, institutions and civil society. To be effective, it must coordinate and channel input and facilitate the appropriate participation of each filament. Decentralization is a multi-faceted, heterogeneous construct, as are the environments within which it is introduced. It must be adapted to each environment and can not be encapsulated as a standardized model of governance reform. While the term implies a “simple” devolution of authority and responsibility, its most defining features are likely the added complexity of resulting relationships, and the need for cooperation, coordination and flexibility for successful outcomes. These needs compel the development of new levels of intergovernmental and public competency and require institutions to evolve beyond the rule-based, definitively structured and hierarchical operating parameters of the centralized system. While standardized application is elusive, cross country experiences do provide markers to point toward required or favorable institutional and structural components.

The results achieved appear to be determined by a combination of pre-existing conditions, the form and mode of decentralization undertaken, and the level of supporting institutional and fiscal frameworks and capacities, such as local administrative and civil service service reforms and political participation. Accountability and responsiveness, both vertically and horizontally, appear to be key features. Without vertical accountability, decentralization risks the diminution of national goals and objectives. Without accountability to local populations, the promise of greater allocative efficiency and responsiveness are likely lost. The development of participatory processes, democratic institutions of local governance, and formal and informal modes of civil input and communication aide in achieving bureaucratic accountability and reducing elite capture. This is conducive to a local sector responsive to the needs of the elite and disadvantaged alike. Without these, design (in the form of expenditure responsibility, revenue authority, and intergovernmental fiscal arrangements) and capacity (in the form of personnel quality, managerial capacity, planning, budgeting and fiscal administration) will be unable to carry the day. Likewise, the role of intergovernmental coordinating mechanisms and process can not be overstated in promoting outcomes which maximized local and national benefits.
The lessons which emerge from this review suggest the following.

•(i) The decentralization process is complex and engenders conflict. It requires significant adjustments in the form of vertical administrative control, development of extensive coordinating and consultative mechanisms, and linkage between managerial and political accountability. Preexisting conditions are important regarding intergovernmental trust, participatory governance institutions and local technical / managerial capacities and must be attended to accordingly.

•(ii) Decentralization is an evolutionary process. It requires the building of consensus and is often best approached progressively. The appropriate scope of decentralization is critical and is dependent on the local situation. Local situation is determined by local capacity, resource availability and accountability mechanisms.

•(iii) Effective decentralization requires an increased role of central and regional governments. New capacities and responsibilities are required to manage multi-tiered systems and promote the development of local jurisdictions as effective governance institutions. Establishing mechanisms for coordinating the roles of multiple central, regional and local government agencies and actor is critical. This also suggests the need for role clarity, both within and between levels of government.

•Incentives, norms and regulation all have roles in effective coordination. Vertical regulation is necessary to assure adherence to national policy objectives, however, its form in a decentralized context is significantly altered. Appropriate local incentives, conveyed in the structure of the intergovernmental fiscal system and via fiscal inducement, are often critical. Representation of national interests at the local level is important and occurs via deconcentrated administration of national agencies and to a lesser extent through prefect systems. Both formal and informal means of communication and consultation across an array of dimensions is necessary to assure appropriate vertical and horizontal coordination. Informal communication is heavily reliant on social capital, civil society and the development of participatory institutions.

•Frameworks for coordinating budgetary processes and the establishment of uniform budgetary principles are required. This requires central leadership in establishing the administrative and legal framework for accounting structures, budget comprehensiveness, budget classifications, auditing and execution reporting.

•Fiscal discipline is required for proper expenditure management. It is
promoted by increased local revenue responsibility, hard budget constraints, sound and effective budgetary institutions, procedures and rules, and requisite technical capacity. Critical aspects of technical capacity include personnel management, procurement and data processing.

• An appropriate fiscal structure is critical and provides the subtext underlying much of decentralization reforms. It requires adequacy regarding total local resources and significant autonomy in the generation of resources from local sources. Often the most critical and central element is the intergovernmental nature of this fiscal framework and the incentives it conveys. This structure is often the most technically influential in determining the overall outcome of decentralization. The importance of an appropriately structured transfer system can not be under estimated. It provides basic revenue capacity, conveys national expectations and priorities, established minimum service guarantees, established operative incentives for fiscal discipline and efficiency, is often critical for infrastructure financing, and provides for equity and equalization.

• Monitoring and evaluation of results in a decentralized context is an essential function of accountability. Accountability is, itself, a function of design. It requires balanced local discretion, with local officials accountable to central and regional institutions, as well as local institutions and citizens. This requires limitations on discretion and a simultaneous ability to hold local officials accountable to citizens, markets and superior level jurisdictions for exercising the discretion they command. Central regulation (indicated above), minimum service standards and conditional transfers are vehicles often used to promote central objectives. The challenge is to transform accountability mechanism to those based upon performance, rather than administrative rule. Promotion of innovation and adaptation at the local level is important, and accountability mechanisms focused on production processes and administrative rule impair innovation. True local public accountability is based on local capacity and discretion, and systems for holding officials responsible for outcomes. This requires active citizen and civil society involvement and adequate performance and financial information dissemination, including third party assessments.

Decentralization promises both improvements in allocative and technical efficiency. However results have been mixed. Its is assumed "... that the devolution of functions occurs within an institutional environment that provides political, administrative, and financial authority to local governments, along with effective channels of local accountability and central oversight. These channels
include: voice mechanisms for citizens to express their views[;] Exit mechanisms for citizens to switch to nonpublic service providers or to move to other localities[;] Central government laws, rules, budget constraints, and oversight over local government operations, and channels for local governments to influence central government decisions regarding them[;] Public sector management arrangements that promote accountability - such as merit-based personnel policies and rules and arrangements promoting fiduciary accountability and constraining corruption.” (PREM 2001) Without theses and the necessary institutional capacity to support them, the benefits of decentralization are not likely to materialize. Effective decentralization is far more than shifting expenditure responsibility or revenue authority to subnational levels. It requires building effective subnational administrative and representational institutions. This is a task which requires a level of both social and governance participatory maturity.
Annex A: The Case for and Against Decentralization

A significant literature exists framing the potential benefits and hazards of decentralization. Both sides of the argument are summarized below.

**Case for Decentralization**

**Allocative efficiency.**

The primary economic justification for decentralization is economic allocative efficiency (Tanzi 1995). This is linked to a more general argument that the proximity of government to constituents matters; that local governments are closer to and more aware of the needs of local populations and will act on that information (stimulated to do so through political accountability) to better serve their constituencies (Boadway, Roberts and Shah 1994: 20). In democratic societies, economic and political rationales converge; democracy is strengthened by decentralization (Tanzi 1995).

The spatial character of benefit distributions vary by public good as do preferred levels of consumption by populations. The existence of limited spatial externalities, and variations in preferences across populations and geographic areas, provides the opportunity to improve efficiency of public good provision through more closely matching the level supplied with the preferences of local population by assigning the provision of such goods to smaller subnational jurisdictions along with responsibility for generating the marginal resources for their financing. Local fiscal responsibility, coupled with a geographic correspondence between the decisionmaking jurisdiction and the benefit distribution of a public good (or alternatively, an appropriate fiscal equivalence effected through a grant system), helps to assure that costs and benefits are properly considered in choosing the level of service to be provided. This enhanced preference match improves the allocative efficiency of the public sector (Olson 1969; Oates 1972; Oates 1999). However, it requires that local public officials act consistently with this variation. This is dependent on the existence of accountability mechanisms.

**Technical / cost efficiency.**

Related to the above, under correct circumstances, decentralization is also expected to provide a public good corollary to the competitive market for private goods. If citizen-consumers are mobile and there are a variety of alternative jurisdictions within which to locate, they will move to jurisdictions producing the most effective and lowest cost mix of public services, forcing efficiency inducing competition between governments (Tiebout 1956; Tanzi 1995). Similarly, this is expected to stimulate experimentation in public service delivery and beneficial technology transfer.
between subnational jurisdictions based on that experimentation. A demand responsive public sector enhances both public support and willingness to pay for public services. Under this competitive corollary, the mobility (or threat of mobility) of capital and populations produces performance incentives as does the simple existence of alternative jurisdictions as a comparative standard.

Accountability.

In an organizational context, decentralization both empowers local officials and makes them accountable to local constituencies. This empowerment fosters a new responsibility for local public service outcomes and is expected to provide incentive for improved performance (Tanzi 1995). Accountability takes the form of accountability of bureaucratic actors to public officials via supervision and public officials to citizens through electoral processes, party systems, press and participatory forums (Blair 1999). Improved accountability is expected to reduce corruption. The closer proximity of subnational jurisdictions to the population and their greater stake in the outcome of local public policies is expected to increase both the capacity and desire for public monitoring of their actions. Exit through mobility provides an additional informal enforcement mechanism.

Democratization and heterogeneous representation.

Additional political justifications for decentralization include a desire to ameliorate centrifugal, secessionist forces sometimes apparent when a nation’s population is heterogeneous ethnically, racially and / or culturally, and is distributed along these divides regionally (Tanzi 1995). Decentralization has also been suggested as a vehicle for recapturing public credibility and has been linked to democratization processes in Latin America, increasing legitimacy and democracy while at the same time linked to strong executive authority (Escobar-Lemmon 2001: 27). It has also been linked to the emergence of multi-party political systems in Africa, regional / ethnic demands for more participation and control in the political process (Ethiopia) and as an outcome of civil war (Mozambique and Uganda) (Ford 1999).

Economic growth.

While allocative efficiency gains may be partially offset by technical efficiency loses and coordination difficulties across communities, the competitive processes are also expected to decrease the cost of public services and the size of the public sector. Improved efficiency and reduced costs could, theoretically, result in an increase or decrease in public spending depending on relative elasticities. Further increased consistency with local preference could produce greater public spending, as populations are willing to pay for more in the way of services which are consistent with their desires. As similar argument can be made for revenue mobilization. Therefore, the argument of reduced public spending is not convincing.

17However, this depends on the size of price elasticities for public services. Increased efficiency and reduced costs could, theoretically, result in an increase or decrease in public spending depending on relative elasticities.
sector decisionmaking is also expected to improve the rate of economic growth.

**Case against Decentralization**

Both the allocative efficiency and political arguments for decentralization are largely derived from experiences of Western democracies. Initial conditions in developing contexts vary considerably. Obstacles to mobility, weak accountability mechanisms, poor technical capacities, and cultural characteristics may mitigate the expected effects.

Inadequate information and central government responsiveness.

The argument that central governments lack adequate information or ability to match subnational expenditure patterns to local preference has been challenged. "There is no compelling reason for the ... assumption that services provided by the central government would be provided uniformly" (Prud'homme 1995). Breton suggests that the assignment of concurrent powers between central and subnational levels, application of uniform minimum standards (with diversity across dimensions and augmentation) and discretionary field administration provides for local variation in centrally provided services (Breton 2000). Central government representatives in subnational offices monitor local conditions and are able to and do modify service provision accordingly. The relevant issue is whether local government officials are in a position to possess more accurate information and be more responsive to public desires. The benefits of decentralization assume the existence of democratically responsive subnational jurisdictions whose officials pursue the local "public interest." With the absence of effective local democratic systems, the benefits of decentralization become problematic (Tanzi 1995).

