

# **The global trend towards devolution and its implications**

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## Abstract

*Globalisation has been accompanied by an equally global tendency towards devolution of authority and resources from nation-states to regions and localities that takes on various forms, depending upon which actors are driving decentralisation efforts. The existence of a general trend towards devolution also has significant implications for efficiency, equity, and administration. This paper outlines first the general drive towards devolution and proceeds to examine which countries are experiencing which forms of decentralisation. A theoretical argument emphasising the role of governmental legitimacy across various tiers of government is used to explain the diversity of devolution initiatives, drawing on examples, which include Brazil and Mexico, India and China, America and some European countries. Having supported our model of decentralisation, the paper then examines the implications of the widespread downward transfer of powers towards regions. Some of the less widely discussed pitfalls of decentralisation are presented and caution in promoting devolutionary efforts is the prescription of this paper.*

Keywords: devolution, decentralisation, globalisation, America, Brazil, China, Europe, India, Mexico.

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## **Introduction**

Research on globalisation has tended to stress the role global processes are playing in undermining the importance of nationally based policy-making, politics, culture, and society. Such trends are underpinned by the proliferation of communication and transportation media, the emergence of dominant forms of international, brand-based capitalism, and the standardisation of various modes of interaction, from the convergence of languages to digitisation (Dicken, 1998). Accordingly, globalisation tends to promote what Agnew (2000, p 101) has called a new international homogeneity across the global order. Such homogeneity implies a certain erosion of the importance of spatiality at the national, and by extension the regional, levels as global processes succeed in diluting and internationalising the traditional 'nexus of interactions' associated with local and regional spaces (Gray, 1998; see also Castells, 1996; Massey, 1999; Storper, 1997).

Yet, in spite of this, globalisation is failing to obliterate the importance of the local dimension across the world. In many ways, recent developments point in an opposite direction: towards a greater relevance of place, space, and regions. The growing visibility of the local and regional dimension has many manifestations. While some argue that the demise of the nation-state is continuing, the rise in regional political activism, the increasing importance of regionalism in government (Keating, 1998) and the regionally-based territorial competition that new forms of mobile capitalism are inducing (Cheshire and Gordon, 1998) have given rise to a renewed interest in the role and prominence of spatiality in general and regions in particular. In this paper we will concentrate on one of the most significant recent developments at the global

level: the widespread transfer of powers downwards towards regions. This process, which in some cases involves the creation of new political entities and bodies at a subnational level and in others an increase in their content and powers, is known, depending on different national contexts, as regionalisation, devolution, or decentralization<sup>1</sup>.

There is now enough evidence to claim that since the outbreak of the process of globalisation – and perhaps as a result of it – subnational units have increased their demands for power, leading to a flourishing of regionalisation across the globe. This process has numerous positive aspects, but it also raises important issues regarding national equity and welfare, public finance, and territorial competition.

The focus of this paper is therefore four-fold. First, in response to the often simplistic conceptions of devolution, a theoretical model based upon Donahue's (1997, pp 7-15) three-fold classification of the mechanisms of devolution – legitimacy and the decentralisation of authority and of resources – is introduced. Subsequently, the second section exposes the devolutionary process in a selection of countries including Brazil, China, India, Mexico, the US, and countries of the European Union. These represent a cross-section of some of the largest areas of the globe and cover both the developed and developing worlds. In the third section, drawing upon the preceding theoretical discussion and given the existence of a universal trend towards decentralisation, different forms of devolution in the selected countries are compared

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<sup>1</sup> Although the words regionalisation, devolution, and decentralization may refer to different things in different geographical contexts, they all imply a transfer of authority, responsibility, and resources from the national government to lower governmental tiers. In this paper, this broad definition of these three words is adopted and, as a consequence, they are used indistinctively throughout.

and examined. The fourth section then critically assesses the global implications of the devolutionary trend in the light of its evident diversity. The final section concludes.

