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# Investing in Cities: Lessons from Decentralisation

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# Is Decentralization Good For Development?

*Perspectives from  
Academics & Policy Makers*

*edited by*  
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See also Faguet, J.P.  
(ed.). 2014.  
“Decentralization and  
Governance.” Special  
Issue of *World  
Development*, 53: 1-112.

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Is Decentralization Good For Development?

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- Field shows increasing technical rigor at expense of...
  - ➔ Narrowing on quantifiables
  - ➔ Ignoring larger, more nuanced, complex questions.
- We return attention to policymakers' primary concerns —> methodologically difficult.
- Marry insights & experience of senior policymakers with leading academics in economics, politics, & development studies.

# Questions

- Why do politicians decentralize?
- How can reform be made politically feasible?
- How can D improve development outcomes?
- Can municipal competition improve policy & services?
- Will D promote clientelism or broad-based development?
- Designing fiscal hierarchy (tax, expenditure, transfers) for:
  - ➔ Efficiency
  - ➔ Growth
  - ➔ Fiscal & Macroeconomic Stability

# How should expenditures and revenues be assigned across levels of government?

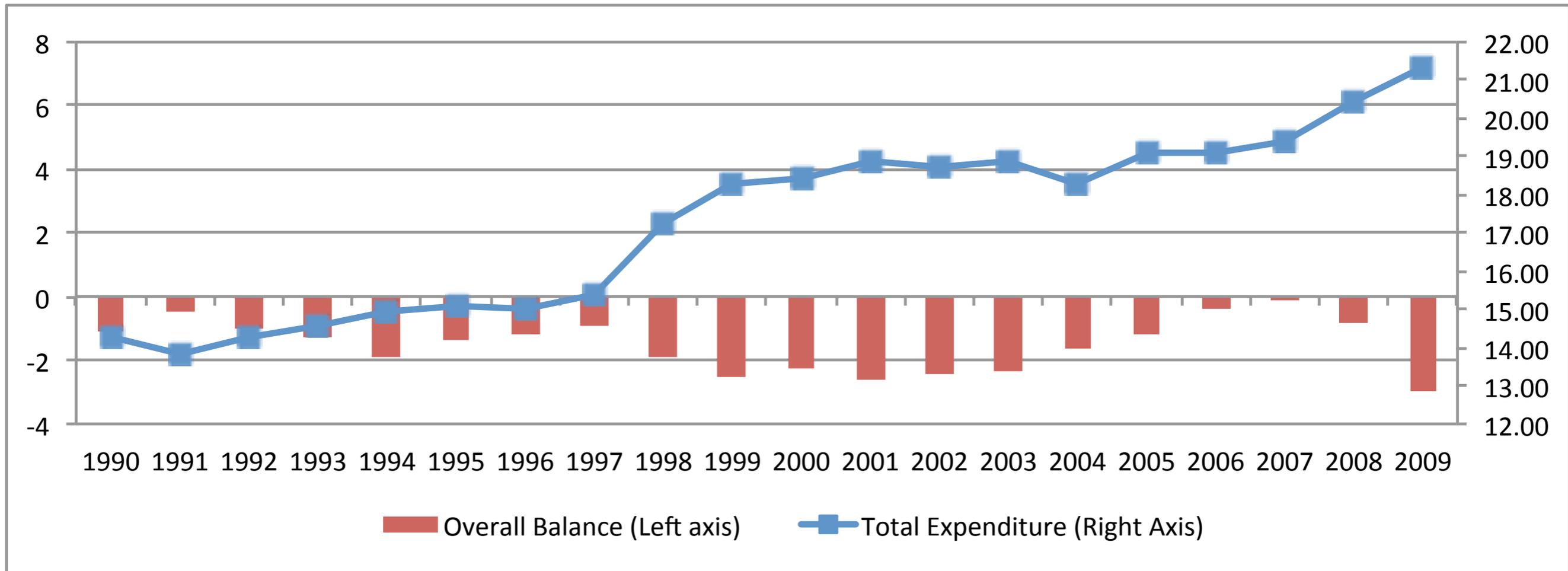
- **Fiscal federalism theory:** public services with locally specific benefits, heterogeneous demand, local info, & low scale economies should be devolved —> *Encompassing principle*
- LGs better at eliciting preference and time-and-place information
- But local taxes always constrained by neutrality, equity and mobility.
  - **Expenditure responsibility >> Local tax base**
- If benefits spill onto wider population, higher-level taxes should pay b/c CG internalizes externalities and levies broader-based taxes —>  
**Transfers**
- Intergovernmental transfers can correct vertical imbalances.
- IGTs large enough to sustain local services, but not so large LGs become “transfer dependent”.
- But this leaves much unanswered.