Electoral accountability and corruption.

In developing countries, local electoral behavior and voting is based on "personal, tribal or political party loyalties" and reveals little about local preferences (Prud’homme 1995). Policy platforms are vague and choices are limited. This, at best, produces a vague electoral mandate, one likely impossible to fill because of an unavailability of revenues and potential bureaucratic obstacles. The cost of obtaining information coupled with weak political opposition and lack of vigorous media surveillance at the local level may impair information flow (Breton 2000). Further, corruption can create a breakdown in the accountability of public officials to local populations and may be more prevalent at the local level, particularly in developing countries. In this context, proximity may breed corruption, as family ties, personal relationships and custom may displace public responsiveness. If corruption is more prevalent locally, decentralization increases its overall level and produces losses in allocative efficiency (Prud’homme 1995; Tanzi 1995). Aggregate
“kickbacks” are likely higher because of more numerous opportunities, greater access to/from differing interests, and greater aggregate discretion (a function of decentralization). Simultaneously fewer obstacles exist, bureaucrats have less insulation from local politicians, local bureaucracies have weaker traditions of professionalism, and media surveillance is less intense (Prud’home 1995: 211).

Vertical competition between levels of government in a decentralized structures may result in increased levels of corruption and lower quality government. Shared authority to regulate business and economic activities may produce “overgrazing” as public officials at multiple tiers seek to extract payment from the same individuals or organizations in exchange for regulatory or other leniency or preferences. The result: “A higher aggregate bribe rate reduces output by discouraging economic activity” (Treisman 2000: 4-5). It is also expected to increase the cost of government and lower the quality of services for which there is shared responsibility. Shared responsibility blurs lines of accountability.

Effective participation is needed for decentralization to produce popular mechanisms of accountability. This requires a minimum level of “literacy, basic capabilities and gender equality .... Accountability is ... a question of democratic control” (Dethier, 2000). However, decentralization in itself is not a mechanism of accountability. Electoral competition is generally greater at national levels. Decentralization can result in increased corruption and reduced accountability through a capturing of the state by specific interests and corrupt bureaucrats. Elite capture varies with income heterogeneity, with capture heightened by decentralization in more heterogeneous regions. The result is higher service costs, black market transfers of public goods and poorer service levels.¹⁸ (see Bardhan and Mookherjee, 2002).

Local bureaucratic professionalism.

Decentralization increases the authority and discretion of the local administrative apparatus. In developing contexts, the skill and professionalism of local bureaucracies is likely to be substantially lower than that of national bureaucracies. For a variety of reasons (better career ladders, higher salaries, more prestige), central government bureaucracies will likely attract more qualified staff. Principle-agent difficulties between local elected officials and local bureaucrats may produce bureaucratic unresponsiveness (Prud’home 1995). Benefits of decentralization are in a consequential fashion linked to the quality and capacity of local administrations, this quality is highly dependent on the quality of personnel. The benefits of decentralization are also likely to vary (possibly widely) from region to region within a nation, as there is often great variation in education and skill complement of the population and in the ability of subnational governments to attract and retain qualified staff. (Tanzi

¹⁸For an overview of the modes corruption may take and possible ameliorative steps, see Rose-Ackerman (1997). For an overview of the importance of political processes and the structuring of government institution to reduce corruption and its costs, see Shleifer and Vishny (1993).
Regions around the capital and urbanized areas are likely to be significantly better staffed than are rural areas.

Shah (1998) suggest that a dysfunctional public sector in developing countries inhibits the benefits of decentralization. He suggests a disconnect between public sector "mission and values," which is oriented toward 'command and control' rather than citizen service, an "authorizing environment" (including formal budgetary process and institutions and informal institutions of accountability and participation) in which institutional norms and compliance are violated without sanction, and "operational and capacity constraints" which limit the actual implementation of what is authorized via limited capabilities and through a bureaucratic culture of corruption and patronage (p. 6-7).

Correspondence and inter-jurisdictional spillovers.

The geographic scale and demographic composition of the area comprised by the units to which authority / responsibility is decentralized is not inconsequential for the effectiveness of decentralization. The composition of local jurisdictions is, however, likely to be based on prior political consideration and historical accident rather than economic principle. To the degree that public service benefits spillover into neighboring jurisdictions, under provision will exist unless measures are taken to internalize the economic effects through appropriate shared national (regional) / subnational financing (Boadway, Roberts and Shah 1994: 20; Breton 2000: 9). The likelihood that the actual structure of subnational levels and jurisdiction will match the appropriate spatial characteristics of public goods is limited. The greater this divergence, the less likely are the "advantages" of decentralization to materialize. (Tanzi 1994) Beyond this, initial expenditure assignments in "decentralized" contexts may be made not with a desire to match governance structure to benefit range, but to off load expenditure responsibility (or shift deficits) from national to local levels, often without requisite resources. Decentralization driven by these objectives is likely not to be effective.

Technical and demographic change.

Technology for delivering and the need for public services changes over time, suggesting the need for innovation in delivery vehicles and a changing complement of services. Further, with changing demographics and mobility the spatial characteristics of public services are also modified. For example with low population mobility, the benefits of education may be largely contained locally or regionally, with high mobility these benefits become much broader in geographic scope. The level of government with policy authority and provision responsibility should be adjusted to the changing scale of benefits. This requires flexibility in the intergovernmental arrangements of service delivery if decentralization is to be optimal. (Tanzi 1994) However, public officials (local and national) often resist change which may mitigate the benefits of decentralization.
A demand efficiency / mobility fallacy.

The basic difficulty in developing contexts is not the efficient matching of local public services to variations in preferences. Service levels in developing countries do experience variations, but these variations are a function of variations in income rather than variation in desired "mix" based on differing marginal preferences. The difficulty is providing for "basic" needs in low capacity settings. "The welfare gains associated with a better match of supply and demand are not that large" (Prud'homme 1995). Decentralization (as explained below) can impair the satisfaction of basic needs by increasing disparities and concentrating resources.

Public expenditure management.

As Tanzi explains "... if the quality of local bureaucracies is not as good as that of the national bureaucracy, and if the public interest is not the guiding principal of local officials, independence and experimentation by local jurisdictions may not achieve the desired results." Decentralization entails the transfer of substantial expenditure and revenue responsibility to subnational jurisdictions. The general state of expenditure management systems in developing countries is rather poor and lesser at the subnational level. It is often highly questionable whether these system (planning, forecasting, budgetary classification, accounting, cash flow, etc.) are capable to the task, particularly in situations where more implicit accountability mechanism are also weak.

These problems are magnified in the face of potential decentralized corruption.

Increased disparities.

Decentralization can result in increased disparities across regions (Prud'homme 1995). Income redistribution is, by nature, a national function. Subnational jurisdictions, by their geographic nature, lack the inclusiveness of income groups and resource endowments and, therefore, can not establish a redistributive framework on par with a national government; impoverished regions have little capacity to redistribute, while resource rich regions have greater capacity but lesser need. Should they attempt to embark on redistributive policies, the effort would be expected to be largely self defeating as resource rich households and businesses attempt to escape redistribution by hiding or shifting the geographic location of their assets. Therefore, decentralization of redistributive functions will increase disparities. Beyond direct redistributive functions, many publicly financed services, such as education, have implicit redistributive implications. Devolution of education provision and financing can result in disparate outcomes similar to that for directly redistributive programs. In decentralized structures, the absence of implicit subsidization of lower income regions expenditures by higher income regions requires that lower income regions levy higher relative effective tax burdens on their populations to achieve a significantly lower quality of public services. This situation reinforces and accentuates preexisting disparities by creating disincentives for investment and
growth in high tax / low service poorer regions. Decentralization of revenue and expenditure responsibility may inhibit decentralization of economic activity. As Prud'homme suggests "Decentralization can ... be the mother of segregation." The greater the level of decentralization the more problematic this effect, unless substantial resources are devoted to equalizing transfers from the central government or central provision of basic service support.

Sub-optimal subnational spending.

Competition (spurred by decentralization) between regions and localities to attract population and investment can produce destructive results. If subnational jurisdictions universally lower tax burdens and service levels in competition with one another to attract investment, public service levels can be pushed below optimal levels to such an extent that they can no longer provide the requisite human and capital infrastructure environment necessary to promote economic growth and social development (Prud'homme 1995: 204-205; Treisman 2000; Breton 2000: 9-10). Past research has shown most scale economies to be exhausted at relatively moderate populations and geographic ranges (Hirsch 1969-cite) and alternative service production arrangements would likely be available for those that are not. Economies of scope may, however, exist as a function of bureaucratic technical capacity and professionalism at the national level aiding service planning, organizing and development.

Problems in technical efficiency.

The existence of economies of scale and economies of scope present a challenge to decentralization (Prud'homme 1995). The first is likely easily dispatched with, as there are few decentralized services which would benefit from production on a national scale, however, it could remain as an issue regarding regional / local assignment (Boadway, Roberts and Shah 1994: 20; Breton 2000: 9-10). Past research has shown most scale economies to be exhausted at relatively moderate populations and geographic ranges (Hirsch 1969-cite) and alternative service production arrangements would likely be available for those that are not. Economies of scope may, however, exist as a function of bureaucratic technical capacity and professionalism at the national level aiding service planning, organizing and development.

Macroeconomic stability and fiscal perversity.

Decentralization can impair the pursuit of economic stability. A basic macroeconomic need in developing countries is fiscal adjustment to reduce chronic fiscal imbalance (Tanzi 1995). Decentralization is likely to inhibit this adjustment. Without proper fiscal discipline, subnational jurisdictions may experience incentives to spend beyond revenues. This is often done with the expectation that the central government will absorb subnational debt, thus shifting subnational expenditure financing to the national level. With this potential outcome, all subnational units have incentives to do the same, producing a form of "fiscal perversity" (Prud'homme 1995), acerbating the consolidated fiscal deficit substantially.
beyond that which would exist under central control. This situation can be accentuated by decentralized expenditure responsibility without corresponding revenue responsibility, poor public expenditure management systems, failure of explicit or implicit assignment of subnational responsibility for subnational fiscal deficits, vague expenditure assignment and imposition of unfunded mandates, and soft subnational budget constraints (Tanzi 1995: 306).
Annex B: A Review of the Observed Actual Effects of Decentralization

A growing body of literature exists which attempts to assess the actual effects of decentralization. This literature is reviewed below with specific emphasis on its findings regarding effects on the accountability and responsiveness of government, service delivery outcomes and meeting needs of the poor.

Affect of Decentralization.

