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## **ADB Working Paper Series**

### **LOOKING BEYOND CONVENTIONAL INTERGOVERNMENTAL FISCAL FRAMEWORKS: PRINCIPLES, REALITIES, AND NEGLECTED ISSUES**

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**Abstract**

Fiscal decentralization and intergovernmental fiscal relations reform have become nearly ubiquitous in developing countries. Performance, however, has often been disappointing in terms of both policy formulation and outcomes. The dynamics underlying these results have been poorly researched. Available literature focuses heavily on policy and institutional design concerns framed by public finance, fiscal federalism, and public management principles. The literature tends to explain unsatisfactory outcomes largely as a result of some combination of flawed design and management of intergovernmental fiscal systems, insufficient capacity, and lack of political will. These factors are important, but there is room to broaden the analysis in at least two potentially valuable ways. First, much can be learned by more robustly examining how national and local political and bureaucratic forces shape the policy space, providing opportunities for and placing constraints on effective and sustainable reform. Second, the analysis would benefit from moving beyond design to considering how to implement reform more strategically.

**JEL Classification:** H70, H71, H72, H73, H77

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# 1. INTRODUCTION

Fiscal decentralization and intergovernmental relations have been prominent aspects of public sector reform in developing countries for decades. Actual performance, however, has often lagged expectations, both in terms of policy (relative to design principles and the extent to which systems are implemented as designed) and results (fiscal outcomes—local revenue generation, and use of intergovernmental transfers, among others—as well as developmental and governance goals).<sup>1</sup>

The lackluster performance is a function of both how the mainstream framework is used and its basic limitations. While beneficial, the framework is normative and dominantly technical, and it fails to consider key elements of context that intrinsically shape how decentralization is designed and performs. There is consensus in the literature that context matters for decentralization, but the usual catalog of factors—degree of development, nature of the system (federal versus unitary), levels of capacity, and “political will,” among others—does not do justice to the scope and variety of potentially pertinent concerns. Even if basic principles were interpreted in a more expansive and nuanced way for system design, there are typically compelling implementation challenges that also merit specific attention. Although the mainstream approach has been invaluable in many countries and in various respects, it is on its own fundamentally insufficient to shape pragmatic policy.

The next section provides a short synopsis of the broader landscape of fiscal decentralization, highlighting some key assumptions and expectations of the mainstream approach, as well as some of the challenges encountered in applying it. This is followed by a selective overview of Asian countries that have pursued decentralization, illustrating the great diversity of intergovernmental systems even in one region.<sup>2</sup> The next section turns to neglected factors underlying the shape fiscal decentralization takes, with an emphasis on a range of political economy factors and the lack of adequately strategic implementation. Finally, a summary and some suggestions are provided regarding how to think about intergovernmental fiscal relations more productively and pragmatically, and a few avenues for future research are outlined.

## 2. THE LANDSCAPE OF FISCAL DECENTRALIZATION AND INTERGOVERNMENTAL RELATIONS

The starting point for considering alternative ways to think about intergovernmental fiscal relations is to evoke the fundamentals of conventional thinking. This section briefly reminds the reader of some basics,<sup>3</sup> and then reviews selected recognized challenges to applying the mainstream approach.

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<sup>1</sup> Examples of synthetic reviews on various aspects of decentralization performance include World Bank (2005); Bardhan and Mookherjee (2006); Smoke, Gomez, and Peterson (2006); Treisman (2007); Connerley, Eaton, and Smoke (2010); United Cities and Local Governments (2010); Martinez–Vazquez (2011); Martinez–Vazquez and Vaillancourt (2011); Local Development International (2013); Dickovick and Wunsch (2014); Ojendal and Dellnas (2013); Gadenne and Singhal (2014); and Faguet and Poschi (2015).

<sup>2</sup> There is no attempt to exhaustively cover the region; the paper focuses on countries the author has worked on or has access to information on.