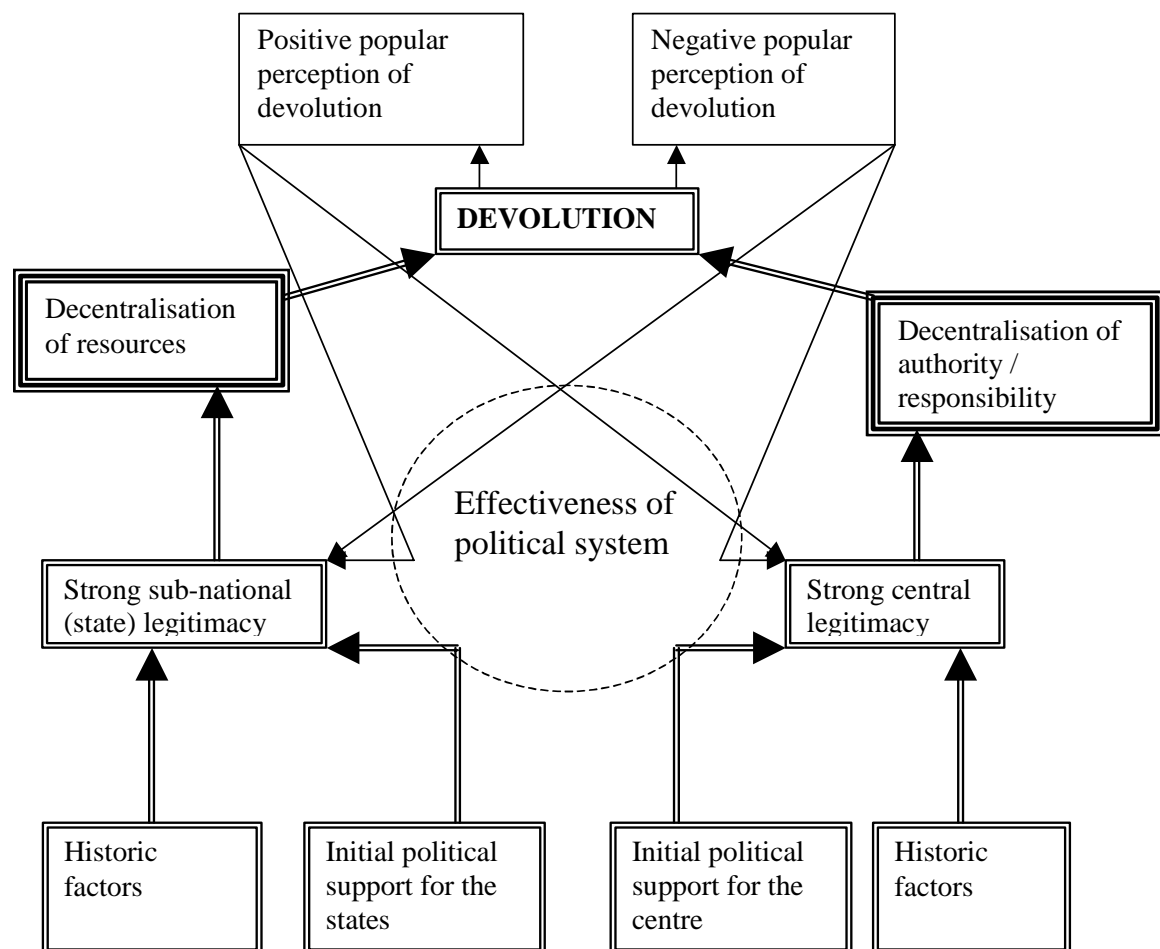
## **1. The Theoretical Framework**

Regional devolution is a complex and heterogeneous process. From the high level of decentralization of certain federal states, such as Germany, and of some Spanish regions, to the more limited influence of regions in France, for example or, until recently, Mexico, decentralization processes across the world have adopted a wide variety of forms. Consequently, conceptualising devolution is far from simple. Looking for a minimum common denominator, Donahue (1997, p 7-15) characterizes the process as being made up of three separate factors: legitimacy, the decentralisation of resources and the decentralisation of authority. Any form of devolution implies some degree of subnational legitimacy and some form of decentralization of authority and resources; consequently, any analysis of devolution should take these three factors into consideration.

There is, however, a need for caution in examining evidence, because a simple list-based approach may overlook the interaction between the elements. The complexity of the devolution process derives from the interest-conflicts of the various actors involved, and the differences in legitimacy that they share. Most importantly, the interests of subnational and national governments tend to be at odds across the component factors of devolution. While national governments would, *ceteris paribus*, devolve responsibilities (authority) to their regional or state governments, with as few

accompanying resources as possible, the subnational governments would prefer the opposite case. The balance between these two extremes will depend upon the relative strength, or, in political terms, legitimacy, of the two tiers of government<sup>2</sup>. Figure 1 depicts this approach.

Figure 1: The Complexity of Devolution



Beginning at the bottom of the diagram, the legitimacy of subnational and national governments is determined for the most part by processes of history and respective political support. Of the former, culture, language, and religion have traditionally

<sup>2</sup> Donahue (1997, p 12) conceptualises legitimacy as incorporating ‘popular support’ and ‘citizen’s co-operation’. He states that, ‘Ultimately the most important asset that government can command ... is not legal authority, or fiscal resources, or even talented personnel, but *legitimacy*’ (Donahue, 1997, p 12).

been the factors behind a strong regional identity and determine the legitimacy of subnational claims. Economic development has also recently been added to the list (Keating, 1998; Allmendinger and Tewdwr-Jones, 2000). Of the latter, the inclusion of legitimacy into the analysis brings into play a wealth of political factors that shape the power and margin of manoeuvre of governmental tiers. An important caveat here, however, is that a reasonably effective political and democratic system is in place to facilitate the influence of the electorate. This being the case, and all other things equal, poor political support for the regional cause would translate into a relatively weak regional legitimacy and therefore tend to promote a devolutionary process in which the central government holds the upper hand, favouring progressive decentralisation of responsibilities and often forcing regional and local governments 'to undertake increasing expenditure responsibilities on a static, and often narrowing, financial base' (Bennett, 1997, p 330). In contrast, a strong regional legitimacy, underpinned by high political support for the regional lobby, would favour a more rapid decentralisation of resources from the centre, since there would be strong demand for transfers to subnational tiers of government. In general, the combination of historical and political factors in democratic countries shapes the legitimacy of governmental tiers, the relative strength of their respective lobbies, and hence the forms which devolution initiatives are likely to assume. In non-democratic systems, however, the influence of the electorate is compromised, and other factors, which are less transparent, take on more importance in the determination of the legitimacy of government tiers.

As depicted in Figure 1 by the single-line boxes and flows, the importance of legitimacy and popular support does not end at the initial stage. There is also an

endogenous role (assuming again an operative political and democratic system). Following initial moves towards devolution, in terms of either resource or authority decentralisation, the popular perception of devolution will subsequently impact upon the legitimacy of the two government tiers. It is difficult to predict what direction this impact will assume – it is just as feasible to envisage a popular approval or disapproval of decentralization originating from the centre, for example. Approval would mean a strengthening of central legitimacy and disapproval a relative reduction, which, in turn, may be translated into greater or lower transfers of authority and/or resources from the centre to the regions. Although the political reaction to devolution is case-specific, therefore, it nevertheless remains an important driver in the evolution of legitimacy between the two tiers, wherever a reasonable democracy has taken root.

In general, an understanding of the interaction between legitimacy and the transfer of resources and authority is imperative to the examination of devolutionary trends (Donahue, 1997). A case that depicts strong decentralisation of resources displays no more evidence for devolution than one showing strong decentralisation of responsibilities. It merely indicates a different type of devolution, driven by different levels of government and deriving, ultimately, from a different allocation of legitimacy across governmental tiers. Moreover, following from this, we should not necessarily expect cases to depict high levels of both resource and responsibility devolution, since forces are often operative to promote their mutual exclusivity. It is with this conceptualisation in mind that we approach recent devolutionary efforts.



## **2. The Global Trend Towards Devolution**

Before the onset of globalisation, the world was dominated by strong national governments, and regional governments tended to be either weak or non-existent. Hence in Europe, with the exceptions of Austria, Germany, Switzerland, and Yugoslavia, as well as in Africa and Asia, central governments dominated throughout the post-war era. Latin American countries also had centralized states. Although some officially maintained federalist or regionalist constitutions, such as Brazil, Mexico, or Venezuela, among others, they tended in reality to be just federalist on paper, with regions and states representing little more than administrative units<sup>3</sup>. In the former Soviet Union the situation was similar to that of the Latin American countries. The USSR was comprised of a union of sovereign states on paper, but, in reality, was heavily centralized and controlled by the Communist Party from Moscow. Outside this framework, only the above-mentioned European countries, Australia, Canada, India, and the US had systems in which the regional tier of government played any significant role. And even in some of these cases the role of regional governments had been waning. This was, for example, the case of the US, where the power and functions of the states had been declining with respect to those of the federal government since at least the reforms introduced by Franklin Roosevelt during the Great Depression (Donahue, 1997), or of India, where the centrally based mechanism of planned economic development over five year periods, put in place immediately after independence, undermined the power of the regions, since the central government dictated financial and economic goals to the states (Sury, 1998).

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<sup>3</sup> In Mexico and Venezuela, for example, regional governors were until recently directly appointed by the government, rather than elected.

At the beginning of the 21<sup>st</sup> century this panorama has radically changed. A devolutionary trend has swept the world. In some cases, subnational turbulence has led to the complete demise of former countries and to the emergence of new states, whose dimension is often no larger than that of most regions. The fifteen constituent republics of the former Soviet Union have become independent states; Czechoslovakia peacefully split into the Czech Republic and Slovakia; four new states have emerged of war-torn Yugoslavia, and Kosovo and Montenegro may follow suit. This phenomenon is, however, not exclusive to former eastern European socialist countries. In Africa, Eritrea achieved independence after a long guerrilla war, and East Timor has recently emerged as an independent state after twenty-five years of Indonesian occupation.