The case for decentralization suggests positive effects for poverty reduction through public involvement in governance and the provision of more efficient and effective public services targeted at the needs of local populations with less waste and more effectively supporting private economic activities and development, democratization and nation building. The case against suggests the possibility of an opposite set of effects. The result that emerges appears to be determined by the existing pre-conditions, the form and mode of decentralization undertaken and the level of development of supporting institutional frameworks and capacities, such as local administrative and civil service reforms and political participation. This, however, is not to suggest that such positive results do not also emerge in relatively centralized settings. The decentralized context may hold additional potential, but its complexity and variability suggests the need for greater specification of the conditions and elements (particularly institutional elements) likely to produce success or failure in differing contexts.

Unfortunately, most research has neglected a focus on determining the existence of necessary pre-conditions and institutions\(^\text{19}\) and has instead focused on specifying the structure of decentralization (usually with a focus on fiscal decentralization)\(^\text{20}\) and on the assessment of some measure of outcome. Much of this research is rather superficial in its approach, focusing on statistical cross sectional analyses (sometimes in panel form) of the relationship of measures of decentralization (such as proportion of total expenditures made by subnational governments) to measures of outcomes (such as growth or living/development standards). Others use similarly specified models to trace changes in single countries over time. Still others

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19Vito Tanzi has assembled an essay of necessary conditions (Tanzi 2000).
20This line tends to focus on prescriptions for revenue assignment, expenditure assignment and intergovernmental transfer systems.
focus on more contextually rich cases studies, but these still often do not develop well the link between preconditions, institutions, capacities and processes, and success at furthering poverty reduction strategies in a decentralized, developing context. Little systematic empirical work has been done comparing relative preconditions and institutions, however, studies focused on more specific issues of service delivery, accountability and meeting the needs of the poor together allow us to construct a composite view of more successful approaches.

Accountability and responsiveness.

There are at least two levels of accountability in intergovernmental systems. At one level, there is a concern for accountability between institutions. Between, for example, bureaucratic agencies and executives and legislative bodies and accountability between governmental levels (local to regional to national and visa versa). At a more basic level, concern is for accountability between the public (however defined) and institutions of governance. The general thrust of decentralization is the latter, however, in an effective governance system the former is no less critical.

The appropriate balance of upward accountability (through regulation) and downward accountability (to constituents) is critical and situational (Dillinger 1994). Regulation is surely appropriate when local government action might affect national monetary, trade or fiscal policy or where local governments are conducting functions on behalf of the central government. Where the effect of local behavior/policy is localized and requires detailed knowledge of local conditions, the justification for central regulation is more difficult.

Decentralization can positively effect urban services, social sectors, non-urban infrastructure, national economic stability, and poverty alleviation efforts; however, these results are not assured. While meaningful across the board for accountability and responsiveness, Dillinger (1994) identifies important elements in effective service delivery as: "(a) the clarification of functional responsibilities between levels of government; (b) the authorization of revenue sources corresponding to functional responsibilities, and (c) the institution of a system of accountability that encompasses both regulation by central government and incentives for responsiveness to local constituents." Synchronization in the process is critical. The pace of political decentralization must match the pace of regulatory and other forms of reform.

It is generally presumed that decentralized governance structures are more accountable to the public than are more centralized systems. This is based on the assumption of the existence of an aware and responsive local government; however, greater relative local accountability should not be taken as a given. General cross sectional empirical evidence has suggested that it is democratic institutions, rule of law and bureaucratic culture that is important to a reduction in corruption rather than the level of centralization/decentralization (Gurgur and Shah 2000). Decentralization is not likely to be successful at reducing
corruption if not supported by community participation in policy making.

Bardhan and Mookherjee (2000) suggest that accountability failures exist for two reasons, (i) political capture or (ii) bureaucratic corruption. Political capture generally results from low voter political awareness and special interest access. Bureaucratic corruption is a result of "... an agency problem between elected politicians and central bureaucrats, arising from poor communication and information systems that prevent effective monitoring and performance evaluation of bureaucrats." (p. 5) Agency problems are assumed to be reduced at the local level because elected local officials either personally manage or can closely monitor service delivery systems. Local capture does exist. The question that emerges is whether or not this problem is greater for decentralized compared to centralized structures.

In a theoretical examination of the determinants of relative capture, Bardhan and Mookherjee (2002) find that these determinants run in countering directions. At the national level, reduced interest group cohesiveness, greater voter awareness and greater electoral competition function to reduce relative national capture, as does national party power-sharing. More electoral uncertainty and lower campaign spending, reduces relative local capture. Greater intradistrict economic and political awareness heterogeneity increases local capture. Whether or not local jurisdictions are relatively more subject to capture is context specific and dependent upon the degree of voter awareness, cohesion of special interests, district heterogeneity and the national electoral system, including its competitiveness.

The presumption in the literature is that local governments are more prone to capture. If this presumption is not correct, decentralization "... can potentially combine the advantages of greater utilization of local information without sacrificing accountability." (Bardhan and Mookherjee 2002, p. 35) It should also be considers that the extent of local political awareness may actually be a function of decentralization. Voters have little incentive to become politically aware regarding the actions of a government which has little discretion or authority. It should be noted that the results of these models assume a functional democracy at the local level, without it greater local capture may be highly likely. In Spain, decentralization of education was motivated as a symbolic demonstration of the practice of local democracy and is considered successful irrespective of actual educational improvement (Fiske 1996).

Local political accountability is undermined by poorly developed local democracy (Dillinger 1994). Alternative and supplementary means exist to promote accountability and revolve around, organizational rules and defined organizational outputs, local fiscal responsibility and demonstrations of willingness to pay, minimizing transaction cost in articulating voice, appointed vs. elected office holding, forms of access, and sub-municipal administrative branch offices. "Yardstick competition"21 is also

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21Yardstick competition is competition based on the ability of the public to compare performance of public officials in their locality to that of other
suggested as a vehicle for holding local officials accountable for outcomes (Bardhan 2002). Its use in China allowed coastal jurisdictions experimenting with institutional reform to function as a model for other jurisdictions.

Supportive formal and informal institutions are necessary for success in decentralization. Shah (1998) suggests that participation of citizens and transparency in decisionmaking is quite critical. Even barriers to decentralization in the form immature budgeting, auditing and accounting systems can be overcome by "...institutions and mechanisms for citizen voice and exit, [and] norms and networks of civic engagement ...." Decentralization can also be asymmetric (as in Indonesia and Pakistan), such that responsibilities are assigned to different levels based on capacity. In creating "government closer to the people," in Latin America, Peterson (1997) suggests that "Voting is the most basic form of citizen participation." To achieve "direct citizen participation requires that citizens have clear information regarding the municipal budget and service costs, and that they participate in actual budget choices." Formal structures identifying the role of community organizations and citizens are important.

To some degree, the effectiveness of the electoral process is a function of the vigilance of voters in monitoring government. Defining vigilant voters as "retrospective voters who evaluate incumbents on the basis of their overall performance during the entire term in office," (p. 1) elections for state legislative assembly seats in India have been analyzed to determine the relative level of vigilance in local compared to national elections. Possibly due to lower costs of information and higher potential for marginal benefit, voters are found more likely to hold local office holders accountable for policy outcomes than national office holders and due so with a longer time perspective (Khemani 2001).

Additional evidence regarding preference matching is provided by Azfar et al. (2001). Household opinion surveys in Uganda and the Philippines reveal a closer correspondence between the preferences expressed by local populations and those perceived by subregional officials. When asked their perception of constituent's marginal expenditure preferences, the correlation to actual expressed preferences was stronger at the municipal/sub-county level and at times "essentially non-existent at the provincial/district level" (Azfar et al. 2001, p. 27-28). Of the different methods of gathering information about preferences reported by public officials, none were found to be particularly associated with a greater preference match. It is interesting to note that there was a much stronger correlation between national official's and the public's perceptions regarding national spending priorities. Still, this supports the proposition that more locally efficient allocative decisions are likely to be made by local officials.

22This interpretation by the authors appears to be more true for Uganda than The Philippines. The table of regression coefficients reported actually show a greater magnitude at the provincial level than the municipal level (Azfar et al. 2001, table 6).
Failures in urban service delivery, in addition to problems in technical knowledge, are a function of "constraints and perverse incentives confronting local personnel and their political leadership, and ... these, in turn, are often the inadvertent result of problems in the relationship between central and local government" (Dillinger 1994). Decentralization could help alleviate some of these problems, however, as it has been pursued "... it is not a carefully designed sequence of reforms aimed at improving the efficiency of public service delivery; it appears to be a reluctant and disorderly series of concessions by central governments attempting to maintain political stability." In misaligned systems, perverse incentives in service delivery create technical inefficiency, allocative inefficiency, and inequity. Brazil serves as an example of a perversely regulated local sector. Expenditure responsibility has been devolved without fiscal capacity. The results have been negotiated, ad hoc gap filling transfers by the national government to locals; providing national control/intervention in local spheres and providing disincentives for local fiscal responsibility (Dillinger 1994: 21).

The effectiveness of decentralization in improved service delivery has also been explored by contrasting the experiences of decentralized Hungary with centralized Slovakia (Dethier 2000). Effectiveness, defined as promoting efficiency, ensuring accountability and encouraging participation, is found to hinge on three central factors: (i) "appropriate expenditure and tax assignment," (ii) "governance mechanisms to strengthen accountability and fiduciary responsibility," and (iii) "incentive mechanisms to ensure that agents deliver services of an acceptable quality at least cost." It takes more than legislation, however, accountability mechanisms and incentives are crucial. Free rider problems force recognition of the decentralized provision of public goods as both a political and budget process problem. Information asymmetries between central and local governments require that compliance be induced either by monitoring and reporting intended to make cheating and information costly or through incentive mechanisms to align the utility maximizing behavior of both actors. This requires that a great deal of attention be focused on the intergovernmental finance structure linking expenditure needs and fiscal capacity in a way which promotes efficiency, accountability and equity; meeting both needs to satisfy local preferences and central needs to assure that basic service priorities are achieved.

Local independence is often considered a threat to accountability, however, imposition of too stringent central controls on local jurisdictions negates the important objectives of decentralization. Key is to establish a framework (for example financial management and accounting), establish reporting requirements, and monitor compliance directly and through public accountability requirements. These should be reinforced by incentive systems. Proper management of funds and functions is required and this is served by transparency (of budget
documents and processes and annual financial statements) and enforcement of standards such as audit of local jurisdictions (Dethier).

In his review of Latin America, Peterson (1997) cautions that "Transfer of service responsibilities to local authorities will make citizens better off only if local governments are capable - or swiftly become capable - of delivering services effectively." Strengthening municipal capacity requires professionalization of staff, mechanisms of citizen feedback and control, increased output expectations of local public employees, and workforce stability. Peterson also highlights the role of citizen participation, public and market accountability and own source and intergovernmental fiscal instruments in promoting appropriate incentives.