<sup>3</sup> See Morgan and Trinh (2016) for more detail.

## 2.1 The Basics

Several elements are commonly considered essential to create an enabling environment for sustainable subnational government fiscal performance. First and foremost, clearly defined constitutional and/or legal provisions regarding fiscal structure are required. Basic principles for assigning public functions and revenues to subnational governments are well documented elsewhere.<sup>4</sup> It is sufficient here to indicate that they involve determining appropriate local functions (considering spatial demand heterogeneity relative to scale economies and externalities) and revenues (with a concentration on benefit taxes and immobile tax bases). Additional principles cover the sharing of national resources with subnational governments in order to meet desired objectives (such as revenue adequacy, improving efficiency, and/or equity, among others).

In addition to basic provisions for dividing functions and resources, it is considered important to define accountability relationships—with citizens through elections (if there is devolution) and/or other local means, with higher levels of government, and between legislators and administrators at the subnational level.<sup>5</sup> Structures and managerial processes of local administration and governance need to be set up or modified. All levels need appropriate staffing, planning, budgeting, public financial management, and audit systems, among others. There is a general appreciation that these elements should create an effective balance between reasonable fiscal autonomy exercised by subnational levels to promote downward accountability and legitimate upward accountability to help ensure standards and deal with national interest concerns. Frameworks are needed to enable local governments to partner with peer governments, private sector firms, and nongovernment organizations in the execution of their duties. Such provisions include, for example, mechanisms for joint undertakings, procurement regulations, and public–private partnerships.

As if these fiscal, political, and administrative requirements were not sufficiently demanding, there are other elements of the broader legal framework that are not specific to decentralization, but that likely condition the ability of subnational governments to perform as conventional theory expects. These include, for example, rule of law, property rights, civic association rights, and freedom of information and media, among others.

## 2.2 Commonly Recognized Challenges

National governments often follow the basic logic of the core fiscal decentralization principles in shaping intergovernmental fiscal policy and generally also take some steps to deal with the additional structures, procedures, and non-decentralization-specific elements of the broader public sector framework noted above. At the same time, there are well-acknowledged challenges to pulling everything together.<sup>6</sup>

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<sup>4</sup> This field emerged under the rubric of fiscal federalism as advanced by Oates (1982). Useful reviews include Boadway and Shah (2009); Bahl, Linn, and Wetzel (2013); Ahmad and Brosio (2014); and Blochsliger (2014).

<sup>5</sup> Although devolution to elected governments has emerged as a generally preferred form of decentralization in international circles, other forms can be appropriate in certain situations. See Eaton and Connerley (2010).

<sup>6</sup> Broader decentralization reform needs and the challenges of realizing them are covered in a range of literature, including Manor (1998, 2013); Bardhan and Mookherjee (2006); Shah (2006); Cheema and Rondinelli (2007); Boex and Yilmaz (2010); Eaton, Connerley, and Smoke (2010); United Cities and

First, even most technical aspects of intergovernmental system design are not entirely straightforward to manage. Various trade-offs are inherent in the fiscal decentralization principles, making their application potentially difficult and contentious. If the framework is applied in a diligent way, hard decisions will still have to be taken, and there will be a need for inherently elusive coordination among elements of the system that may be primarily influenced by different actors. For example, particular services may be devolved without a strong linkage to the structure of intergovernmental finances. Getting the elements of the system to work together can be a daunting task.

Second, decentralization policy and intergovernmental system designers and implementers are often constrained by a deficit of adequate and reliable information. Even data that exist may be managed by separate agencies, be defined in a way that does not sufficiently capture what needs to be measured, cover different time periods, or be modified over time, among others. Without the right information, designing and managing intergovernmental relations effectively can be hindered.

Third, lack of capacity is also recognized as an important constraint on advancing intergovernmental fiscal relations and effective local fiscal performance. Even with a well-designed system, low-capacity local governments will be unable to act so as to realize the potential benefits of decentralization in terms of how they raise resources, use transfers, and manage public expenditures. There has been much attention to capacity building, but also concerns that conventional approaches have not met their objectives.

