Does decentralization lead to effective service delivery and poverty reduction?

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Antecedents

- Handbook of Fiscal Federalism (2006) surveyed the developments in the literature
  - Focus on positive approaches—going back in some sense to de Tocqueville and J.S. Mills and early political economy
  - Provides a basis for thinking about policy, without details or empirical assessments.

- Current volume looks at what works and what does not
  - Impetus from bilateral agencies: GTZ, Treasury, and multilateral donors: UNDP, World Bank, IFPRI, IMF

- Includes detailed assessments of practice and how to approach policy—
  - Focus on effective service delivery and poverty reduction
  - What are the preconditions?

- Agenda for further work
Follow-up to Handbook of Fiscal Federalism

- Joint work by FAD-UNDP (focus on Eastern Europe)...leading to Poland study.
- In house (IMF) assessments (African context, Uganda, Bolivia—author now in IADB)
  - Own work from China—engagement with the fiscal reforms in the 1990s and 2000s; following on from academic contacts between LSE and China in 1988.
- World Bank work: partial decentralization; subnational debt
- IFPRI: poverty reduction/ and joint IFPRI-FAD on special purpose transfers
- Participation by GTZ, USAID and bilaterals in the planning stage
Interests of the international agencies

- **Bank:** Correctly the focus of WDRs—including those on service delivery, and earlier ones on poverty
- **Development Banks, UNDP and IFPRI:** core functions
  - Service delivery, poverty reduction
  - Political economy: what works and what does not?
- **IMF:** quality of public spending, effectiveness of poverty reduction;
  - Macro-interactions
  - Incentives and effectiveness of provision
  - Issues of design and financing. Taxation and sub-national borrowing
How does the volume contribute to the literature?

Addresses two main streams of literature:

- second-generation fiscal federalism theory:
  - incentive-driven officials; politicians...
  - questions main assumptions underlying the normative or first generation approaches

- empirical studies evaluating the effective outcomes of decentralization.
Theoretical contributions

- Focus by Platteau:
  - community level considerations;
  - plus distortions of incentives created by donors
- Bardhan: reiteration of possible capture
- Lockwood on political economy approaches
- Devarajan, Khemani, and Shah: partial decentralization
Platteau, *Decentralization and participatory development*

- Advantages of participatory approaches not as clear as may be assumed
- Depends on
  - social stratification of communities and the consequent distribution of powers
  - information flows between
    - donors and sponsors
    - beneficiary communities and formal levels of government
- Adaptation by elites to garner and ‘capture’ donor resources
Bardhan: Accountability and local capture

Dilemma facing decentralized provision of public services at the local level:

- Autonomy versus accountability of decision-makers.
- Possibility of “capture” in stratified societies
- Need for:
  - a competitive political process,
  - free flow of information,
  - reduction of inequality,
  - consistent decentralization strategy.
Lockwood *Political economy of decentralization*

- Summary of new literature relies on specific but more realistic hypotheses,
- More useful in terms of guidance to policy-making.
- Focuses on strategic role of information
Devarajan, Khemani, and Shah: *Partial decentralization*

- False starts and structural failures compromise merits of decentralization processes.
- Lack of accountability of local elected politicians and officials.
  - e.g., in education, little influence over allocation of resources
  - No local control over tax instruments
  - Reliance on earmarked grants
  - Weak constraints on borrowing, increasing chances of bailing out by the central government
- Could exacerbate “capture”.

Central government could design decentralization to weaken local governments (Pakistan)

Donor-interventions could ironically lead to partial decentralization

- Overriding local preferences
- Example: public works providing immediate benefits in terms of higher wage payments
- Diverting from social and personal benefits in education.
Empirical assessments
What is expected from decentralization?

i) production efficiency;
ii) preference matching;
iii) improvements in service delivery;
iv) higher growth.

Problems with empirical analysis

- lack of reliable information
- need for observing real decentralization
- concurrent reform: is it decentralization or growth in general that generates prosperity and improvements in living standards? Causality is hard to establish.
Bolivia (Inchauste)

- Most interesting “laboratory” case study
- Since the early 1990’s decentralization used to provide additional resources for the poorer and less developed regions
- Spawned a major strand in the literature extolling the virtues of decentralization.
- HIPC funds transferred directly to local governments.
Bolivia

- Poorer municipalities had difficulties in using resources for effective spending.
- Increases in education transfers do not significantly affect the share of children not attending school.
- Spending on infrastructure does not translate to increased access to water and electricity.
Bolivia