In reviewing the effect of decentralization on service delivery in the Philippines and Uganda, a number of preconditions are found to be required for improved outcomes (PREM 2001; Azfar et al. 2000). To achieve improved allocative efficiency, local officials must not only be more aware of local needs and desires, they must also have the authority to adjust service levels accordingly. In both Uganda and the Philippines, flexibility at the lowest levels is quite limited, both centrally and regionally, impairing the link between service needs and resource allocation. Technical efficiency also requires absence of waste. While corruption was perceived to be less pronounced locally in both nations, it was still perceived as substantial, producing a leakage of funds and resources. Effectively eliciting accountability through citizen participation and voting requires information. Citizens in both countries appear less informed about local government policies than national. Local community leaders, public officials and and personal contacts are often the source of information regarding local government, while the organized media provides national coverage. More effective media based information dissemination is required. Exit as a motivation for public service improvement was found to be quite weak. Mobility across jurisdictions in search of improved public services is quite limited as are the market alternatives to government provision. Adequate levels of local government capacity were also, not surprisingly, found to be important to effective service delivery. Personnel, materials and equipment constraints were found to seriously limit this capacity and services with significant interjurisdictional spillovers are inhibited by coordination difficulties.

A review of the the outcomes of decentralization in education found quite mixed results across countries (Fiske 1996). Improvements in the efficiency of service administration were found in Mexico, Minas Gerais, Chile, the Philippines and Spain. Operating costs appeared to increase in Papua New Guinea, Jamaica and Argentina. Local revenue mobilization was increased in Argentina and Chile. Bardhan’s (2002) assessment of empirical evaluations of the effects of decentralization on service delivery suggests numerous, though not universally promising results. In Nicaragua’s school decentralization program, where autonomy over school management activities had in fact been
transferred to local councils, significant improvements were seen in student achievement (King and Ozler 1998; see Bardhan 2002). The participatory municipal budgeting model used in in Porto Alegre Brazil employs a city wide council, elected in regional assembly meetings which include the public and neighborhood associations, to allocate resources by ward. These assemblies also consider investment priorities and review fiscal accounts. As Bardhan summarizes, "... impressive results have followed: between 1989 and 1996 access to basic sanitation (water and sewerage) as well as enrollment in elementary or secondary schools nearly doubles, while increasing revenue collections by 48 percent; see Santos (1998)."

The participatory budgeting in these changes is unclear, however, it is suspected to have contributed to the positive outcomes and improved the allocation of resources to poorer areas. The Bolivian decentralization initiative devolved administrative responsibility, and infrastructure and public investment to the municipal level. With this shift came a large scale redistribution of public resources to smaller and less affluent jurisdiction and to social sectors. Three quarters of municipalities saw increased education, water and sanitation investment. This new investment also appeared targeted toward areas of need; education spending increased more in communities with higher illiteracy and fewer private alternatives (Bardhan 2002; see also Faguet 2001).

The 1994 World Bank Infrastructure for Development (World Development Report) identifies numerous examples of "the potential for improving service delivery by decentralizing government authority to independent sub national governments." (p. 74) Included is Mexico’s experience in decentralizing roads, bridges and water supply systems, where costs totaled only one-half to two-thirds of those of centrally administered projects. "A review of forty-two developing countries found that, where road maintenance was decentralized, backlogs were lower and the conditions of roads were better." (p. 75). Decentralization of water and sanitation was found to also produce improved maintenance and performance. "...[P]er capita water production costs are four times higher in centralized than fully decentralized systems and are lowest when decentralization is combined with central coordination."

Participation is recognized as a key contributor to effective service delivery. In reviewing the five to ten year history of 25 agriculture and rural development projects, the participation of "beneficiaries and grass-roots institutions" was found to be critical in long term success. A review of 121 rural water supply projects found that those with "... high participation in project selection and design were much more likely to have the water supply maintained in good condition...." (World Development Report 1994, p. 76) The three keys to effective participation are: (i) directly involving beneficiaries; (ii) developing early project consensus; and (iii) acquiring beneficiary in-kind or cash contributions. Korean village road building projects are cited as an example of consensus building. The experience of the Brazilian water sanitation project (PROSANEAR) highlights the importance of tailoring participation to local
population conditions, and the importance of blending centralized and decentralized infrastructure planning is highlighted in Malaysia.

Bardhan relies on Wade (1997) to demonstrate that it is the strength of democratic involvement at the local level that determines local accountability and that influences the success of local water system investment. He contrasts South India’s generally nationally democratic system, but locally less responsive development planning, with that of South Korea. He finds that, while South Korea is less democratic nationally, its local apparatus is more responsive to local conditions. This local responsiveness results in more effective outcomes. He finds similar results in a comparative review of North India’s health and education success and that of China and Cuba. While the later are nationally non-democratic, local participation has worked to improve education and health outcomes (see DrPze and Saran 1993).

Needs of the poor.

Bardhan and Mookherjee (2000) attempt to theoretically assess the degree to which bias may exist against providing for the needs of the poor in centralized versus decentralized governance structures. They, again, formulate this bias in the form of political capture and/or bureaucratic corruption. With political capture, an “... anti-poor policy-bias ... [results] from low levels of political awareness among poor voters, and lobbying by special interest groups that disproportionately represent the interests of the non-poor.” (p. 5)

Bureaucratic corruption (as addressed above) is assumed to be lower at the local level. Local capture tends to be greater in areas of higher poverty due to lower levels of political awareness of poor voters. Whether or not local governments are more or less vulnerable to this than the central government is dependent on the heterogeneity across regions in poverty rates and the nature of political institutions.

Bardhan and Mookherjee model relative service cost effectiveness and targeting of intended beneficiaries. They find that decentralized structures are in general more cost-effective due to lesser scope of bureaucratic corruption. The decentralized regime is better at within-region targeting at smaller scales, but worse at higher scales. However, inter-regional targeting may decline under decentralization and, because program scale is smaller in regions with weak local governance (where poverty rates are high), wealthier regions will experience greater poverty reduction. This is magnified with higher rates of local political capture to an extent that centralization may produce superior outcomes.

“The primary problem with the decentralized delivery mode is the proneness of local governments to pressure from local elites to divert supplies to them. These [sic] reflect weaknesses in the functioning of a fair electoral process at the local level, lower levels of political awareness among the poor, and the tendency for wealthier groups to form special interest groups that

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contribute to campaign finance of political parties. The anti-poor bias, and hence targeting failures ..., tend to be more severe in regions with high poverty rates.” (p. 35)

von Braun and Grote (2000) in cross country comparisons examine the effect of decentralization in advancing the needs of the poor. The proposition that elected local governments are likely more responsive and accountable and more inclined to involve the poor in political processes, leads to an expectation of improved outcomes. Effective decentralization may be expected to lead to both improved technocratic responses (improved targeting of limited resources) and institutional voice (through enhanced political participation). However, if unsuccessful, decentralization can have negative outcomes. “...[T]hose in power have few incentives to allow participatory institutions to develop.” Corruption is an important element, as its effects are quite regressive and it increases income inequality. Decentralization is not a cure, as many decentralized nations (such as Nigeria, India and China) experience high levels of corruption.

Specifically considering the effects of education decentralization on the equity side, decentralization has often widened performance gaps between wealthy and poor jurisdictions, such as in Burkina Faso and Chile. However, in other nations (coupled with appropriate financing structures) gaps have closed. In New Zealand, Mexico and Argentina inequalities have declined (Fiske 1996).

Still, decentralization can be linked to positive outcomes for the poor. With regard to political decentralization, casual observation reveals that countries scoring low on the UNPD Human Development Index tend to be politically centralized, however, causality is still an issue in interpreting this relationship (von Braun and Grote). With the potential for undesirable outcomes regarding regional inequality acknowledged, decentralization is expected to produce an overall improvement in the satisfaction of basic needs (for example education and health). Cross-sectional regression of the UNDP index on measures of expenditure and revenue decentralization have also shown a relationship between fiscal decentralization and satisfaction of basic needs (Lindaman and Thurmaier 2002). Again, however, methodology and causality problems limit any general conclusions.

When decentralization serves as a catalyst for dampening secessionist pressures by providing institutional mechanisms for bargaining between divided groups, it tends to promote the maintenance of redistributive policies and stability needed to provide for basic needs. South Africa and Uganda are cited as examples of decentralization as a tool for promoting national unity. Decentralization can also escalate inter-regional tension were regional income differences are extreme. To improve the conditions of the poor, improved intra-regional targeting is also required. Without this, significant inter-regional transfers (such as in India or

23 Local participation is expected to promote efficient production and more equitable provision of public services.
Indonesia) will have limited effect (von Braun and Grote 2000).

Looking at relative household effects of decentralization, a study by Galasso and Ravallion (2001) of a decentralized food for education program found mildly pro-poor results in that a larger fraction of the poor benefited from the program. While actually a central government program, within community distribution was determined by local committees composed of school administrators, teacher and parents. Targeting within communities was better than that achieved by central allocation across communities. However, some capturing appeared in areas of remote location with high inequality (see Bardhan 2002). This somewhat contrasts with targeting in Mexico’s Progresa program. In this case, the most effective targeting is the first stage selection of communities, rather than in the distribution to recipient households within communities. (Coady 2001; see Bardhan 2002). A decentralized social assistance program in Albania was found to experience “modest gains” in within community targeting and cost effectiveness. There, local officials use additional local information in identifying households for participation. No evidence of elite capture is found. However, central allocations of resources to individual communities was ad hoc and not significantly related to relative levels of poverty. (Alderman 1998; see Bardhan 2002).

von Braun and Grote further consider the effects of political decentralization on inequality and income distribution across several countries. In China, they report an increase in economic inequality and significant rural poverty. They attribute this outcome to governance factors such as “...distorted incentive structure, existence of powerful elite, or inoperative legal systems.” India’s decentralization allows the poor to exercise voting rights at three levels of local government. However, patron-client relationships sometime require the poor to vote based on preferences of their landlords. “India combines consistently high poverty rates, illiteracy, and poor social indicators with democracy.” Only limited improvements have been made in the living conditions of impoverished populations. Ghana’s district assemblies establish a framework for implementing participatory, pro-poor focused projects. Still, while the general poverty rate has declined, the benefits of growth have not accrued significantly to the poor. These authors find that political decentralization often benefits the poor due to the involvement of civil society. They find less evidence for similar effects of administrative decentralization or fiscal decentralization. A minimum threshold of subnational expenditure responsibility appears to be a precondition for poverty reduction, but the reduction appears to plateau, such that high subnational shares are not associated with high levels of poverty reduction. Expenditure decentralization can also impair the delivery of critical social services (such as education and health) due to problems in institutional and/or managerial capacity and local political power of the poor. In China in particular, health services for the poor appear to have been negatively affected by fiscal decentralization.
Evidence of the importance of representation in determining the distribution of policy outcomes is also found in India. Mandated representation of women in leadership positions at the local level is associated with increased female public participation and increased investment in infrastructure (such as water, fuel and roads) which provides for rural women’s needs. (Chattopadhyay and Duflo 2001; see Bardhan 2002). Relatedly, Foster and Rosenzweig (2001) find that fiscal decentralization and democratization increases the political representation of landless households. They base their findings on shifts in the allocation of resources toward road construction (assumed to benefit landless workers) and away from irrigation (benefiting land owners). (see Bardhan 2002)