Fourth, interjurisdictional variations may be inadequately considered in setting up intergovernmental systems. Regional, provincial, and metropolitan governments are often in a position to assume major functions and raise substantial revenues if offered the opportunity, but conditions can be substantially different in more rural and more remote locations with less diversified economic bases and a high incidence of poverty.

Finally, the importance of political obstacles to productive decentralization and intergovernmental relations is recognized, but often in a fairly ad hoc way and/or in terms of the vague assertion that there is not adequate “political will” to apply fiscal principles appropriately.<sup>7</sup> So-called “second generation” fiscal federalism focuses on issues that move beyond the technical concerns of first generation theory, but not in an integrated way.<sup>8</sup> And while the point about “political will” may in a general sense be correct, the implication that politicians should just follow the normative advice of fiscal experts is not a very powerful approach for formulating how to improve on the status quo.

### 3. THE DIVERSITY OF ASIAN EXPERIENCES

Having briefly reviewed mainstream thinking, it is useful to ground the discussion in a review of how selected countries in Asia have organized their systems. This section briefly compares eight Asian countries—Bangladesh, Cambodia, India, Indonesia, Pakistan, the Philippines, Sri Lanka, and Viet Nam.<sup>9</sup> This discussion summarizes

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Local Governments (2010); Martinez–Vazquez (2011); Ojendal and Dellnas (2013); Faguet (2014); and Smoke (2015).

<sup>7</sup> More detail on broader perspectives for considering political concerns is provided in section 4.

<sup>8</sup> Examples of second generation fiscal federalism literature include Oates (2005) and Weingast (2009, 2014).

<sup>9</sup> The material on the countries comes from a range of sources, but the information in the tables was largely drawn from four major sources: Local Development International (2013); Smoke (2013a); World

key fiscal matters that are treated in more detail elsewhere, but there is also coverage of other elements of the intergovernmental systems expected to affect fiscal performance.<sup>10</sup>

### 3.1 Overview

At the risk of stating the obvious, decentralization occurs in countries of all sizes and in highly diverse contexts. Countries differ by physical area and the size and composition of the population, among many others. Some countries have reached middle-income status, while others are still poor. A number of countries have long experience with decentralization and democratization, while others have been more centralized and less openly governed. While some countries are relatively stable, others are in postconflict or conflict situations. Many of these characteristics surely influence how decentralization is pursued, although not always in apparently systematic ways.

To demonstrate the diversity involved, several basic comparisons of the eight countries listed above are provided.<sup>11</sup> There is significant variation in the structure of their intergovernmental systems, their decentralization policy frameworks, and how they compare in terms of subnational powers and functions. There are also major differences in their levels of local autonomy and the nature and strength of their subnational accountability mechanisms. These considerations go well beyond traditional fiscal concerns, but are important because, as noted above, they can influence how decentralization and intergovernmental relations unfold on the ground.

This synopsis is neither comprehensive nor authoritative, and there are deficiencies and ambiguities in the underlying data. The purpose is not to be definitive, but to provide a sense of extreme differences across countries and suggest that conventional fiscal decentralization frameworks do not adequately take into account certain diverse contextual characteristics that necessarily affect intergovernmental relations and how subnational governments function and perform. Note that this section mostly describes the country systems—underlying drivers of reform are further explored in section 4.

### 3.2 Fundamental Intergovernmental Structures

Most countries considered here—with the exceptions of India and Pakistan—are unitary governments. This means that the national government is the center of power and makes decisions regarding decentralization to lower tiers. In the federal systems, the states or provinces have some control over the roles of local bodies.

Each country uses multiple types of subnational government (Table 1). The situation is further complicated by the fact that various units listed in the table need not be at different levels—for example, there can be multiple types of subnational government at the same level, such as the more urbanized *kota* and less urbanized *kabupaten* in Indonesia, which have comparable legal status. Certain levels are devolved units with elected governments and autonomous powers, while others are deconcentrated administrative entities.