To contextualise, the emergence of new independent states is an extreme form of a more general, global trend in the transference of powers, authority, and resources to subnational levels of government. Many formerly centralized states have witnessed some form of devolution, and many states that were already decentralised have experienced even greater transfers of power to meso-levels of government. Few spaces around the world have remained untouched by this trend. Eight out of the fifteen members of the current EU – comprising 87% of its population (Rodríguez-Pose, 2002, p 174) – have seen some level of decentralization. In addition to the already federalized Austria and Germany, Belgium became a federal state in the early 1990s and Italy is in the process of federalization. Spain, despite not being a federal state, is arguably the most decentralised state in Western Europe. France has taken limited steps towards regionalisation – with ongoing debates over the granting of regional autonomy to Corsica – and the UK and Portugal have transferred a

considerable amount of power to some of their regions. Poland has also recently followed the path towards regional devolution.

Outside Europe, the devolutionary trend has been widespread, especially in large and heterogeneous states. In some cases, regional autonomy has been granted *ex nihilo*. This is the case of Indonesia, which passed autonomy laws aimed at undoing decades of extremely centralized government and at appeasing separatist tendencies in 1999 (Aspinall and Berger, 2001). In China, although political devolution has not formally occurred and the Chinese Communist party still keeps a tight grip on political developments, there has been widespread fiscal decentralisation that has provided regional and local governments with considerable powers and greatly encouraged policy innovations at the regional level (Ma, 1996, p 5).

In other cases, pre-existing levels of regional autonomy have been greatly enhanced. The most striking cases of decentralization have been those of Latin American countries. In Mexico the collapse of the economic system in 1982 and the political uncertainty that followed led to extensive changes in territorial politics. Although Mexico's constitution has officially been one of federalism since at least the revolution of 1910<sup>4</sup>, extreme presidentialism and the dominance of the executive branch of government over the judicial and legislative branches ensured seventy subsequent years of centralism and an enduring centralist culture (Rodríguez, 1998, pp 235-6). But as Ward and Rodríguez (1999, p 28) assert, the last two decades have seen a dramatic improvement in the political systems of representation,

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<sup>4</sup> See Rodríguez (1998, pp 236 – 8) for a history of early federalism in Mexico.

accountability, flexibility, and democracy throughout the country and have led to a profound reform of territorial politics in support of greater federalism.

In Brazil, the powers of the states were considerably reinforced after the passing of the 1988 Constitution. The 'regional interests' lobby was extremely influential during the drafting process and was well placed to capitalise on the anti-central government sentiment that had been development during military rule (Coutinho, 1996, p 7). Following the pattern set by earlier Brazilian constitutions, the regions were able to secure residual powers of legislation in the states rather than the centre and maintain a lack of any clear constitutional demarcation of responsibilities between the state, the centre and the local governments (Dillinger and Webb, 1999, pp 9–11). This has subsequently afforded them a hitherto unprecedented level of discretion over their own financing, administration, and responsibilities.

Among the states which had considerable regional autonomy before the onset of globalization, the trend has also been towards even greater decentralization. In India, the over-concentration of power in the hands of a few national elites since independence and until the early 1980s brought about a reaction that started to redress the balance from the centre to the regions (Sharma, 1999). In the US, the trend towards centralization which some trace back to the American Civil War or to the Great Depression, started to be reverted during Nixon's presidency in the early 1970s (Donahue, 1997). But it was really under Reagan's New Federalism in the 1980s when states began to recover greater freedom of action.

The global trend towards devolution and decentralization is based on subnational legitimacy and implies greater transfers of authority and resources from the centre to the states. In most cases, and as in previous decentralization waves, regional legitimacy has historic, linguistic, religious, and/or cultural roots. Regions and states with their own ethnic, historical, cultural, or linguistic identity have paved the way for decentralization. That has been the case of Catalonia and the Basque Country in Spain, Scotland in the UK, Brittany or Corsica in France, or even Chiapas in Mexico or Tibet and Xinjiang in China, which have brandished the ethnic, cultural, or historical argument as the source of their demands for greater autonomy. Economic arguments are also increasingly becoming a source of subnational legitimacy (Keating, 1998). Uneven regional economic development, alongside the achievement of greater economic efficiency through decentralization, are coming to the fore and gradually starting to occupy the bulk of the regionalist discourse in favour of decentralisation. The Northern Italian Leagues were the first to heavily base their devolutionary claims on economic demands, after their relative failure to gain visibility by using traditional ethnic or linguistic arguments (Segatti, 1992; Diamanti, 1993; Torpey, 1994). Nationalist and regionalist parties in Spain have increasingly resorted to similar arguments, as indeed have the Zapatistas in Chiapas.

Additional factors also contribute to boost the legitimacy of decentralizing claims. In some circumstances, decentralization goes hand in hand with democracy. This is the case of Brazil and most of Latin America, where the advent of democracy and decentralization are intrinsically related (Shah, 1991; Souza, 1997). Spain represents a similar case: forty years of dictatorship generated greater legitimacy for the devolutionary cause, and contributed to the profound territorial transformation of the

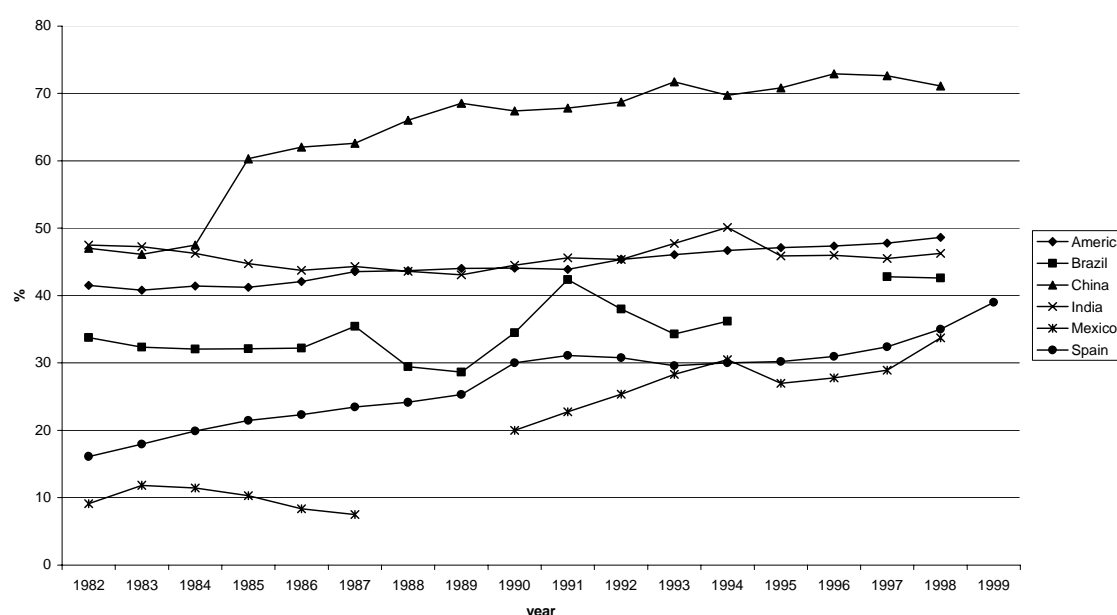
Spanish state after the return to democracy (Pérez Díaz, 1990). In other circumstances, decentralization tends to accompany changes in the economic regime – especially moves towards the marketisation of national economies. This trend has been followed in India (Roa, 1997), China (Ping, 2000, p 180; Da-dao and Sit, 2001, p 29) and, to a lesser extent, in Mexico and Brazil, since the opening of these countries to trade.