Altered governance structures are also expected to be associated with increased economic output and growth. But, in spite of economic improvements, the poor are often excluded due to capture and corruption. Looking at decentralization in India more closely, Dither (2000) suggests that "On paper, fiscal responsibilities in many domains were transferred to the village panchayats .... In practice, in most states, the panchayats have no meaningful involvement .... They have neither the power nor the resources to get involved." The system of local finance provided disincentives for local revenue mobilization and the ability for ad hoc state intervention. It is found, however, that where elections are more frequent, where parent-teacher associations exist and where democratic participation is more prevalent, positive results exist for child mortality and school enrollment. However, capture by the non-poor is still an issue and mechanisms are required to assure adequate participation and targeting. Heavily subsidizing education and health is likely to be pro-poor, partly because the non-poor augment education consumption through private provision. However, exit by the privileged diminishes pressure for effective and efficient public services. This may result in the establishment of parallel systems. One for the well off, providing efficient and costly private services and the other, for the poor, providing dysfunctional public services. To mitigate local capture effects, sectors relevant to poverty reduction should have shared local / central responsibility. For education, for example "some parts of the system (setting the curriculum, organizing examinations at the secondary school level, monitoring the quality of instruction, etc.) are best provided by central authorities with democratic control and oversight; for some tasks (such as fixing leaky roofs) it does not make sense for the center to get involved to sign off on decisions; for other issues, it is best to share governance." (p. 12)
Annex C: Vertically Coordinated Planning in a Decentralized Context

Planning and its Local and Regional Forms

Planning encompasses a diverse set of geographic and spatial ranges, needs and objectives and is therefore multi-faceted in nature. Frequently referenced forms include land-use planning, strategic / economic development planning, infrastructure planning and regional and metropolitan planning. (see Marshall 2000) Land-use planning is planning in its most traditional form in the West. It entails questions of settlement density, characteristics of construction and economic activities permitted on a parcel by parcel or zone by zone area of a city. Also considered are local transportation, housing and infrastructure needs. Strategic planning focuses on economic development, social and environmental goals and objectives. It is oriented toward facilitating economic growth and quality of life and is often directed to promoting a community's competitive economic position via sector development and promotion of social or public service goals through combined government and private services and investment. Infrastructure planning’s emphasis is on providing coordinated infrastructure (sanitation, transportation, public facilities) development on a broader scale, but must be coordinated with both land-use and strategic planning. Regional planning is in some ways a coordinated extension of local infrastructure and strategic planning to a regional scale and presumably takes place within broader national planning initiatives.

In decentralized contexts, responsibilities for these forms is by necessity nearly universally assigned to diverse sets of bodies. These bodies have diverse constituencies, participants and processes. This creates an implicit need for coordination between planning institutions in addition to the need for internal consistency within the individual elements. As such, planning requires (and is likely defined by) coordination, both vertically and horizontally. The appropriate representation and coordination of interests within, among and between theses different elements of planning is often the cornerstone of debates on the efficacy of results. Models of effective planning abound and recent popular discussions of a “Barcelona Model” as an example for Europe (as well as Latin America) have focused on coordinated operations of plans and projects and collaborative interaction between citizens, politicians and professionals.24 (Marshall 2000)

24Coordination and participation in the Barcelona context is, however, not as extensive or as comprehensive as suggested beyond the confines of land-use planning (see Marshall 2000).
Private Certainty v. Public Flexibility

There is considerable national variety in the role of central versus local government in developed planning systems. Obvious demarcations suggest details of land-use regulation as a local function with strategic and regional likely of broader scale. In the area of land-use there is also considerable variation in the level of individual versus government determination. European views of land tend to place more emphasis on its communal attributes and the attachment of value emanating from surrounding external and public investment, rather than as a right of appropriable gain to parcel owners. This translates into a more significant government role in land-use and planning. In the United States, land is more commoditized, with a greater tendency to view it as a source of profitable private gain to land owners. There is a resulting tendency to defer to the rights of the land owner rather than benefit to the community. (see Cullingworth 1994)

In the area of land-use regulation, there is conflict between the competing need for certainty and flexibility. Certainty in economic usage is a desire of land owners which may conflict with public objectives of flexibility in regulation to accommodate emergent public needs. The U.S. Systems appears to provides certainty in zoning, but the ability for manipulation through exception creates significant flexibility which may benefit individual land owners. In contrast, the British deference to public objectives produces “an explicitly flexible system,” however, the long-term nature of established policies provides considerable implicit certainty. (Cullingworth 1994)

The system in the Netherlands is based on ‘legal certainty’ ingrained in Dutch public administration. Local plans are developed in the context of a regional plan. Municipalities often actively engage in development activities and the legal status of the local plan means that development proposals which meet its requirements must be approved. In France, the national government maintains substantial control of planning. Local development plans are drafted based on national prescriptions. An approved local plan is required before planning responsibilities can be devolved to the local level. Without such, development beyond already built-up areas is under national regulatory control. The establishment of local plans, however, confers development rights if proposals adhere to plan provisions. While this would appear to confer certainty, regular modification and elaboration of requirements (due to changing circumstances) creates complexity and the need for negotiation in project proposals. Observances of European planning structures conclude that “... there is no way to resolve the competition between certainty

25This benefit often comes at the detriment to neighboring uses.
and flexibility. ... At present, flexibility appears to be the stronger contender, simply because the future is uncertain ...” (Cullingworth 1994) Judicial process are sometimes invoked to resolve this competition and compensatory systems are sometimes used in the U.S. and Europe to compensate land owners for the denial private usage due to over riding public needs.

Vertical Coordination

As highlighted above, intergovernmental coordination is a critical element in planning, particularly in decentralized contexts. Planning systems should entail an elaboration of regional (and or state and national) goals as a foundation for meaningful local plans. Local adherence to broader frameworks should be assured through “mechanisms to prompt, attract, bribe and if necessary force local governments to devise and implement local plans that reflect the state goals.” (Cullingworth 1994: 166) For example, Alberta Canada’s Planning Act requires that local actions conform to the regional plan. It attempts to foster local autonomy over development and land use within “a broad regional framework and authority within which independently determined objectives can be achieved.” The state of Oregon uses a joint legislative committee, the Land Conservation and Development Commission and the Land Use Board of Appeals to monitor local compliance with state legislative planning mandates. The commission is required to approve local comprehensive plans and ‘develop standards to carry out the intent of the law through full implementation of the goals’ (DeGrove 1984: 256, see Cullingworth 1994) The State of Florida attempts to establish conformance by segregating issues between state and local governments. Areas of critical state concern are reserved to the State. These include issues of environmental, regional or historical importance and those developments with regional impacts. In these areas, the State develops planning and implementation procedures. All cities and counties are required to develop and adopt comprehensive plans whose form and content must then must be reviewed by several agencies and approved by the state Department of Community Affairs. Florida also imposes numerous and detailed mandates on local jurisdictions to promote State policy objectives in local planning (Deyle and Smith 1998).

Mandate Experience in the States

Over the past three decades in the United States, planning responsibilities previously the purview of local jurisdictions have been increasing assumed by States, with States mandating local compliance on environmental, regional growth, land use and social issues (Berke et al. 1996; Dalton and Burby 1994). Mandates have taken two
forms: (i) “direct regulation and state mandates of local regulation of matters of particular state concern,” and (ii) attempts to foster general planning and coordination, with an emphasis on policy consistency “horizontally across state agencies and units of local government, vertically among state, regional and local governments, and functionally between land use and public infrastructure.” (Dalton and Burby 1994) Proponents of the former suggest the political difficulty of and the diffuse nature of the latter and the ability of a combination of single-purpose laws to collectively function as a comprehensive plan. However, beyond technical compliance, commitment is required on the part of local officials and planners if broader state policy goals are to be advanced. Experience in the U.S. Suggests that:

“General planning mandates help with coordination ..., but are too broad to affect commitment to specific policy objectives. Thus, single-purpose mandates are also needed, because they build commitment. If state policy maker are serious about goals embodied in planning mandates, they should reinforce those mandates with single-purpose mandates, which require local government attention to each goal ( and which provide financial and technical assistance for goal attainment). Thus, we see general planning and single-purpose mandates as having the potential to work together effectively to achieve state policy objectives. (Dalton and Burby 1994: 454)

Reviews of planning mandates in several states reveal that “… mandates can influence the content of local plans and that stronger mandates, backed by statutory authority to review local plans and sanction communities for noncompliance, are associated with higher quality plans” (Deyle and Smith 1998: 457; also Dalton and Burby 1994) Mandates stimulate the development of plans in communities which otherwise would not do planning and notably improve their fact basis, goal elements, strength of policy recommendations and increase the likelihood that that they will contribute to implemented policy (Berke et al. 1996). Stronger mandates appear to have greater effect, however, there is more variation in the quality of planning components in mandated jurisdictions. Overall quality is dependent on the content and character of the mandate. Oversight and sanctions are particularly required when disagreement exists between levels of government regarding the substance or priority of policy goals and objectives. Mandates which include local capacity and commitment building provisions contribute more to desired results. State mandates can also substitute for the absence of local physical, economic and political factors conducive to planning and produce greater consistency across jurisdictions on a variety of “environmental, economic and social problems” (Berke et al. 1996).

26Specifically, these states are Florida, North Carolina, California, Washington and Texas.
The European Experience – Divergent and Shifting Models

Multi-Level Spatial Planning – Variant Local Purviews

Germany as an Example of a Rationalized Structure. Compared to the United States, European planning systems have a tradition of significant centralization. This tradition has required more purposefully engineered national, regional and local components. Typical of a rationalized multi-level spatial planning process is that of Hanover Germany. In this context, five planning layers exist. The broadest is that of the European Union European Commission which provides a European spatial development perspective. This is followed by the Federal Republic of Germany’s federal guidelines for regional planning, the Lower Saxony State Government’s spatial state development program, the Hanover region’s strategic regional market coordination and, then, 21 local government development and planning zones. Hanover’s planning process presides over one of the 21 local zones. Each tier establishes development goals, implementation methods, and spatial land-use. “This is done in a complex system of time-consuming, top-down and bottom-up procedures, following well established principles within legitimized parliamentary decision making processes at the federal and state levels, but with little public involvement beyond the representative democratic system ...” (Albrechts et al. 2003: 116). Political and civil servant support for a regional approach has resulted in the translation of strategic concepts into regional land-use plans, but “it has been more the search for territory-based policy integration and ways to strengthen regional identity that motivated politicians and planners” (p. 118-119). A strong institutional planning inheritance and local professionalism is instrumental to the fulfillment of the local role.