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Bank (2015a); and European Commission (2015). Additional references on each country are provided in section 4.1.

<sup>10</sup> Fiscal and regulatory mechanisms for many of the countries are covered more in Morgan and Trinh (2016).

<sup>11</sup> Table 1 in Morgan and Trinh (2016) provides basic socioeconomic and institutional data on most of the countries covered here.

Relationships among levels can also vary—some are fairly autonomous while others are more hierarchical, leading to differences in intergovernmental relations that surely affect performance. In certain cases, such as India, Indonesia, and the Philippines, there are special states or regions with some type of preferential treatment, and capital (and/or other major) cities may have a specific designation.

**Table 1: Subnational Government Systems**

Subnational Levels/Types of Government	
Bangladesh	<ul style="list-style-type: none"> <li>Rural local (<i>parishads</i>): <i>zila</i> (districts, 64); <i>upazila</i> (subdistricts, 510); union (5,000)</li> <li>Urban local: city corporations (11); <i>pourashavas</i> (municipalities, 315)</li> <li>Hill district authorities (3)</li> </ul>
Cambodia	<ul style="list-style-type: none"> <li>Provinces (23, including 3 municipal) and capital</li> <li>Districts (159) and municipalities (26)</li> <li>Communes and <i>sangkat</i> (municipal communes, 1,621) divided into villages</li> </ul>
India	<ul style="list-style-type: none"> <li>States (28, 11 special status) and union territories (7)</li> <li>Urban local: municipal corporations (138), municipalities (1,595), towns (2,108)</li> <li>Rural local (<i>panchayati raj</i>): <i>zila</i> (districts, 593), <i>samities</i> (blocks, 6,087), <i>gram</i> (villages, 239,432)</li> </ul>
Indonesia	<ul style="list-style-type: none"> <li>Provinces (34, of which 5 are special regions)</li> <li>Local governments: <i>kota</i> (cities, 98), <i>kabupaten</i> (rural districts, 410), special capital, district</li> <li><i>Kecamatan</i> and <i>desa</i> (subdistricts and villages, 69,249)—these two lower tiers have limited formal roles, although the role of villages is being increased</li> </ul>
Pakistan	<ul style="list-style-type: none"> <li>Provinces (4), territories (4), and capital territory</li> <li>Districts (<i>zilas</i>, 96); <i>tehsils</i> (337); unions (6,022)</li> </ul>
Philippines	<ul style="list-style-type: none"> <li>Regions (18, 1 autonomous)</li> <li>Provinces (79)</li> <li>Cities (112), municipalities (1,496), <i>barangays</i> (villages, 41,944)</li> </ul>
Sri Lanka	<ul style="list-style-type: none"> <li>Provinces (9)</li> <li>Urban: municipal councils (large urban areas, 23); urban councils (smaller urban areas, 41)</li> <li>Rural: <i>pradeshiya sabhas</i> (rural, 257)</li> </ul>
Viet Nam	<ul style="list-style-type: none"> <li>Provincial level: provinces (58) and (centrally controlled) municipalities (5)</li> <li>District level (700): provincial cities/urban districts, towns, and rural districts</li> <li>Commune level (&gt; 11,000): townships, communes (rural), and wards (urban)</li> </ul>

Source: World Bank online data and references listed in footnote 10.

### 3.3 Essentials of the Intergovernmental Policy Framework

Each of the countries under consideration has developed a decentralization and intergovernmental relations policy framework. There is, however, much variation across countries—in terms of the constitutional and/or legal foundations of the system, the nature and strength of empowerment and intergovernmental relations, and other factors.