The process of devolution operates through transfers of authority and resources. Subnational governments across the globe currently enjoy greater authority and powers than they did a few decades ago. The trend is widespread. The powers of Italian regions have progressively increased since the late 1970s, and today they exercise considerable control in the fields of agriculture, tourism, regional planning, environment, and economic development (Rodríguez-Pose, 2002). All Spanish regions now have competences over health and education, while some have also secured powers over policy areas, such as policing, taxation, and fiscal affairs, which have traditionally been the prerogative of the nation-state (Castells, 2001). The Scottish Parliament enjoys both tax-raising and law-making powers and the Northern Ireland Assembly, the Welsh Assembly, or the Greater London Authority have taken over varying levels of central government activities (Tomaney, 2000; Tomaney and Ward, 2000).

Outside Europe, the transfer of authority from the centre to the regions has also taken place. The US has, for example witnessed devolutionary efforts centred around two key areas: welfare and medical insurance (Schram and Soss, 1998). In Mexico, the transfers of powers from the centre to the states include the increased ability of states to raise revenue; greater control for the states over development funds; a strengthened

administrative capacity of the municipalities; and a clarification of the divisions of responsibility between the federal, state, and municipal governments (Rodríguez, 1998, pp 251-2). In India, state responsibilities embrace public order, police, prisons, irrigation, agriculture and related activities, land, public health, industries other than those centrally assigned, and trade and commerce. In addition, states share with the central government authority over economic and social planning, education, labour, and forestry (Bagchi *et al.* 1992; Reserve Bank of India, 2000). Chinese reforms since 1980 have been aimed at granting provinces greater responsibility for budgets (Ma, 1996, p 5), and the Brazilian Constitution of 1988 grants, as mentioned above, state governors all powers not otherwise prohibited by the Constitution (Dillinger and Webb, 1999).

**Figure 2: Percentage Sub-national Expenditure in Total Government Expenditure**



Source: IMF Government Finance Statistics, Various Years.

Note: includes local government expenditure (as well as state or provincial expenditure) in the cases of Brazil, Mexico, Spain, and the USA.

Finally, decentralization has also implied a substantial transfer of resources from the centre to the regions. Figure 2 illustrates the growth in subnational government expenditures as a proportion of total government expenditures in our case countries between 1982 and 1999. Two points are apparent. First, there is an average increase of around 15% in the proportion of governmental expenditures carried out at the subnational level in the group of countries as a whole, indicating a movement towards devolution in general and decentralisation of resources in particular. Second, as the framework in Figure 1 implies, not all countries are party to this trend. Some countries (i.e. Brazil, China, or Spain) have witnessed a considerable decentralization of resources, which, in the cases of Brazil and China, has not been accompanied by similar levels of decentralization of authority. In other cases, such as India, the decentralization of authority has not been matched by a similar decentralization of resources, since the share of central government expenditure has increased slightly at the expense of that of the regional governments during the period of analysis.

### **3. Differing Forms of Devolution**

Having established the existence of a widespread trend towards devolution, this section addresses its diversity, with reference to the theoretical discussion in section 1. Recall that the inter-relationship between the relative legitimacy of governmental tiers and the form of devolution we can expect to find in a given country was examined. In general, all other things equal, where subnational governments enjoyed relatively strong legitimacy (as in the case of Spain (Rodríguez-Pose, 1996)), devolution biased towards the decentralisation of resources could be expected, whereas where the central government dominated (as in the case of the English regions (Jones, 2001)),



greater responsibility decentralisation may well ensue. This section presents support for this contention through the examination of China, India, Brazil, Mexico, and the USA.

China's efforts towards decentralisation began in conjunction with its marketisation initiatives in the late 1970s. The recognition that marketisation warranted a shift in government outlook, from a commanding role towards facilitating functions, brought about a series of fiscal reforms that saw the centre's influence over public resources reduce markedly across the 1980s (Ping, 2000, pp 180-1). By 1993, the provinces held complete control over revenue collection and the centre's share in total revenue had consequently fallen from 35.8% in 1983 to 22% in 1993 (Yi and Chusheng, 2001, p 86). From Figure 1, therefore, provincial legitimacy had soared to unprecedented levels, largely due to the enthusiastic nature of devolutionary initiatives. Furthermore, the importance of the provinces was compounded by the introduction of negotiation-based fiscal contracting between the provinces and the centre at the end of the 1980s (Lee, 2000, p 1009-15), which allowed certain states, especially the richer ones, to exploit their bargaining positions to a far greater extent than under the previous formula-based revenue sharing contracts. The impacts of this drastic rise in the relative power of the provinces in relation to the centre soon became evident, as Figure 1 indicates. Alongside the stated increase in subnational revenue claims, the provinces were able to extract far more aid from the centre than the centre itself could afford, contributing to the national deficit spiralling from parity to 600 billion yuan between 1985 and 1995 (Yi and Chusheng, 2001, p 90). Inevitably, this effect was skewed towards the richer provinces, whose bargaining positions were stronger, and Ma (1996, pp 22-3) documents a dramatic decline in the progressivity of transfers

from the centre to the regions between 1983 and 1991. Alongside this, as Figure 2 illustrates, the central government's share in public expenditures fell steadily, from around 53% in 1982 to under 30% in 1998, hindering macroeconomic control and prompting emergency widespread fiscal reforms in 1994 (Bahl, 1999, pp 105-29). While these fiscal reforms succeeded in increasing the centre's involvement in revenue raising, Lee (2000, p 1009-15) documents the influence the provinces had in preserving their expenditure levels, throughout the reforms, undermining the centre's equilibrating efforts. But while resources have been decentralised many subnational governmental responsibilities, in accordance with the marketisation of China, have been discontinued, including large areas of responsibility over state run enterprises. In general then, China's provinces can be seen to have increased their legitimacy markedly over the past 25 years, leading, as Figure 1 would predict, to a surge in regional financing in excess of any accompanying responsibility devolution.