- **Pöschl and Weingast (Chp.7):** Distribution of tax powers, responsibilities, and resources shapes policy choices and economic performance.
- Transfer formulas can provide incentives to collect local taxes by tying central government transfers to tax effort.
- Tax motivation can incentivize growth-promoting policies and investments, greater sensitivity to residents' needs, and better fiscal discipline.
- By contrast, dependence on central transfers —> opposite outcomes on each count.

# Evidence

- **Grazzi and Jaramillo (Chp.5)**: D in Argentina & Brazil in 1990s expected to improve public efficiency. Instead, explosion of D'd expenditure and fiscal deficits.
- Lack of clarity in division of responsibilities between CG & LGs and periodic bailouts created “tragedy of the commons” problems and moral hazards —> fiscal debts and severe macroeconomic problems.
- Since then, D programs adjusted.
  - ➔ Fiscal responsibility laws in Argentina & Brazil set limits on subnational spending and borrowing.
  - ➔ Stringent accounting rules increased transparency and control of accounts.
  - ➔ More autonomy to raise local revenues —> more fiscally responsible behavior.

# Public sector total expenditure and overall balance in Latin America, 1990–2009, % GDP



Source: Grazi and Jaramillo (Chp.5)

# There is no optimal design

- No consensus about ideal intergovernmental distributions of power and competencies, and enormous empirical variation across countries in these arrangements.
- This is as it should be. There should be no common model.
- Fiscal arrangements should be tailored to a country's fiscal, political & economic characteristics, and should be expected to differ as much as the countries do themselves.
- Research can lay out trade-offs clearly, and analyze the consequences of different choices in real episodes of reform.

Thank You

# 1. Introduction

- Decentralization at the center of policy reform agenda everywhere.
- Mexico, Egypt, Ghana and India have active D programs in place.
- EU, UK and US —> subsidiarity, devolution and federalism.
- World Bank (2000) estimated 80-100% of world's countries experimenting with D. Since then, new or deepening reforms announced in Japan, Cambodia, France, Turkey, and Kenya, amongst many others.

- Huge literature: 100s of published papers, 1000s of studies over 40 years.
- Older studies now criticized for lack of rigor: too much case study, “anecdote”.
- Past 20 years: more quantitative and formal (e.g. Besley & Coate 2003; Faguet & Sánchez 2009; Galiani, Gertler & Schargrodsky 2008)
- But technical rigor comes at expense of narrowing on quantifiables, ignoring larger, more nuanced, complex questions. Much beyond practitioners’ grasp.
- We seek to return attention to questions that are policymakers’ first concerns, but methodologically difficult.
- We marry insights & experience of senior policymakers with leading academics in economics, politics, & development studies.

# Definition

*Decentralization* is the devolution by central government of specific functions, with all of the administrative, political, and economic attributes that these entail, to regional and local governments independent of the center within given geographic and functional domains. (Faguet 2012; Manor 1999)

## 2. Why do governments decentralize?

- Urge to decentralize is irrational in those who must do it.
  - Normative arguments about state effectiveness?
  - Politically convenient?
  - Can politicians be altruistic?
- Important b/c point to common incentives leaders face. Such incentives shape sincere Ds, and distinguish them from Ds that fail, or are never implemented.