Ireland and Empowering Local Jurisdictions. Significant local discretion is not, however, guaranteed in multi-tiered structures. Informal political and power dynamics, as well as the vertical assignment of responsibilities may be critical to determining influence and authority across tiers. The experiences of Dublin Ireland suggests properly “networked” local governance as important in empowering local jurisdictions in planning and engaging in a manner which meaningfully shapes policies to the needs of local populations. Local governments are often depicted as being enfeebled relative to the market and established development driving policies and resources of the central government and private capital. Changes in modes of governance, however, produces instability in established power networks and offers opportunities to local governments to build new associations through capitalizing on the need for resource sharing in both public and private outcomes. Local jurisdiction’s require resource independence and an ability to independently mobilize these resources to promote outcomes to gain meaningful access to and roles in policy networks. Resources relevant for local mobilization include legal and regulatory
purview, professional expertise, investment, local knowledge of social and economic conditions, and legitimacy in political representation. (McGuirk 2000)

**British Central Control.** The British system of planning is highly unitary and coordination has hierarchical characteristics. Legislation mandates nation-wide prescriptions and central government agencies are charged with ensuring conformity of local governments to national planning and land-use policies. Law requires local submission of proposals and development plans to central government agencies for approval. Central review of local actions extends also to local fiscal issues such as the issuance of debt and tax levies.27 (Cullingworth 1994) British planning expresses policies in broad terms intended to promote the public interest with local operationalization approved for consistency in the details from above. Concern for individual property rights is overridden by concern for public pursuits. Appeals of usage restrictions are made directly to the central government.

**Scottish Regional Reports and the Enabling of Effective Decentralization?** Planning structures can be support systems for effective decentralization. In the early 1970’s Scottish local government was considered “... a fragmented and disorganized arrangement of authorities characterized by their lack of direction, effectiveness and ambition” (Lloyd 1997: 731). This structure was remolded into a two-tiered system of regional and district councils. Responsibilities were divided between “... strategic planning and development functions such as ... water and sewerage, roads and structure planning, and the local functions of housing, local planning, development controls and licensing.” Simultaneously, a new planning instrument, the “regional report” was instituted to facilitate local government reform and promote strategic planning.

“[R]egional reports were intended to assess the available resources and competing priorities of the regional authorities and thereby provide a strategic context to decision making and investment planning by the district councils ....” They were established in parallel to National Planning Guidelines and submitted to the Secretary of State. As implemented, regional reports entailed an economic focus and dealt with issues such as unemployment and the needs of the socially disadvantaged and publicly identified strategic concerns as a guide to district council land-use and structure plans. In aggregate, they provided a somewhat de facto national plan. They often highlighted insufficient regional / local fiscal resources as a major barrier to fulfilling the policy agenda.

While lacking in direct public participation, district councils were involved in regional report development, creating a regional political consensus on the resulting policy agenda. It provided for the identification and prioritization of problem areas in individual regional jurisdictions and relatively rapid policy responses, and improved central-local government relations. In a 1994-96 reform, the regional authority was fragmented and

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27Home office approval is even required to ban dogs from parks.
the two-tiered structure was replaced with thirty-two single-tier, unitary Councils which “... combine strategic and local functions, including structure planning, local planning and development control, and social services.” Concerns exist for the potential loss of regional coherence and strategic capacity through an emphasis on decentralization and a new vehicle has been sought to reinvigorate a corollary to the regional report in this restructured setting.

Coordination, Barcelona Style. Multi-tiered systems, as suggested above, require significant attention to the need for coordinated initiatives and responsibilities. Formal and informal dynamics of coordination are both critical. Barcelona, Spain has been lauded for its attempts at regional coordination. However, even in the face of concerted efforts, meaningful coordination of local land-use and strategic elements of planning has proved difficult. Institutional, market, participatory and power difficulties have mitigated effects. While strategic planning claims a foundation based on inclusiveness, the actual process has been largely conducted within a specific elite alliance. Pursuit of social and environmental goals has become constrained by a reliance on private funding for project implementation. Projects reliant on public funding are, however, more likely to realize these goals. Regional planning, on the other hand is largely disregarded because of the absence of institution to deal with metropolitan scale issues and implementation, and real differences in interests. (Marshall 2000)

In Barcelona, fragmentation in planning is somewhat reduced by political leadership. The degree that planning actually becomes consensual or collaborative in this context is a function of the concentration of authority in an elite process. Without effective participatory institutions for strategic, infrastructure and regional planning, public / democratic control of environment, development, and infrastructure is limited. (Marshall 2000)

In the context of elite politics, however, fragmentation in planning may be desirable. It may increase popular voice in local land-use planning, where “real” localized development and service impacts may be possible, by channeling elite dominance to strategic and infrastructure planning elements. In this case, “a dislocated process ... [may] protect weaker social interests” (p. 317). Coherence may then only be desirable when linked “… to some form of powerful progressive politics.” Context is important and caution is warranted. It is the dynamic of power relationships between broader society and politics and within institutions and planning instruments, not planning method or style, which dominates outcomes.

Lessons from European Regional Planning Experiences.

Lessons emerge from a review of European regional planning experiences. First, while they may look similar, planning initiatives are context specific. Forms are dependent upon modes of governance and objectives, and roles. Local responses are of critical importance to the efficacy of outcomes. Effective and lasting innovation and transformation tends to be locally driven in response to challenges and
opportunities. Local innovation should be encouraged, not discouraged.

Second, strategic planning initiatives (while holding the potential for facilitating innovation) can reinforce the “status quo.” It is necessary to build institutional alliances across power centers and contexts to facilitate acceptance across actors and empower the process to frame investment and regulation.

Third, the spatial element requires more than technical analysis. Spatial identity requires the establishment of a persuasive logic or argument (and metaphors) linking geography and people to a common objective or strategy. This is often the motivator for behind success; this linkage can carry “persuasive power in complex political contexts.”

Forth, the creation of “institutional arenas” for developing regional initiatives is critical. Inherited regional or subregional institutional relationship are often a vehicle for mobilizing regional planning initiatives. However, this institutional inheritance can also be a liability if it becomes an obstacle to innovation. (see panel 1) Effective regional planning often requires establishing a new governance culture.28 New practices and strategies must be “connected to accountable political levels of government and to formal legal requirements that affect both regulatory and investment practices”

Fifth, an established, strong state role and consciousness of local place identity are important to planning initiatives. In essence the effectiveness of spatial strategies lies in the ability frame concepts and images, the establishment of policy discourse, availability of statutory tools and procedures, the establishment of “expert policy communities” and the ability to shift governance culture, toward open and collaborative practices (Albrechts et al. 2003).

28For example, a strong regional government tradition in Europe (above the municipality) can facilitate acceptance of regional initiatives. However, established policy actors may be wedded to status quo practices and responsibilities.
Panel 1: Institutional Facilitators and Inhibitors of Decentralized Planning in Israel.

Many organizational and implementation factors have been identified which affect the success or efficacy of participatory planning. Those affecting success of decentralized planning in Israel have included both promoting and inhibiting factors. Inhibitors include (i) relying for implementation on existing agencies with a heritage of centralization in the absence of organizational plans to incorporate decentralization and public participation goals into agency operations, (ii) a reluctance to clearly identify the division of responsibility between central and local levels, and (iii) mingled allegiances to central or local authority in key officers. Factors suggested to promote decentralization success have included (i) the existence of a low political profile and an incubation period (or “policy shelter”) away from media and political scrutiny allowing development of elements based on professional input, (ii) long-term commitment of high level administrative and professional leadership, (iii) absence of competition with existing agencies regarding personnel, (iv) support from independent sources of power, and (v) open conduits for innovation. (Alterman 1988)

Coercion v. Cooperation

Paramount in the above discussions has been the search for coordination while maintaining local initiative and appropriate levels of local discretion. Pursuit of intergovernmental coordination “... entails the imposition of procedural and/or substantive requirements by a higher-level government on subnational (state or local) governments, either as conditions for assistance or as direct orders” (May 1998) This coordination can take either “coercive” or “cooperative” forms (see panel 2). Coercive frameworks treat local jurisdictions as “regulatory agents” charged with following standards and procedures and enforcing prescriptions of higher-level governments to achieve policy goals. Monitoring local compliance is a critical element and often focuses on prescribed actions, plans and processes. Local compliance is enforced by the threat of sanctions for deviation from roles, procedures, prescriptions or policy mandates. Cooperative models attempt to stimulate local interest, support and capacity to facilitate the achievement of “higher-level policy goals.” There is an assumption of lower-level goal commitment. Local jurisdictions function as “regulatory trustees” in pursuit of shared goals. Monitoring focuses on levels of substantive achievement and building local capacity to conduct assigned roles. Local innovation in approaches to policy success is encouraged.
## Panel 2: Coercive and Cooperative Intergovernmental Policy Designs

<table>
<thead>
<tr>
<th>Features</th>
<th>Comparison of Policy Features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Role of Lower-Level Governments (State, Regional, or Local)</td>
<td><strong>Coercive Policy Design</strong>  Regulatory Agents: Enforce rules or regulations prescribed by higher-level governments.  Regulatory Trustees: Develop and apply rules that are consistent with higher-level goals.</td>
</tr>
<tr>
<td>Emphasis of Intergovernmental Mandate</td>
<td>Prescribe regulatory actions and process. Specify regulatory actions and conditions, along with required process or plans.  Prescribe process and goals. Specify planning components and considerations, along with performance goals.</td>
</tr>
<tr>
<td>Control of Lower-Level Governments</td>
<td>Monitoring for procedural compliance. Enforcement and sanctions for failing to meet deadlines, for not adhering to prescribed process, or for not enforcing prescribed rules.  Monitoring for substantive compliance with more limited monitoring for procedural compliance. Monitoring systems for assessing outcomes and progress toward them.</td>
</tr>
<tr>
<td>Assumptions about Intergovernmental Implementation</td>
<td>Compliance is a potential problem. Need for uniformity in application of policies.  Compliance is not a problem. Need for local discretion in policy development.</td>
</tr>
<tr>
<td>Source of Policy Innovation</td>
<td>Higher-level governments  Lower-level governments</td>
</tr>
<tr>
<td>Implementation Emphasis</td>
<td>Inducing adherence to policy prescriptions and regulatory standards. Building “calculated” commitment as a primary means of inducing compliance.  Building capacity of subordinates to reach policy goals. Enhancing “normative” commitment as a primary means of inducing compliance.</td>
</tr>
</tbody>
</table>


Florida as a Coercive Model.

Florida’s process is considered one of the most coercive in the United States. State agencies administering mandates can impose significant fiscal sanctions for noncompliance. Discretion exists, however, in the level of enforcement actually undertaken. Factors found to affect the level of agency enforcement of these planning mandates include both political and administrative issues (Deyle and Smith 1998: 462; May 1998). Complaints by communities of excessively thorough review has prompted pressure for more flexibility. Shifts in gubernatorial leadership was also associated with a reduction in the level of enforcement.