- Careful empirical analysis
- No evidence of a clear improvement in the poorest municipalities, or for the poorest people
- Findings did not *per se* speak against decentralization, or provide arguments in favor of centralization.
- May be due to
  - inadequate targeting of HIPC resources
  - excessive earmarking;
  - lack of clarity in spending responsibilities
  - Lack of accountability, absence of own-source revenues
- Poor incentives, example of incomplete decentralization?
Uganda (Ahmad, Brosio, Gonzalez)

- Great deal of work, mainly improving the effectiveness of conditional transfers
- Sub-national sources of revenue removed
- Education:
  - Center: no control over numbers or quality of teachers, but finances spending; and sets policy
  - Local governments (municipalities and districts): do not face financial consequences of their choices
- Similar story on health care: little local responsibility
Uganda

- **Water:**
  - spending modest, but
  - the share of expenditure directly executed by the LGs is large
  - Conditional financing, largely non-wage related; hence more flexibility to local preferences
  - In all regions, accessibility to safe water has increased for the lowest quintile of the population

- **Central funding and policy, as well as the recentralization tendencies**
  - likely reduced local accountability in education and health
Spain (Solé-Ollé)

- Transformation of a unitary state to quasi-federal status,
- Asymmetric decentralization facilitates evaluation of different degrees of decentralization
- Autonomous Communities- characterized by higher degrees of fiscal and regulatory decentralization.
Spain

Two topics

- Education: assessment of the impact of decentralization on the *Survival rate* at the age of 16 (i.e., the proportion who gain access to non-compulsory post secondary education).
  - Improvement in results with decentralization.
  - But improvements are more significant in richer and well financially managed regions.
Spain

- Second topic: investment in roads and schools.
- Results corroborate theory:
  - more road construction in congested areas and
  - more school construction in areas with higher student population growth.
Poland (Jakubowski and Topińska)

- Largely methodological—
  - using time series of cross-section household surveys,
  - spliced administrative and fiscal data
- Deconcentrated story remains, earmarked central transfers for primary education
- Outcomes remain complex
  - Local autonomy led to a negative effect on access, especially for the poor, to pre-school and secondary education
- Evidence of partial decentralization
Selected policy issues
Birner and Von Braun.  
*Links with poverty reduction*

- How to make service provision an effective tool in combating poverty?
  - Minimization of the sum of production costs plus transaction costs,
  - with a view to political costs, and
  - heterogeneity of preferences.
Ahmad: Conditional cash transfers: fads and realities—Mexico and China

- Typical dilemma: absence of accurate information
  - reaching poorest people without family support
  - requires local information for effective identification and targeting (China)
  - But very few incentives to disclose information to higher funding bodies or senior levels of government

- Make transfers conditional on policy reforms, or past performance

- Multi-year budget framework, with simple outcome indicators
Conditional cash transfers

- Oportunidades, a central program, has been hard to replicate
  - Distortions in financing
  - Local governments face overlapping responsibilities
- Local governments without own-source revenues, incentives to divert resources?
- Pakistan: political economy of Benazir Income Support Scheme?
Incentives for effective decentralization affected by access to credit

Inadequate structures negate hard budget constraints

Ex-ante limits and rules need to be supplemented by ex-post insolvency mechanisms

2008 crisis in the US brings sustainability of effective service delivery focus,
  
- with lower sub-national revenues as well as more stringent borrowing constraints (deteriorating credit ratings)—lagged effects becoming more evident
  
- Can continued public services be assured?
What next? Priorities for further work
Effective taxes, accountability and incentives

- What policies are needed to hold sub-national governments responsible?
  - Clarity in “functional” responsibilities (lot of work in Latin America and China)
  - Flexibility of own-source revenues at margin
  - Joint determination of taxes and spending policy—extension of “Tax-Benefit models?”

- Importance of institutions, for taxes and spending
  - Role of vested political interests
  - Bureaucratic “capture”
  - Implications for technical assistance
Governance and Institutions

- Mechanics of transparency known, but how to get them to work?
  - Incentives and sanctions
  - Information flows
  - Coordination and cooperation
- Political economy of institutional change is particularly important
- Design of transfer systems and access to credit—for hard budget constraints
Household security

- Both economic, social and physical
- How to ensure access to minimum basket of goods and services
- Who provides what? And how?
- Fragile states and insecurity
  - Pakistan and Afghanistan;
  - Andean States;
  - SSA
Additional research projects underway

- LSE-Bonn-Turin core
- Together with collaboration involving
  - Inter-American Development Bank
  - World Bank
  - Research institutions in concerned countries; Mexico, Colombia, Korea, China, Pakistan, India