# D in Pakistan

- **Cheema, Khan and Myerson (Chp.3)**: D is a tool of military regimes to legitimize themselves and strengthen control.
- Since independence, military regimes tried 3x to build own political support by creating locally elected political offices.
- Established parties excluded from local elections.
- Rules selectively applied against regime opponents.
- Non-partisan local governments tarnished for voters and political parties as military instrument for creating a class of collaborators who displace parties locally.

# D in Bolivia

- **Sánchez de Lozada & Faguet (Chp.2)**: Government faced two problems:
  - Ineffective state —> poor Ed & He services.
  - Militant regional interests that extracted resources from the center by threatening to break the country apart.
- Latter were hangovers from dictatorships: Self-appointed regional bodies representing strongest local interests in the name of the entire region.
- The solution: Undermine them and cleave off supporters by going directly to the grass roots and creating local governments.

# Results

- **Bolivia:** D as a democratizing riposte to the agitation and demands of authoritarian regional movements that threatened national breakup.
- **Pakistan:** D as an authoritarian strategy to undermine established political parties and legitimize military rule.
- Not surprising that Bolivia's political parties took to local politics eagerly, organizing territorially nationwide.
- Pakistan's parties treated D like a pox, closing down local governments on return to power.
- Different imperatives —> Different designs —> Different fates
- Bolivia: strengthening & deepening of D || Pakistan: abolition.

# Other Motivations

- Canada and Spain: D helped appease fractious groups and hold nation together.
- Afghanistan and Iraq: D as power-sharing instrument to prevent conflict amongst warring factions.
- Ethiopia: D used to knit together federal ruling party and army based on 1-party regions. None dominant after overthrow of *Dergue*, so D was the only solution.

# 3. Political obstacles to reform and partial decentralizations

- Authoritarian regimes may only require agreement of a few leaders to D'ize.
- How do democratic leaders build coalitions to give power and resources away? How are bureaucracies convinced to do likewise?
- D obliges those who must carry it out to diminish themselves professionally. Self-interested political agents do not act in this way, nor do real bureaucrats.

- **Bolivia:** MNR was most extensively organized party in the country —> would capture the larger share of local governments and resources.
  - MNR: Historic opportunity to reverse LT electoral decline by striking a new alliance with rural voters.
  - Other parties experienced regional demands as internal conflict.
  - Business leaders feared populist parties from peri-urban slums, liked a reform that shifted power to countryside.
- ==> Broad base of support for D. Reform sustained.

# Insincere reform

- Many governments are not sincere.
- Common failure: D does not really happen.
- Reform undermined by CG that won't hand power & resources to independent subnational governments.
- Powers often D'd half-heartedly, and resulting structures diverge widely from any theoretical ideal.
- Political motives hijack incentives that reformed fiscal systems aim to create.
- Intergovernmental power relations & political motives thus merit close attention.

# India

- **Aiyar (Chp.4)**: D in India incomplete because CG won't give up power to rural villages. Bureaucracy captured decision-making. This implies:
  - Duplication of efforts.
  - Village communities not allowed to identify own specific needs.
  - Overlapping services in some areas, and none in others as CG coordination fails.
  - Local knowledge about local needs unexploited.

# Decision Space

- **Bossert (Chp.12):** *Decision Space* = Local discretion over functions and sub-functions about financing, service delivery, human resources and governance.
- Empirical measures allow us to explore whether local authorities have policy discretion, or CG imposes rules and incentives to promote central objectives.
- Approach stresses D as multidimensional and complex. Not binary.
- Questions involve a range of discretion over different functions and types of decisions.

- Evidence from Africa, Asia & Latin America.
- Even in “D’ed countries”, many functions remained highly centralized. Considerable variation in decision space among countries. Within countries decision space varies among different functions.
- Strong positive correlations amongst different “dimensions of decentralization”: local decision space, capacities, and accountability in specific services and sectors.
- High decision space in a function —> high capacities and accountability for that function.
- Capacities —> accountability amongst the three dimensions in Pakistan, India and Vietnam.