In Brazil, the 1988 Brazilian constitution was written in an environment of pronounced hostility towards central government control (Hagopian, 1996, p 259-62 and 268-9). Constitutional provisions to curb national party dominance resulted in a lack of consistent central politics, a persistent feature of the Brazilian system since the return to democracy. In 1990 the 27 states were represented at the central level by fully 11 different parties (Kraemer, 1997, p 35) and in such a climate it comes as no surprise that state legitimacy and power has outweighed that of the centre, despite nominal provisions for the presidency. As Dillinger and Webb point out, 'even when the President seems to have strong political support on a roll call vote, that support is the result of extensive prior negotiations and concessions to regional interests' (1999, p 11). The power of the states has been translated into an unruly fiscal behaviour.

States over-spent massively during the late 1980s and 1990s, to the extent of printing their own money, borrowing from their own banks, and running up huge state level debts (Dillinger and Webb, 1999, pp 23-5). Subsequently, the central government has been forced to service these debts, and has faced little choice but to offer financial assistance to struggling states (Montero, 2000, p 67).

More recently, from the mid 1990s onwards, large debtor states have repeatedly threatened the central government with default and in January 1999 seven state governments declared themselves bankrupt, contributing to trigger with their action an economic crisis, a further manifestation of state supremacy that has necessitated central expenditure (Dillinger and Webb, 1999, p 25-6). Hence, state legitimacy can be viewed as so strong in Brazil that devolution initiatives have not only been biased towards resource devolution, but resource devolution has been paid for by the centre itself. Moreover, when individual fiscal packages with the states were eventually negotiated, beginning with São Paulo in 1997, the lack of significant extra debt servicing responsibilities for large debtor states, that might have served as a deterrent against future over-spending, confirmed instead that states had secured such a degree of legitimacy as to be able to promote resource-biased decentralisation while avoiding responsibility ramifications (Dillinger and Webb, 1999, p 25-6). Brazil therefore epitomises both the rapid resource decentralisation and gradual responsibility decentralisation that we would expect, from Figure 1, to proceed from high subnational governmental legitimacy.

India, on the other hand, presents a contrasting case. Here the continued legislative and administrative dominance of the central government has engendered a very

different decentralisation trajectory. While the Chinese and Brazilian central governments readily yielded to the provinces and states in recent years, the Indian central government maintained its influence and managed devolutionary initiatives largely to its own advantage. Historically, although India is a highly decentralised state, the influence of the central government has been consistently high. Following British rule, which emphasised the centre as a means of co-ordination of export and political control, the regimented system of five-year economic plans, sourced from the centre throughout independence, has guaranteed the preservation of central legitimacy. So when, during the 1980s, fiscal imbalance began to seriously affect the national budget, with the internal debt of the central government rising from 15.9% of GDP in 1980-1 to 33.6% in 1993-4 (Buiter and Patel, 1997, p 36), the temptation to exploit this legitimacy advantage and to decentralise legislative and developmental responsibilities began to manifest itself.

The Indian federal system is based upon three lists of responsibilities – accruing to the centre, the centre and the states, and the states alone. The centre's progressive redefining of the contents of both the state and joint lists has allowed the central government to continuously and subtly raise the responsibilities of Indian states over the past 20 years (see Bagchi *et al*, 1992 and Reserve Bank of India, 2000). Simultaneously, aid to the states as a proportion of state expenditures has actually fallen, from 54.3% in 1990/1 to 50.6% in 1998/9 (Statistical Abstract of India, 1999). To find that central expenditure as a proportion of total public expenditure has risen slightly over the period (as Figure 2 illustrates) therefore comes as no surprise. As discussed in section 1, this fact should not be taken as evidence of centralisation but, as the preceding discussion confirms, a symptom of the form of devolution India has

experienced, underpinned by central legitimacy and consequently dominated by the central government's agenda.

Mexico and the US represent intermediate cases. Political currents in Mexico have also had a decentralising effect. Through the presidencies of de la Madrid (1982-8), Salinas (1988-94) and Zedillo (1994-2000) the historical dominance of the centre has been progressively undermined. This is owed in large part to the political development of Mexico, which has served to make the centre more accountable while, at the same time, providing regional politics and politicians with ever-increasing legitimacy. Political developments have taken various forms. The first set of changes took place in national politics. The incorporation in 1977 of 100 (out of 400) seats based on proportional representation, as opposed to the original, and remaining, first past the post allocated seats gave opposition parties at least some representation at the central level (Ward and Rodríguez, 1999, p 23-7). In 1986 this representation was increased again as seats allocated on the basis of proportional representation swelled to account for 200 out of the 500 congressional seats.

Regional politics provided opposition politicians with a second forum. The central government, suffering from a legitimacy deficit in the mid 1980s (Rodríguez, 1998, p 241) took the first steps towards greater decentralisation, but, with time, the process led to a rise in state legitimacy at the expense of central legitimacy. As Figure 1 would predict, devolution initiatives have graduated from emphasising the decentralisation of responsibilities to the states initially, as central government held a strong legitimacy advantage, towards a much more well-funded programme as states have risen in political terms and the fallibility of the centre has developed. Hence,

under de la Madrid, although devolution initiatives emphasised the ‘autonomy’ of regions and included many initiatives designed to give the states and municipalities of Mexico ‘greater freedom’ over their own governance, these policies could be dismissed as either lip-service or thinly veiled excuses to dump expenditure responsibilities on the states (Ward and Rodríguez, 1999, pp 51-3). During Salinas’ presidency further responsibilities were devolved to the states and localities, including comprehensive welfare duties. In addition, opposition governors began to be returned to office. Finally, Zedillo’s ascendancy to the Presidency brought with it the renunciation of presidential meta-constitutional powers and the initiation of a cross-party forum on inter-governmental relations that has defined drives towards a new federalism in the country since 1996. The level of transparency and co-governance these initiatives have achieved have guaranteed the states at least a reasonable accompaniment of resources with each devolutionary effort (Ward and Rodríguez, 1999). In general, then, the 1980s and 1990s have witnessed an increase in resource devolution alongside responsibility devolution, as a result of political changes that have acted to equalise the relative legitimacy of governmental tiers, in line with the mechanisms illustrated in Figure 1.

The case of America, in spite of significant political and economic differences, bears some similarities to the case of Mexico. As in Mexico, it was the centre, under the Presidencies of Nixon and Reagan, who initiated drives towards devolution (Donahue, 1997). Indeed, Nixon famously coined the phrase ‘New Federalism’ in his bid to involve the states far more closely in national governance. Popular disillusionment with the centre during the 1970s and 1980s, following the Vietnam War, the oil crises and a shift in ideological principles away from macro-economic management, served

as a convenient political platform from which to launch various responsibility-shifting policies. The 1990s, during Clinton's presidency, saw a continuation of this trend, with the introduction of block grants for welfare shifting much of the risk and decision-making capacity for social security to the states, while including only nominal, and potentially short-lived, increases in funding, partly as a political compensation to the states (Powers, 1999). Central legitimacy, therefore, has so far served to emphasise responsibility-biased devolution in America.