All countries here have formalized decentralization in a constitution, a stronger provision than law to the extent that it is more difficult to change, but the degree of detail differs. In Cambodia and Pakistan, the constitution refers only in a general way to local government. Other countries define more specific roles of each level in the constitution (Sri Lanka) or laws (Indonesia, the Philippines). In some cases,

constitutional reform initiated decentralization, while the framework was retrofitted to match evolving policy elsewhere.

Despite constitutional and legal mandates, needed subsequent laws further detailing decentralization design and operations often remain incomplete or fragmented. In some cases, this is because decentralization is in earlier phases, but in others it may reflect intentional delay of the reform process (see the political economy discussion in section 4). There is not uncommonly weak coordination of reform, resulting in policy inconsistencies that weaken the prospects for subnational governments to play their intended role.

In India, Pakistan, Sri Lanka, and Viet Nam, intermediate tiers are more prominent than local tiers. In contrast, Indonesia and the Philippines privilege local tiers. Design can also be based on other factors. Bangladesh, India, and Sri Lanka, for example, empower urban more than rural areas. In some cases, relationships among levels are hierarchical, as in Bangladesh, Sri Lanka, and Viet Nam, as are state–local relations in the federal countries. In other cases, each level is more independent, as in Indonesia and the Philippines, indicating a need for dedicated efforts to coordinate levels as needed.

Although space limitations preclude detailed treatment here, other major aspects of the intergovernmental framework, including the nature and strength of fiscal rules, subnational oversight mechanisms, management systems, and partnership frameworks, are generally provided for.<sup>12</sup> A few countries have more advanced policies on multiple fronts, but their relevance varies since local governments in some cases have limited autonomy and/or do not adequately use revenue and borrowing powers accorded to them.

Other elements of the framework are detailed to various degrees. Development planning and public financial management (PFM) systems are officially in place in each country (in India and Pakistan, local procedures are regulated by the state or province), but in some cases, such as Bangladesh and Sri Lanka, they are less developed, and not all countries have dedicated subnational PFM. The PFM systems are rarely strong, but in all cases there appear to be ongoing efforts to improve them. While there is movement to adopt medium-term expenditure frameworks, linkages between development plans, public investment programs, and annual budgets are a weakness in the countries covered here. Some countries, such as Indonesia and the Philippines, have made progress, but there are not exemplary cases of countries overcoming this significant system flaw.

### **3.4 Subnational Government Fiscal Empowerment**

The degree of fiscal empowerment of subnational governments and their role in public spending varies greatly.<sup>13</sup> In most cases here, subnational expenditure<sup>14</sup> constitutes 20%–35% (the mix varies among levels) of the total, but with outliers. Subnational spending in Sri Lanka and Bangladesh is respectively less than 1% and 3% (not including deconcentrated spending), compared with 56% in Viet Nam and 66% in India. Functions are often shared across multiple levels, and there is a tendency for lower spending shares at the more local levels (with exceptions, such as Indonesia and the Philippines).

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<sup>12</sup> More information is provided in World Bank (2005, 2015); Smoke (2013); European Commission (2015); and Morgan and Trinh (2016).

<sup>13</sup> See Morgan and Trinh (2016) for more detail on fiscal systems in several Asian countries.

<sup>14</sup> Note that in some cases it is not possible to distinguish devolved and deconcentrated spending fully.

The extent and clarity of expenditure assignments vary, but subnational government roles are often subject to interpretation and contestation. Even with greater clarity, as in Indonesia and the Philippines, there is ongoing ambiguity and debate. On balance, there is a propensity for ample oversight—even interference—from higher levels. In the majority of these countries, decentralized revenue sources (including borrowing) are fairly limited and not very productive, although performance in urban areas is often better. Most subnational governments in these cases heavily rely on intergovernmental transfers (Table 2). A number of countries (Indonesia, Pakistan, and the Philippines) share a few individual national taxes, but only in Viet Nam does this approach dominate subnational finances. Unconditional transfers are the main revenue in Indonesia and the Philippines. Revenue sharing by formula (federal to state and state to local) is substantial in India, but the latter transfers are governed by individual state finance commissions, so there is considerable diversity. Unconditional transfers are also important in Cambodia, Pakistan, and Sri Lanka—the former are small (set periodically by the Ministry of Economy and Finance) and the latter two are set by national finance commissions. Bangladesh makes limited use of unconditional transfers.