# 5. D & governance

## Have government processes changed to improve information, participation and accountability?

- **Bossert:** Evidence from Guatemala and Ghana suggests inventory control & logistics information systems should be centralized, while planning & budgeting should be decentralized.
- Not so much *whether* policy makers choose to design and implement decentralization, but *how* they do so that matters.
- Where decision space effectively decentralized, local capacity & accountability higher, and health system performance superior than more centralized cases.
- **Bardhan et al.:** Neither landless nor low-caste households participate less. Main determinants of participation are education, immigrant status and gender.

## Are government outputs or outcomes more efficient or better matched to local needs?

- **Bossert:** strong evidence that D  $\rightarrow$  higher equity of allocations.
- Gaps between the wealthiest and poorest municipalities in Chile & Colombia fell significantly. Both transfers & local revenues.
- Pre-D Colombia: Wealthiest 20% of municipalities received 6x more per capita *in transfers* vs avg.
- Post-D: Almost equal CG allocations.
- Gap in rich v. poor *own-revenues* also declined, from 42x higher per capita to only 12x higher in richest.
- D encourages poorer localities to increase health expenditures, and wealthier localities don't keep pace.
- Stronger institutional capacities & decision space associated with improvements in health coverage and better health administration.

- Likewise for targeting, **Bardhan et al.** find no evidence that LGs discriminate on caste, education, political partisanship, or wealth in allocating benefits *within* villages.
- *Across* villages, however, a different story. Villages with many landless households received fewer benefits from higher-level governments.
- Their results suggest greater accountability in LGs vs. higher-level (block or district) governments. Village meetings form a channel of LG accountability to poor and low-caste groups.

# Competition amongst municipalities

- **Capuno et al. (Chp.10), ‘yardstick competition’:** LG’s service provision is positively influenced by expenditures on the same services in neighboring municipalities. But only when mayor is not term-limited.
- Electoral pressures make officials responsive to local needs.
- Publishing comparable information on LG performance could influence voter assessments via comparisons with neighbors.
- Even members of powerful political clans respond to yardstick competition —> political dynasties persist in LDCs because they substitute for missing strong parties.

- **Li and Zhang (Chp.11), area-based competitions:**  
ABCs common in China, EU, UK, etc.
- Local governments compete for CG prizes. Single policy goal, e.g. GDP growth or educational targets, or complex menu of goals & targets across sectors.
- Potential to align interests of CG, LG, and users. Turn users into principals who actively monitor performance and work with providers to achieve shared goals.
- Li and Zhang examine Hygienic City program, a multidimensional competition to improve the environment, service sector hygiene, and pest control.

- Striking increase in number of volunteers. Transformed relationship between citizens and government.
- Public began to see themselves and LG as members of same team; dedicated time and energy to campaign.
- User voice & participation can be margin between winning and losing —> local authorities more open to suggestions and innovative ideas from below.
- But not all rosy. Much expensive housing demolition in the name of “city beautification”, murkily defined.
- Massive increase in competitions across China —> exhausting burdens on LGs & citizens.
- Chinese gov’t cancelled hundreds of competitions in 1996, 2006 and 2007.

# 6. Clientelism vs. development

- **Clientelism:** Exchange of targeted benefits for political support.
- **Bardhan et al.:** Left Front domination of local governments in West Bengal over 5 electoral cycles partly due to recurring short-term benefits (e.g. subsidized credit, employment & relief programs) to poorer voters.
- Stronger effect on voter support than infrastructure improvements or big one-time benefits (e.g. registering a tenancy contract, receiving a land title).
- But rising urbanization and HK (Ed & He) undermine clientelistic party's support in long run.

# Cynical decentralization?

- Some Ds appear designed to facilitate political capture – by central authorities. **Khemani (Chp.9)** offers a theoretical model plus empirical examples.
- Small LGs dependent on CG grants —> CG directs expenditure & keeps itself in power, at expense of broader public goods.
- Local elite capture dominates literature, and is a threat.
- But *national* elite capture far more dangerous, because stakes are far far higher. Who will counteract? Witness US “democracy”: Hacker & Pierson (2011), Hall (2015), Johnson (2009).