Political forces have required enforcement agencies to modify their approach to incorporate more negotiation and selective enforcement or face the possibility of legislative revision or even recision of their mandate. Administrative limitations on the ability of state agencies to review and comment on hundreds of plans and several hundred specific directives and mandates (in addition to political pressure) prompted a prioritizing of issues at the state level. Only “major issues” were given detailed scrutiny. The result was greater local compliance on these salient issues and lessened attention to non-priorities. In the mandate environment, local conditions are also influential. Beyond the fact that mandating agencies also tend to provide
technical support to plan development, local factors such as predisposition toward issues, professionalism and capacity, economic and fiscal conditions are also expected to affect compliance.

Based on the U.S. Experience, evidence suggests that planning mandates do produce compliance in the development of local plans. However, compliance varies with the vigor of oversight, how well defined were the issues, and the level of enforcement mechanisms. (Deyle and Smith 1998: 466) Mandates appear to significantly influence issues addressed by local plans, but, questions of implementation of plan content remain. To be effective, the “plan” must influence local decision making. This requires local commitment to policies beyond their inclusion in the plan.

New Zealand and the Cooperative Approach.

New Zealand and New South Wales, Australia use cooperative approaches. (May 1998) The New Zealand approach most embodies this model in the establishment of its Resource Management Act (1991) replacing approximately 60 pieces of individual legislation. This act was adopted within the context of significant reforms to local government structure begun in 1989 intending to devolve power to local jurisdictions.

Previously, New Zealand used a prescriptive (coercive) planning approach under the Town and Country Planning Act of 1977. The new act was to provide a mechanism “to sustainably manage physical and natural resources within a planning system with a focus on environmental outcomes” (Dixon et al. 1997). The national government’s role is to establish national guidelines and policies and prescribe processes for the development of regional plans and policy statements and monitor local plan development. Rather than a reliance on sanctions, “persuasion” is used to encourage compliance. The intent is to foster increased local capacity, provide information sharing, grants for plan development, review and comment on regional policies and local plans, and establish a focus on effects or outcomes.

Preliminary evaluations suggest that implementation of this cooperative approach can be credited with greater local innovation, however, it has not been without difficulties. The translation of broad policy objectives into practice has been inconsistent and national policy guidance in general was slow to materialize. Inconsistencies have created confusion and “mistrust on the part of local governments” (May 1998). Principal agencies did not provide expected levels of facilitation, guidance or technical support to local councils and, as a result, reviews of plans and policy statement were more “directive.” Local councils have also not coordinated well in conducting mandated responsibilities. A tensions has also emerged between flexibility and certainty, as certainty for resources users has been somewhat reduced.

Vertical and horizontal planning integration is encouraged in New Zealand through a “hierarchy of policies and plans.” (Dixon et al. 1997) “[T]he central
government establishes national goals and policy statements; regional governments develop regional policy statements, plans and environmental regulations; and local governments prepare district land use plans and development rules” (May 1998)

Regional and local governments are able to develop their own approaches so long as the outcomes specified in the Act are achieved and the specified processes are followed. Procedural requirements specify consultation among parties and consistency in policies between levels of government. The commitment of local governments to national policies is encouraged through grants, public education, and thorough review and commentary.

Procedural compliance has been mixed. Four fifths of local plans and all regional policy statements were developed on-time, but only one-third of policy statements were operative. Substantive compliance was similarly mixed. Plan quality varied, but their were instances of innovation and evidence of “attention” to policy goals. Local decision making showed greater flexibility and willingness to negotiate development issues, however, local backlash over the cost of plan preparation and resource consents was not an insignificant issue.

Constraints and Dilemmas.

Each form of coordination suffers from its own constraints and “dilemmas.” The coercive regime may discourage and sacrifice local initiative in the pursuit of state-initiated innovations. Procedural compliance may be emphasized over substantive compliance, as straight-jacketed local jurisdictions are expected to employ cookie-cutter approaches. Local officials are likely inhibited by “prescriptive and coercive provisions.” This result is likely reinforced by the legalistic environment and local jurisdictions concern for sanctions should they stray too far from directives. Over the longer-term, there is considerable risk of undermining coercive mechanisms through a backlash of local officials.

Coercive models require constant monitoring and compliance may erode if monitoring or enforcement agencies become complacent or if local predisposition to compliance change.

The cooperative regime’s more “flexible” approach attempts to capitalize on local innovation. However, while cooperative regimes attempt to foster local ownership of broader policy objectives, they may also experience procedural and policy compliance gaps because of local government reluctance to follow policy and process prescriptions and the possibility of capture by more parochial local interests. Gaps result in ‘spotty compliance’ and the absence of sanctions creates difficulties in motivating resisting jurisdictions. Instead, incentive systems are relied on to bring the reluctant into the fold. Flexibility may also result in policy divergence based on local adaptation. Coercive models appear better able to secure procedural compliance, however, cooperative models may produce greater substantive compliance in situations where local and higher policy interests and incentives are aligned. Cooperative systems may also degrade if divergence takes place between policy interests and priorities across levels (May 1998).
Conditions of Relative Efficacy.

In cooperative approaches, capture is likely a greater issue in instances of heterogeneity regarding policy positions and when local input into decision making is inequitable, such that relevant stakeholders are unrepresented. Additional failures in cooperative compliance exist when broader policy desires conflict with general local interests. In these circumstance, coercive means may be the only tenable way of assuring compliance.

In both coercive and cooperative models, open, participatory planning may serves a useful role. In cooperative models, participation likely results in policies which are more responsive to local needs. If participation is broad, it can work to limit capture, but can also generate conflict. In coercive models, participation can mobilize community groups behind policy objectives and increase the commitment of local officials to higher-level policy goals.

The overall efficacy of coercive versus cooperative models hinges on a number of factors. Essentially, cooperative approaches require that policy objectives be shared. "When there is fundamental disagreement over policy objectives or the allowable means for meeting them, the cooperative nature of the intergovernmental partnership will be doomed ..." (May 1998). Cooperative approaches are also more likely to be effective if precision can be avoided in defining policy or methods without necessarily impairing the satisfaction of policy goals. For a cooperative model to have meaning, real responsibility devolution to local jurisdictions is a requisite. On the other hand, local devolution impedes the coercive model. Coercive approaches "... require higher-level authority to carry out monitoring of compliance by lower-level governments and the power of enforcement ...." Cooperative models require strong commitment and capacity of implementing agencies to facilitate local performance. However, when local policy commitment exists substantive results at least rival that of coercive mechanisms and over the long-term the likelihood of sustained local commitment may be increased. (May and Burby 1998)

Participatory Planning: Issues, Modes and Cautions

Greater levels of participation in planning decision making in general is often advocated. However, the reality of participation may differ from its idealized outcomes. Questions of the efficacy of participatory models remain. Even the existence of a progressive political environment does not assure the superiority of participation. Outcomes are dependent upon the form of participation, range of
community views and forms of knowledge which have access to decision arenas, the institutional framework for articulating these views, and the ability of the political actors and institutions to process input and deal with the engendered conflict.

There are five rationales for public participation which divide along the nature of the motivation intended to be served. Competing motivations include self-interested and community focused. Self-interested participation takes the form of: (i) instrumental participation, predicated on a basic “right” of the individual to pursue their own self-interest, (ii) politics of the consumer, emphasizing the “rights” of customers or consumers to pursue freedom of choice and express preferences, and (iii) politics of presence, conveying the “right” of inclusion for excluded groups in the decision-making process. Community focused participation takes two forms: (i) communitarian participation stressing the obligation of individuals to contribute to achievement of the “collective well-being” and associated duties and rights, and (ii) deliberative democracy, stressing process and the development of institutions to promote “open dialogue,” “shared solutions,” and “new forms of knowledge.” (Campbell and Marshall 2000)

In a study of local participation in California, even a rather elaborate participatory environment excluded large segments of socially and economically disadvantaged elements of society and appeared to alter outcomes little. Participation did, however, produced some perverse effects in the form of limited access, dominating motivations, increased conflict and intractable decision making. (Campbell and Marshall 2000) Tendencies of elected officials to bow to the will of the most vocal at a given time produced inconsistent and unstable, cycling decisions. Decisions made at one hearing were undone at the next. Motivations of participants appeared highly rights-based, self-interested and self-serving rather than community interested. Participation became a vehicle of personal gain. With the emergence of information clutter generated by less than salient inputs to decision making, searches were undertaken for alternative forms of “scientific” information to validate and bring clarity to issued muddied by alternative forms of conflicting “knowledge.” Elected official’s desires not to offend participants also produced tendencies to table rather than decide.

Evidence of acute dangers associated with a rights-based orientation emerged as tendencies to focus on narrow, single-issue self-interest pervaded the process at the expense of a focus on the complex and interrelated nature of collective welfare. This study also highlighted the absence of a “community view” and the difficulties generated by the existence of conflicting voices. Due to the dominant motivation self-interested motivation, prevailing “community interests” could not be considered synonymous with “collective interests.” Results, in this environment, were not by definition democratic and sometime espoused “morally unacceptable views.” Institutional structures intended to promote deliberation were commonly stymied by participants fixed, narrowly self-interested
positions, reducing local democratic processes to “confusion and noise.”

Pervasive power structures remained relatively unchallenged, however, the efficiency of decision making was impeded, and the relative voice of disadvantaged groups declined compared to representative local structures. Emerging cautions suggest that participation must be managed as an input to accountable representational democratic decision making, it is no substitute for it. Unbridled participation may result in egregious consequences driven by unaccountable self-interest. Community focused forms of participation as input to representative decision making should be encouraged, as should vehicles for representatives and practitioners to retain their decision making capacity.
Annex D: Intergovernmental Revenue Assignment and Transfers

Primary considerations of intergovernmental finance systems include the degree to which the structure adequately deals with two universal intergovernmental problems: (i) *vertical balance*, the degree to which the revenue and transfer system provides resources adequate for the basic expenditure obligations of the subnational and subregional levels of government; and (ii) *horizontal balance*, the degree to which the system accommodates or adjusts for differences in revenue capacity across individual units of government (see panel D1).

### Panel D1: Requirements of Horizontal & Vertical Balance

**Vertical Balance.** Decisions regarding the appropriate revenue assignment between levels of government are largely decisions of vertical balance. Basic considerations in revenue assignment between levels revolve around resource adequacy relative to service responsibilities. The policy goal is to provide basic resource assignment consistent with these responsibilities, producing a resource distribution adequate to meet the basic expenditure obligations of local governments (providing vertical balance in revenue assignment between levels of government relative to expenditure responsibilities).