As with Mexico, however, there have been forces operating to dilute this dominance, which have gained greater momentum over the past ten years. While Mexico experienced an exogenous concreting of state-level legitimacy, driven by the political revolution, America's states have been able to bolster their own bargaining and negotiating positions as a result of endogenous factors – precisely because their responsibilities and authority have increased throughout the reforms. From Figure 1, the states have benefited from a positive popular perception of devolution, which has increasingly held the central government to account. As Donahue (1997, p 13) asserts, 'Contemporary opinion surveys ... show dwindling faith in the federal government and (at least in relative terms) rising state legitimacy ... (T)he fraction of respondents identifying the federal government as "the level from which you feel you get least for your money" rose by 10 points (to 46%) between 1989 and 1994 alone'. This rise in legitimacy of the states has acted to curb to the responsibility emphasis so prominent in previous devolutionary efforts. As an illustration, President Clinton's reluctance to devolve responsibilities for medical health, although trumpeted as a moralistic decision in order to safeguard equity, was prompted by widespread resistance from the states whose fears over defective funding procedures stemmed from their

experience of welfare reform (Offner, 1999). As regional and state-level politics continues to become more important in America, such checks and balances, facilitated by the democratic system and the electorate's confidence in regional politics, will act to equalise the devolution of responsibilities and resources. In the future, greater resource devolution to the states may become a political necessity for the centre.

#### **4. The Impacts of The Devolutionary Trend**

At this point we are able to draw two conclusions. First, as evidenced in section 2, the devolutionary trend is a common and general one. Second, however, this generality should not be mistaken for homogeneity. As section 3 reveals, there are different forms of devolution that arise from different legitimacy distributions. This section reassesses the implications of the trend in the light of its virtual universality and complexity.

From a strategic-political perspective, we should not be surprised to learn that the awareness of the advantages of devolution tend to be more developed than the awareness of drawbacks. Whether devolution is driven mostly by national or subnational governments, each potential driver has an inherent interest in defending their policies to the electorate and bolstering their legitimacy and popularity. The most common supporting arguments for devolutionary policies draw upon the efficiency advantages that lower level governance can engender (Oates, 1972; Donahue, 1997; Keating, 1999). Given that the population in any country has a diverse preference structure, which varies across geographical space, this efficiency has three major sources, the themes of which recur time and again (Oates, 1972).



First, a smaller democratic and financial base should result in a managerial reform that would lead to a heightened degree of accountability, bolstered by the reduced administrative distance between the electorate and the politicians (Bennett, 1990; Hatry, 1994). Second, the lack of diluting influences brought about by responsibilities for alternative, diverse regions, tends to allow local governments the flexibility to respond to the preferences of their 'customers' or electorates (Bennett, 1990). And third, the local nature of governance implies a greater chance of local politicians with the specialist knowledge necessary to detect and react to the wishes of the electorate and defend their interests at higher levels (Putnam, 1993), as well as the capacity to implement policy innovations that would have been more difficult to pursue at the central or federal level (Bennett, 1990; Donahue, 1997). The basic conceptual argument of devolutionists therefore acknowledges these three factors as acting to both ensure and allow local governments to be more representative of and responsive to the interests of a given locality or region. Thus, public policy in general is brought closer into line with the diverse preference sets of a nation and welfare efficiency increases. Moreover, for those whose interests are not represented in their original location, there is in theory an increasing opportunity to choose and move between both regional and local governmental systems as devolution progresses and the diversity of public systems available to a nation as a whole increases. Arguments in favour of devolution are therefore underpinned by free market assumptions, such as easy mobility, the political-economic machinery of choice and democracy, and rational models of public sector behaviour under a democratic framework. There are areas, however, where developments associated with the global decentralizing trend we have identified cast doubt on the rosy picture of greater efficiency, greater democracy, and greater welfare painted by devolutionists. In the following

subsections we explore some of these developments by focusing on three aspects – efficiency issues, equity issues, and administrative issues. The aim is to shed more light on the diversity and contradictions of devolutionary effects.

#### 4.1. Efficiency Issues

##### 4.1.1. Devolution and Debt

As has been discussed in earlier sections, devolutionary initiatives in our case countries have often included some separation of responsibilities from resources. It is rare to find a simultaneous decentralisation, since the driving actor behind devolutionary efforts will invariably have incentives to separate these two factors one way or another (see Figure 1). Under these circumstances it is common to discover a mismatch between responsibilities and financing, which, as Bennett underlines, have inevitably led to the development of debts either at the central or local levels, to a steady erosion of the linkage of local decisions from their financial consequences, and growing tension between central governments and subnational administrations (1997, p 331). The cases of India, Brazil, and Spain illustrate various ways in which devolution can encourage debt formation.

In India, central government debt has been one of the major drivers behind devolutionary efforts. Between 1980-1 and 1993-4 the internal debt of the central government expanded from 15.9% of GDP to 33.6% (see section 3). Moreover, during the same period, total internal state debts in India rose from 4.6% of GDP to 7% (Buiter and Patel, 1997, p 36). It is easy, therefore, to envisage a situation where

the pressure on central government finances at least contributed to a decentralisation of expenditure responsibilities. With a strong centre and calls for greater regional autonomy the temptation to engineer favourable forms of devolution that assist in limiting the central deficit may well become overwhelming.

In cases where the states have played a key role in the decentralization effort, the decentralization of resources can contribute towards both large central deficits and developing regional debts – the former due to the *de facto* decentralisation of resources and the latter through the moral-hazard problem of central governments effectively underwriting the expenditure of regions. Perhaps the most apparent case of this type of development is Brazil. In Brazil, where decentralisation initiatives have been driven more by the states than the centre, states were allowed to accumulate huge debts, often resulting from the development of short-term populist policies by Brazilian governors, aimed at securing their grip on power (Dillinger and Webb, 1999; Rodríguez-Pose and Arbix, 2001). Generating large regional debts were traditionally perceived as a low risk strategy by local politicians, since first, the burden of the debt would fall on future generations and not on current voters, and second states expected to be bailed out in the medium term by the federal government. This, in combination with a weak centre, whose political survival during much of the second half of the 1990s depended on the support of regional politicians, created the conditions for several Brazilian states defaulting their debts.

A devolutionary process driven by the so-called ‘historical’ regions in Spain has led to the establishment of a system in which, although in most regions regional finances are still largely based on central government grants, autonomous regions hold the

upper hand. The consequence of this situation has been an erosion of national control over regional spending and a weak fiscal accountability that have led to the spiralling of regional debt across Spain (Castells, 2001; Montero, 2001).