**Table 2: Shared Taxes and Intergovernmental Transfers**

	Shared Taxes	Unconditional Transfers	Conditional Transfers
Bangladesh	No major individually shared taxes	Annual Development Program Block grant is a modest program based on a formula	Most transfers are earmarked for salaries, ministry activities, and development projects (including aid)
Cambodia	No major individually shared taxes	Formula-based commune and district block transfers; low share of national revenues; system evolving	Provinces receive line ministry allocations, not transfers; conditional transfers allowed but not widely used
India	Limited individual tax sharing (state to local varies); shared goods and services tax under development	Federal government shares with states by formula a large revenue pool; state finance commissions allocate lower levels; federal transfers to locals go through states	Conditional transfers have been growing (most from ministries, some through major schemes); allocated in various ways; use of performance-based grants is on the rise
Indonesia	Selected taxes/ state-owned enterprise revenues shared with subnational levels	Formula-based <i>Dana Alokasi Umum</i> revenue sharing accounts by law for at least 26% of domestic revenues	<i>Dana Alokasi Khusus</i> initially limited, but funding has grown, with required matching and performance conditions
Pakistan	2.5% of general sales tax; provincial tax piggybacking allowed	Provinces rely on unconditional transfers; some provinces (e.g., Punjab) make transfers to districts	Ad hoc federal and provincial grants are earmarked for local recurrent and capital spending
Philippines	National wealth composite (national revenues from certain bases) and tobacco excise tax shared	Internal Revenue Allotment (>90% of transfers) allocates by formula 40% of internal revenues: 23% each to provinces and cities, 34% to municipalities, 20% to <i>barangays</i>	Minor categorical but not highly conditional grants, including the Municipal Development Fund, the Local Government Empowerment Fund, and the Calamity Fund
Sri Lanka	No major individually shared taxes	Finance Commission allocates ad hoc grants to local bodies	Earmarked central transfers fund local salaries
Viet Nam	Some taxes shared fully (e.g., natural resource); others (e.g., VAT) partly	Equalization transfer funds jurisdictions if expenditures based on minimum standards exceed resources from shared taxes	Resources once provided through sectoral budget allocations (through unified budget system) now provided as conditional transfers

VAT = value added tax.

Source: References listed in footnote 10.

Conditional transfers are particularly important in Bangladesh and essential for certain purposes in other countries (e.g., local salaries in Sri Lanka). In countries with large unconditional transfers, such as Indonesia and the Philippines, conditional transfer programs are much less prominent, although they have been growing in importance, increasingly in the form of performance-based grants. In most other countries, conditional transfers are not major instruments or are used on a more ad hoc basis. Clearly, intergovernmental transfers are the revenue backbone of the systems covered here, but they are used in diverse ways. Degree of conditionality, rules by which transfer pools are determined and allocated, and provisions for sharing among different lower levels have strong implications for the ability of and incentives for local governments to meet their functional obligations and promote development in their territories.

### **3.5 Subnational Government Autonomy**

The operational autonomy allowed to subnational (especially local) governments, which is central to mainstream theory, is mixed in the countries covered here (Table 3). In some cases, local governments primarily implement centrally planned and financed activities with limited latitude for local influence. Yet the degree of central government involvement varies, and in some cases local actors have considerable legal power. In Indonesia and the Philippines, for example, local governments have high autonomy over a large portfolio. In Cambodia only the lowest tier has established budget autonomy, and only for limited purposes and with few funds. In a number of countries, such as Pakistan, Sri Lanka, and Viet Nam, regional governments have some powers and also determine and manage what lower tiers do.