**Horizontal Balance.** Revenue capacity disparities between jurisdictions are generally of such magnitude that mitigation is required to assure that individual units have sufficient minimum resource capacity available to meet basic (or minimum) expenditure responsibilities. The determination of what constitutes this minimum is a policy choice that, while informed by analysis, cannot be objectively determined. As a general rule, horizontal imbalances are addressed through (equalizing) grant systems, not through revenue assignment. However, the requirements of the grant structure are influenced by the mix of revenues assigned to different tiers of government. Revenue assignments can make the balancing task for the grant system more difficult. Nevertheless, a structure to accommodate and adjusts for differences in revenue capacity (relative to expenditure needs) across individual local units (achieving a horizontal balance across local governments) is required.
In addition to these issues, intergovernmental finance structures need to promote the realization of regional and national priorities and promote socially desirable expenditures on services for which the benefit streams can not be contained within the confines of a single municipal formation (or region). Such a structure requires grants designed to promote specific functional purposes (e.g., education or health), in addition to those designed to redistribute resources to relieve disparities (producing horizontal balance) or provide basic capacity (vertical balance).

Stability and predictability of revenues, an ability to determine the overall budget envelope on the margin, and accountability to the population for the level and quality of services provided are vitally required if the pathologies of the current intergovernmental system in the developing context are to be eliminated. On the revenue side, attention to three structural elements is usually warranted (i) regional / local revenue assignment; (ii) stable regional tax sharing; and (iii) a rational system of regional intergovernmental transfers. The first two of these address the issue of "vertical balance" and are intended to provide basic resource capacity. The third deals with both issues of equity ("horizontal balance") and allocative efficiency. Each are vitally important component of revenue assignment.

Shared Revenues.

Vertical sharing of tax collections is a mechanism often used to provide basic local fiscal capacity. It has the advantage of using the existing (higher yield) regional and national revenue instruments as a foundation for subnational finance. The relative shares across levels should be based on relative expenditure responsibilities. Local government shares of regional tax collections and regional government shares of national tax collections should be clearly defined and stable.29 Law should define (i) taxes to be shared, and (ii) establish fixed sharing rate amenable only legislatively. This stability will allow the shared tax sources to be used as a predictable base level of funding for all local jurisdictions and will prevent the arbitrary manipulation of sharing rates which can produce serious disincentives for revenue collection.

Ideally, sharing rates should be set at uniform levels across all jurisdictions; however, it is the expenditure assignment which is controlling and if asymmetric expenditure responsibility exists within a level, then sharing should also be asymmetric. Local revenues and a supplemental (and objectively determined) transfer system should be relied upon for equalization purposes and to provide unmet resource capacity.

Local Revenue Instruments.

To establish the appropriate economic incentives and promote responsible subnational budgeting, local

29Local share is ideally based on derivation (or origin). That is, the local allocation is based on a fixed share (percent) of the resources from a national revenue instrument of instruments collected from its base within the jurisdictional boundaries of the recipient unit.
Governments need to rely on local revenue sources for funding the marginal expenditures within their budgets. To provide proper price signals, local jurisdictions should be provided discretion in the usage of and tax rates applied to these local instruments. Municipal formations need to be provided the appropriate incentives to generate revenue. The typical transfer system in the developing context is negotiated and allows revenue effort in one year to be siphoned away from local jurisdictions in the following year through a reduction in subsidy levels or manipulation of tax sharing rates. The result is a negative incentive for revenue collection, for local or shared sources. These are damaging incentives that can only be eliminated by a stable revenue assignment and the elimination of ad hoc subsidies in favor of a stable and objective transfer system.

Broader based revenue instruments should be made available to local jurisdictions. Adoption of a particular instrument and the selection of an approved rate structure should be at the discretion of the local government and the revenue generated should be available for general local expenditures. Without adequate revenue control, local autonomy is an empty vessel.

Intergovernmental Transfers.

A complementary set of intergovernmental transfers are also required to deal with issues of (i) horizontal balance, (ii) financing minimum service levels, and (iii) providing local incentives to produce appropriate levels of services for which benefits flow to populations outside their jurisdictional boundaries (or for which upper levels of government have an interest in supporting). The transfer system provides a foundation for conveying national priorities to the subnational level.

Existing transfer system should be restructured in a manner consistent with expenditure assignments and any desires to promote minimum service levels. Common components might include: (i) a formula based, unrestricted grant for equalizing the revenue available between local and regional governments for the delivery of services; (ii) specific lump sum grants to finance minimum levels of services in priority areas; (iii) incentive (matching) grants to facilitate efficient service levels; and (iv) capital project grants (see panel D2). The first two of these are a basic requirement of any system, the second two are desirable. To achieve the desired effects, any existing set of regional or local negotiated or ad hoc gap filling transfers must also be eliminated. For clarity and transparency purposes, each objective the intergovernmental system should ideally be pursued through separate mechanisms and the mechanisms established must be stable, objective and non-negotiated if the appropriate budgetary/fiscal incentives are to be achieved.
Panel D2: Components of a Restructured Intergovernmental Transfer System

(i) Formula Equalizing Grant. Horizontal balance is achieved through a specific set of transfers allocated (in aggregate) inversely to the capacity of a municipal formation to raise revenues from their own sources or from shared taxes.

(ii) Minimum Priority Service Level Grants. Some services, such as health, education and transportation are often of national or regional significance but best produced locally. For services such as these, it is useful to develop a set of specific ("categorical") lump-sum grants (transfers) to local governments for financing minimum service levels. The amount of the grant should be based on national determinations regarding the minimum level of services that should be made available across populations.

(iii) Incentive based Matching Grants. In addition to the minimum expenditure grant, a grant system might include a set of matching incentives (in the form of 'closed-ended matching grants') for expenditures above the minimum level in a sector up to a maximum (closed-ended) per capita local allocation. This matching incentive should provide a fixed additional per capita allocation per additional amount spent from local resources in approved areas within a sector. The matching rate applied could vary inversely with local revenue capacity and directly with tax effort, and should be fixed over time. Examples might include closed-ended matching grants for capital expenditures (see below), supplemental education, and supplemental health and hospitals.

(iv) Capital Project Grants. Financial assistance for the construction of capital projects by lower level units of government can be provided by as system of project (ad hoc) grants for capital construction purposes. These grants should be allocated in a systematic fashion through the establishment of specific, objective criteria for award and can include both lump-sum and matching instruments. Project grants might be available for highway and bridge construction, port facilities, airports, schools and hospitals.

Equalizing Transfers.

To provide budgetary stability and certainty, formula based transfers should be made to equalize the ability to provide basic services. Transfers to local jurisdiction can come from the national level directly and/or from the regional units. Direct national transfers aid in focusing attention on national equalizing objectives. The formula should include measures of both (i) revenue raising capacity (not actual collections), and (ii) basic expenditure need in its construction. This foundation formula should be used to allocate a predefined pool.
of revenues to regional and municipal formations in the form of per capita transfers in direct inverse proportion to the jurisdictions local revenue raising capacity and in direct proportion to its relative expenditure needs. Once established, this formula should be fixed and stable. These transfers will augment the resources available to the local jurisdictions through shared and local revenue systems and should be used for general local government expenditures.

**Minimum / Priority and efficiency Transfers.**

An additional set of grants is also required to finance services of national or regional priority which are appropriately administered at the local level. This includes both specific "categorical" lump-sum grants for services of primarily national/regional benefit or design/specification, and matching grants for services which produce inter-jurisdictional externalities and are susceptible to efficiency inducing price effects. While not their basic intention, these grants also contribute to both horizontal balance and basic capacity objectives.

An efficient grant structure would entail a separate "lump-sum" categorical grant mechanism for each service area for which the national (or regional) government wished to establish a minimum. Funds should be distributed between local units on the basis of a formula which equates revenues provided with the expenditures required to meet minimum service levels per service recipient. These service standards, and the financing of them, are intended to provide a floor below which resources allocated per recipient (and, presumably, service level) will not fall. These amounts should be set annually in order to adjust for price changes in the delivery of services, however, the substantive level of service provided should remain relatively constant from one year to the next.

In addition to fixed (lump-sum) minimum expenditure grants, efficiency enhancing "incentive" grants can also be used to encourage local expenditure on services for which benefits accrue to populations beyond the boundaries of the local jurisdiction or for those services simply felt desirable by the national or regional government. In many cases the priority of the service is not such that a lump-sum transfer (in the form of a minimum service level grant) is warranted. The central government can stimulate additional spending in such areas with minimal levels of outlays by providing service price reductions to local jurisdictions in the form of a matching grant and allowing them to select expenditures accordingly. Additionally, incentive grants can be used to stimulate local spending above the minimum defined by a lump-sum grant.

Transfer systems should avoid ad hoc distributions of resources to lower level governments. This notwithstanding, there are purposes for which a national or regional government would appropriately share the burden of financing capital projects with local jurisdictions. This can be done through a system of capital project grants. These grants would be allocated based on
applications made by local governments for assistance in areas defined by the granting jurisdiction. They may be lump-sum or matching in their funding characteristic. It is important, however, that the eligible projects for such a grant be well defined and that the criteria for allocation be objective (see panel D3).
Panel D3: Special Needs of Capital Projects Financing

In order to deal appropriately with the need for capital investment, eliminate the problematic nature of entry of local jurisdiction into domestic capital markets, and provide for efficient decision-making in capital project development, arrangements need to be made to provide for long-term financing of local capital projects. Capital financing costs should be funded through a mix of national, regional and local revenue sources and resources for repayment should be identified with reasonable certainty and committed prior to project approval. Local governments must be held fully responsible for such debts and the liability for repayment must assume a first position claim on local budgetary resources.

Capital Expenditure Responsibilities. The site of responsibility for capital expenditures for a service sector should be at the same level of government that has responsibility for operating expenditures. In cases of shared operating expenditures, capital expenditures should be shared in roughly the same proportion. Those capital expenditure areas which are of particular national or regional importance should be financed through appropriately structured transfers (lump-sum and matching grants) to local jurisdictions, with similar maintenance grants, or the function should be entirely assumed by the higher level jurisdiction government.

Infrastructure Replacement Revolving Fund. National and regional governments should dedicate annual resources equal to some fixed percent of the previous years revenues to maintain a public infrastructure replacement or expansion fund (IRF). Municipal governments should then be allowed to propose project for infrastructure rehabilitation to be financed through the resources of this fund.

Public Infrastructure Review Board. Public infrastructure review boards (composed of representatives of finance and planning ministries, appropriate sectoral ministries and regional and local governments) should be established to review project proposals from municipal formations for distributions from the IRF. This review should include close scrutiny of probability for repayment.

Local Accountability for Repayment. Subnational governments should be held fully accountable and liable for timely and scheduled repayment of disbursements from the fund.
As a final mechanism to solidify the restructured intergovernmental finance system (and the efficiency incentives it entails), all existing ad hoc or negotiated gap filling budget subsidies should be eliminated. Hard local budget constraints are essential to establishing appropriate fiscal incentives. Local and regional governments should be held accountable for executing their budget within the boundaries of the revenue available through the formalized sharing and intergovernmental grant systems, and revenues available from local sources.


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