#### 4.1.2. Inefficient Competition for Industry

A further factor that threatens to proceed from efforts towards administrative devolution concerns the phenomenon of territorial competition. The proliferation and greater powers of subnational governments are shifting the focus of development policies away from achieving greater equality or national cohesion, towards securing greater economic efficiency at the local level (Cheshire and Gordon, 1998). Consequently, there has been an increasing tendency for subnational governments to engage in competition for the attraction of foreign direct investment (FDI) (Scott, 1998; Vernon, 1998). When subnational governments offer incentives for mobile industry to locate within their region, and the private sector firm chooses between the most attractive packages offered by the states, the impact upon national efficiency could be damaging. Cheshire and Gordon (1996) conceptualise this situation in terms of a zero-sum game – one in which the aggregate payoff of the game for all the actors involved is autonomous of the final outcome of the game across the actors. Specifically, the total gain of the arrival of a firm in a given country will be the same, or very similar, no matter where within the country the firm chooses to locate. But there are costs involved in trying to affect the locational decision of the firm, which stem from the sort of measures offered to the mobile firms – such as tax grants, incentives and subsidies, or specific policy arrangements for foreign investors which contribute to the spiralling of subnational debt (Rodríguez-Pose and Arbix, 2001). So

while the nation has nothing to gain as regions compete for investment, it has much to lose as competition for mobile investment increases and regional advertising and marketing, government grants and loans, and interest and debt concessions become greater. There are numerous examples of this sort of zero-sum competition for industry across Europe and the United States (Donahue, 1997; Mytelka, 2000), but it is perhaps in Brazil and China where the level of inefficiency associated with this sort of territorial competition is more apparent.

Of all the industries in Brazil, the automobile industry represents the clearest illustration of a general tendency. The Brazilian automobile industry expanded rapidly during the relatively stable period between 1995 and 1998 at the start of President Cardoso's term in office. During that time, car manufacturers invested over US \$ 12 billion in Brazil (Rodríguez-Pose and Arbix, 2001, p 134). While this influx of FDI appears beneficial to Brazil as a whole, industrial mobility created the conditions for fierce rivalry between Brazilian states hoping to attract investment, and consequently paved the way for wasteful expenditure designed to influence companies' locational decisions within the country. As Rodríguez-Pose and Arbix point out, '(t)ax and bidding wars have become the norm in the motor industry' (2001, p 145) with concessions routinely including the donation of land, the provision of infrastructure, the provision of state and local tax breaks, loans, and a series of financial cautions and guarantees.

In China, a similar pattern of territorial competition has become commonplace. Under the marketisation drive of the 1980s all provinces, along with thousands of counties and townships, launched their 'opening up' programmes with the establishment of

‘zones’. These included differing varieties, but each shared the common theme of offering significant concessions for the attraction of industry, including, as a typical example, a 15% flat rate on corporation tax, 2 years’ tax exemption on profits and a further 3 years’ 50% tax reduction. Ma (1996, p 15) documents the nature of these zones, which, by mid 1993, had swelled in number to around 1800 across China. Crucially, there were no official standards in the level of concessions that could be offered by the zones. The lack of an official standard of concessions has led to the development of highly intense competition, with concessions often extended well beyond the example above, towards extremes such as five tax-free years and a further five years’ 50% tax payment.

The impact on China as a whole of the development of these zones may well have been detrimental for the reasons Cheshire and Gordon (1996 and 1998) provide. Ma (1996, p 15) points out that not only are concessions available to internationally footloose companies, but also to indigenous companies in an attempt to attract them from one region to another. No discernible national economic gain from the resources expended on inducing these movements, which boil down to a simple spatial reallocation of industry within the nation, can be expected. Furthermore, McKenney (1993, p 20-1) points out that in Beijing, one of the richer and more tax-effective areas in China, the ability of the subnational government to extract the taxes rightfully owed to them in their economic zones has been extremely poor. Over-dependence on large firms in some areas, and a multitude of small, semi-informal firms in others, has contributed to grave difficulties in tax collection at the provincial level. All in all, while much industry has been attracted to China through economic zones, especially

from Hong Kong, Taiwan, and Singapore, the efficiency cost through competitive concession making across provinces detracts markedly from the advantages.

#### 4.2. Equity issues

One of the traditional roles of national government is the redistribution of resources in order to safeguard minimum levels of welfare throughout the country. Decentralisation of authority and resources undermine a central government's ability to achieve this in two fundamental ways. First, devolution of decision-making authority progressively transfers the responsibility for devising ways in which redistribution will occur to subnational government. This leads, in most cases, as seen in Figure 2, to an increase in subnational resources at the expense of national budgets. Second, this tier of government is multifarious, and it is often the case that larger or more prosperous regions are over-represented at this level. Hence, following devolution, a smaller role for national transfers and a larger voice for the regions in deciding how transfers are allocated is likely to result in a less progressive system of fiscal redistribution than under a centralist system (Thompson, 1989). The political and economic muscle of stronger regions is likely to skew public expenditure in their favour, regardless of whether the greatest legitimacy is based in the centre or in the regions and of whether the financing system of regions is based on local tax revenue or on grants from the centre. In the former case because the devolution of fiscal powers will inevitably favour wealthier areas, and in the latter because the greater political muscle of larger and richer regions may be reflected in a greater capacity to secure transfers from the centre and to impede the evolution of a more centralised

regional system of transfers or regional policy, as Markusen (1994) demonstrated in the US case.