- Little systematic evidence. Answers vary according to countries' history, demography, etc.
- Reformers must take careful account of these factors. By definition, D shocks power balance between interstate actors & institutions.
- May disrupt political settlements between elites. May decide the demise or survival of political parties, or alter the power of separatist groups.
- Inevitably creates winners & losers. Anticipate losers' reactions!

# 7. Strengthening the state

## **Will D weaken the state, promote separatism, and undermine national identity?**

- Q.1: Will D stoke *centripetal* or *centrifugal* forces?
- Key factor is regional specificity of elite interests. If coherent regional elites gain more from secession than integration, then national disintegration likely.
- When will regional elites have incentives to invest in candidates, parties, infrastructure, & programs that promote national breakup or national unity?
- E.g. campaigning on regionalist pride and secession; language and culture exclusivity **vs.** improving transport and communication links outwards, and educational & cultural programs built on shared history & identity.

## Design for unity

- Centrifugal reforms limited to spatial confines of major tensions.
- Reforms that underpin unity transcend these boundaries and ways of thinking.
  - ➔ D'ize 1 level beneath a country's major cleavage – e.g. municipalities, not provinces.
- Muns. not identified with group identity or privilege. LGs instead identified with issues of efficiency and service provision. Complementary reforms can promote single market for goods and services —> prevent development of elites with regionally-specific interests.
- Binding a country together 'from the bottom up' via infrastructure and transport —> economic growth. **Faguet, Fox and Pöschl** e.g. Ethiopia, Canada, Spain, Bolivia, Afghanistan? Iraq?

# Strong C'd vs. Weak D'd government?

- Strength of purpose & reach of C'd state vs. More sensitive & responsive D'd state. Stagnant debate.
- **Faguet et al.** cut through impasse: Strong, insensitive vs. weak, sensitive is false.
- Correct dichotomy: (a) Simpler, cleaner, but more brittle C'd command structure —> susceptible to failure in any of its parts **vs.** (b) More complex system: overlapping actors with independent authority.
- Coordination & cooperation vs. Command and control.
- **OR** Trade-off between Strength of national leader vs. Institutional strength of state. C'd leader is strong at expense of the state. D encases her discretion in rules, procedure, and the need to agree decisions with subnational actors —> state is stronger & more stable at the expense of the leader.
- D sacrifices CG leader's authority in favor of institutional strength of state.

# 8. Social learning

- Collective acquisition of knowledge, norms & practices, and trust by groups of voters. Social b/c necessarily concerns shared values, beliefs and behaviors. Knowledge concerns cooperation and group-wise maximization, not individual maximization.
- Intrinsically learning-by-doing phenomenon —> relies on direct interactions amongst citizens. LG gives citizens real access to repeated interactions re: public policy & resources, directly and indirectly via CSOs. Small scale makes citizens political actors. LGs accelerate social learning in a way CG cannot.
- Why? **Scale** is determinant and its effects non-linear. CG demands big resources & organizations for effective engagement.
- Participation & engagement abounds in LGs, not CG.

- Social learning —> Legitimacy. Why? State more 'democratically supple' as number of intermediating organizations and density of their social interactions increase. Greater responsiveness to society's needs —> Greater legitimacy.
- Social learning also abets deeper transformation of clientelistic politics into broad pro-development politics. Clientelism = divide & conquer strategy by parties against voters' collective interests.
- By making citizens see common interests from grass-roots upwards, and teaching them to organize and cooperate, social learning helps transform clientelistic politics into policies and actions that drive development forward.

# Conclusion

- Benefits of D are achievable but never guaranteed.
- To succeed D must be implemented sincerely, and subsequently recalibrated once new incentives created by changes in rules and structures have settled in.
- Ultimate effects of any multidimensional, complex reform are impossible to predict.
- D is not a panacea. It's a process — usually a long and detailed one — that requires sustained attention to get right.