

Does decentralization lead to effective service delivery and poverty reduction?

Ehtisham Ahmad and Giorgio Brosio (editors)
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Edited by **Ehtisham Ahmad** and **Giorgio Brosio**



Contents & Contributors

Preface

1. Does Decentralization Enhance Service Delivery and Poverty Reduction?
Ehtisham Ahmad and **Giorgio Brosio**

PART I: POSITIVE APPROACHES

2. Information Distortion, Elite Capture and Task Complexity in Decentralized Development
Jean-Philippe Platteau
3. Governance Dilemmas in Service Delivery
Pranab Bardhan
4. Political Economy Approaches to Fiscal Decentralization
Ben Lockwood
5. The Politics of Partial Decentralization
Shantayanan Devarajan, Stuti Khemani and **Shekhar Shah**

PART II: WHAT DO WE KNOW?

6. What Do We Know? Evidence on Decentralization and Local Service Provision
Ehtisham Ahmad and **Giorgio Brosio**
7. Decentralization in Bolivia: Has it Made a Difference?
Gabriela Inchauste

8. Uganda: Managing More Effective Decentralization
Ehtisham Ahmad, Giorgio Brosio and **Maria Gonzalez**
9. The Impact of Decentralization on Education in Poland
Maciej Jakubowski and **Irena Topińska**
10. Evaluating the Effects of Decentralization on Public Service Delivery: The Spanish Experience
Albert Solé-Ollé

PART III: SELECTED NORMATIVE AND POLICY ISSUES

11. Decentralization and Public Service Provision – A Framework for Pro-poor Institutional Design
Regina Birner and **Joachim von Braun**
12. Fiscal Policy Instruments and the Political Economy of Designing Programs to Reach the Poorest
Ehtisham Ahmad
13. Subnational Insolvency and Governance: Cross-country Experiences and Lessons
Lili Liu and **Michael Waibel**

Index

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”.

Devarajan, Khemani, and Shah: *Partial decentralization*

- 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?

Liu and Waibel: *Subnational insolvency and governance*

- 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