Figure 3: The Regressiveness of Regional Budgets in Mexico, the US and Spain

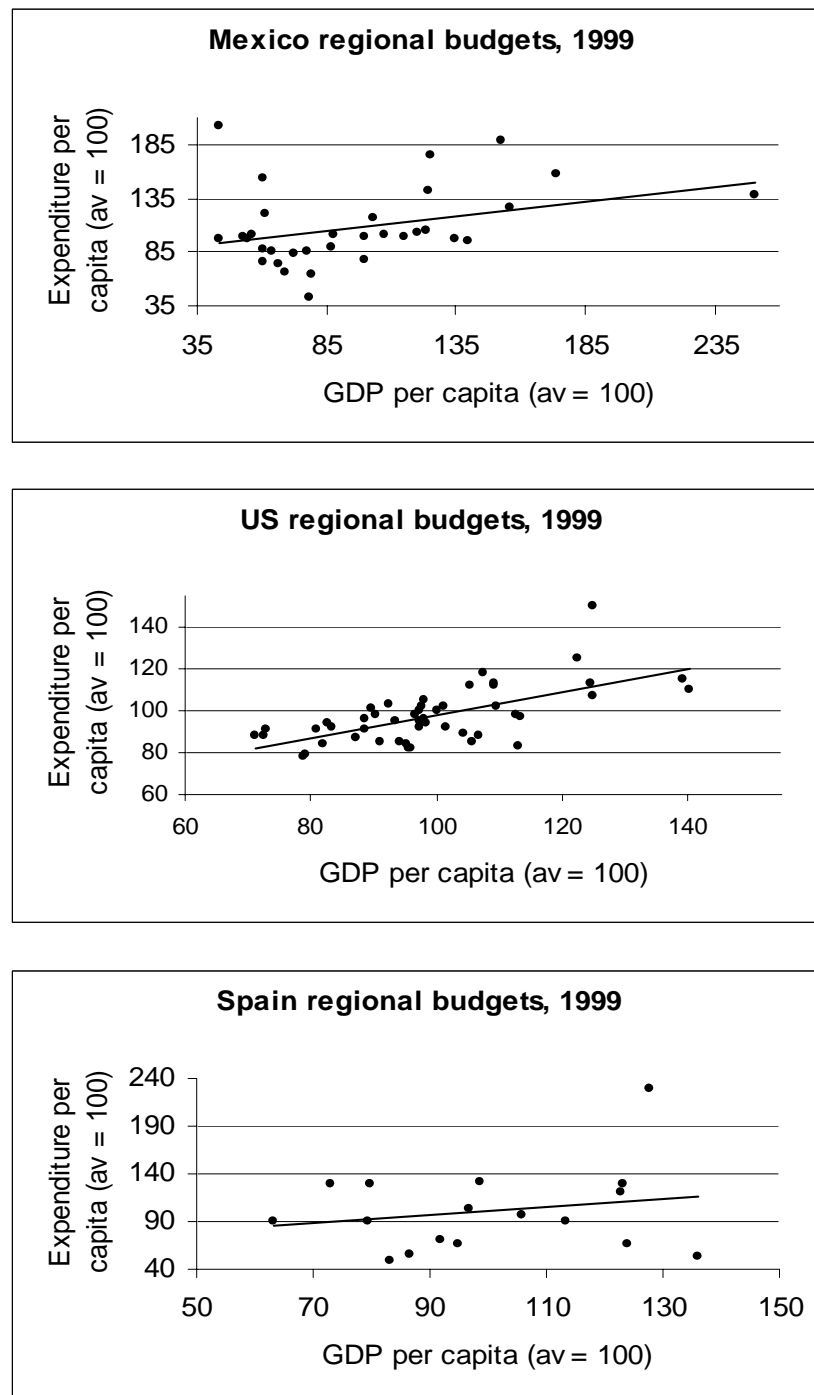




Figure 3 highlights the regressiveness of regional budgets in three of our case countries, Mexico, the US, and Spain. The three cases represent three different forms of devolution and three different forms of regional financing. Yet, in all cases regions with the highest GDP per capita enjoy, as a general rule, a greater expenditure capacity than poorer regions. The positive regression lines in the three graphs confirm this trend (Figure 3).

#### 4.3. Institutional and Political Issues

Three further issues concerning the understated downside of the devolutionary trend outlined in section one merit attention. First, and most obviously, devolution involves an increase in the number and a decrease in the size of administrative units, with accompanying costs. Second, more subtly, lobbying costs under a decentralised system are likely to exceed those under a central system. In much the same way that regions compete for mobile capital under the territorial competition framework outlined at the beginning of this section, subnational governmental units also compete for central financial assistance (see Milgrom and Roberts, 1992). And in the same way at competitive bidding between regions, the expense incurred during the process of competition for government financing is a deadweight loss to the nation as a whole. Moreover, we can expect these losses to become greater as subnational governments become more powerful and complex. The proliferation of intra-governmental conventions and reviews of fiscal relations, for example in Brazil (1989), China (1994), and Mexico (1995) underscore the importance, complexity, and expense associated with public redistribution and it is perhaps no co-incidence that these conventions tend to co-incide with devolutionary trends. Third, devolution of

authority carries with it the threat of increased corruption. By its nature, this factor is difficult to measure, but the incentive structure that decentralised systems present to self-interested actors is enough to raise our concerns (see Das-Gupta and Mookherjee, 1997, pp 181-184). Decentralisation, all other things equal, makes monitoring of public monies more difficult, because it is dispersed across the country and across numerous actors. Furthermore, it may increase the incentive for corruption at lower levels of government, since these levels tend to command more resources. In countries such as China, where, according to Yi and Chusheng 'it has been estimated that cheating on tax returns is practised by 50% of the SREs (*state run enterprises*), 60% of township and village enterprises, 80% of private businesses, 90% of joint ventures and co-operative enterprises, and 95% of individual residents' (2001, p 90-1), these concerns take on considerable significance.

## Conclusion

The purpose of this paper has been to bring to attention the general trend in decentralisation and to outline the complexity of both its forms and implications. To this end, some of the key issues surrounding the mechanisms of devolution were addressed and incorporated into an informal model at the start of the paper. This model identified three factors of decentralisation as composing the devolutionary trend – legitimacy and the decentralisation of resources and of authority. Some of the interest-conflicts arising from the co-existence of these attributes of devolution were addressed in order to deepen our understanding of devolutionary mechanics. The relevance of this understanding becomes clear in lieu of the following section, which outlined the depth and breath of the global trend towards devolution. In those

countries with centralised systems 20 or 30 years ago, decentralisation has been widespread, and in those countries with initially more vertically dispersed government systems, further decentralisation from their respective starting points has become the trend. This global tendency towards the devolution of authority and of resources elevates the importance of understanding this phenomenon. To this end, the theoretical arguments of the first section were then applied to our group of case countries in the third section, which exposed the diversity of devolutionary efforts across the globe.

In the fourth section, given the understated heterogeneity of devolutionary processes, the parallel heterogeneity of devolutionary implications was addressed. In response to the widely held belief that decentralisation generally increases efficiency, facilitates choice, and holds the public sector more accountable than under a centralised framework, a critical examination of each of these hypotheses was presented. The expectation that devolution leads to greater efficiency can be called into question on the grounds that the process tends to engender both debt and territorial competition which are harmful to national efficiency. The gains from devolution through the matching of public services to a heterogeneous population preference structure is a static argument that may overlook dynamic alterations in the behaviour of the actors involved. In these two cases, the incentive structure facing the national and subnational governments alter, and present the potential for opportunistic interaction that is damaging for the economy as a whole. While the matching argument remains strong, it should therefore be weighted against the expected losses through these factors before any devolutionary processes are undertaken.

In terms of equity, evidence was present to support the case that decentralisation of resources is often times regressive from a territorial point of view. The combination of dwindling central government outlays in relative terms with the greater bargaining power of the richer, larger, and/or stronger subnational authorities frequently leaves weaker and poorer regions in a worse financial state than under a centralised system. Section four concluded with a brief discussion of the administrative, lobbying, and corruption costs that devolution is also likely to entail.

In summary, it is imperative for policy makers to recognise varying forms of decentralisation and to be aware of the vested interests of national and subnational governments across these alternative devolutionary forms. It is also imperative that commentators, policy makers, and analysts remain aware of the context of debates and opinions surrounding devolution. It is no co-incidence that devolution tends to be supported by national electorates – in many ways it is inevitable – because powerful and influential actors seek to muster the support of the electorate to facilitate their own initiatives. At the same time, however, this situation might well be damaging if enthusiasm for devolution is not tempered with, first, an awareness of the context of any debates that occur, and, second, an awareness of not just the benefits but also of the understated drawbacks devolution can engender. The prescription of this paper is therefore cautionary with respect to both the interpretation and promotion of devolutionary efforts.

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