In several countries, including Cambodia, Indonesia, and the Philippines, there are, at least at certain levels, dedicated local budgets. In Viet Nam, local budgets are embedded in a unified national budget. The implications of these different arrangements, however, are not unambiguous. In Indonesia and the Philippines, for example, oversight mechanisms, conditional transfers, and central involvement in local functions have grown in recent years, somewhat constraining local autonomy. Similarly, although Viet Nam has a unified budget, subnational governments have increasingly been allowed more discretion. There is also asymmetric treatment in some countries, e.g., regional or urban governments enjoy greater *de jure* or *de facto* discretion than other tiers.

Regarding subnational civil service, local administrative and technical personnel in Bangladesh and Cambodia are largely appointed by central governments or are under central management, and provinces play this role in Sri Lanka. If local governments must answer to their constituents for fiscal performance but cannot control staff who deliver services, the nature and strength of local accountability may be weakened. In other countries, such as India, Indonesia, Pakistan, and the Philippines, local governments have some hiring discretion. Yet local staff management is typically subject to national (in India and Pakistan, state or provincial) regulation and avenues for higher-level intervention.

As already noted above, local revenue autonomy is relatively limited. Subnational governments are assigned revenue sources, especially in Indonesia and the Philippines, but yields are often well below potential. With a few exceptions, local authority over revenue bases or rates is weak. Feeble revenue generation may weaken both performance and accountability relationships between local governments and their constituents.

**Table 3: Subnational Autonomy: Budgeting, Staffing, and Revenue Generation**

	<b>Budgeting and Expenditure Control</b>	<b>Human Resource Management</b>	<b>Revenue Generation</b>
Bangladesh	Central ministry funding dominates; many transfers not transparent or unreliable	Most hiring requires central approval and many local staff report to central ministries	Municipalities set (with central approval) rates or charges as per national guidelines
Cambodia	Communes prepare budget; district and provincial budgets getting more autonomous	Commune councils have few staff; financed/appointed by central ministries.	Communes may legally levy certain revenues, but details require follow-up laws
India	States regulate local budgets but some flexibility if not indebted	State public service commissions regulate hiring; local autonomy varies by state	Revenue autonomy is narrow and faces other regulatory and political constraints
Indonesia	Originally autonomy, with higher-level legal review; now increased oversight	National regulations allow discretion; Law 32/2004 expanded oversight of hiring	Comparatively good, but restrictions and not always used by local governments
Pakistan	Districts may form their own budgets following district government budgeting rules	District and <i>tehsil</i> governments hire staff as per formal provincial guidelines	Some discretion; city districts and <i>tehsils</i> set property rates under guidelines
Philippines	Local governments prepare budgets with legality review by the next-higher level	National civil service regulations allow meaningful local discretion	National guidelines allow nontrivial local government revenue discretion
Sri Lanka	Some discretion in local budget but technical capacity often limited	Provinces hire local staff and influence HRM; center appoints provincial chief	Local governments have highly constrained revenue autonomy
Viet Nam	Unified budget; cities/provinces have more discretion; provinces oversee local budgets	All staff under national civil service; local staff selected locally with higher approval	Most revenue shared, not independent; provinces have more discretion

Source: References listed in footnote 10.

### 3.6 Subnational Government Accountability

Some political decentralization has been adopted in the countries covered here (Table 4), with elections at all or most subnational levels. Subnational council and assembly elections are generally direct (except Cambodia). Most countries have a multiparty electoral system, although its practical relevance varies. In Cambodia, local competition is curtailed by the influence of a dominant national party, the Cambodia People's Party (CPP). In Indonesia, Pakistan, and Sri Lanka, some political parties are ethnically or religiously based. In Viet Nam, the Vietnamese Communist Party (VCP) oversees nominations, but some competition is derived from rivalry among party factions. The different experiences offer varying and uncertain degrees of citizen influence in choosing local representatives.

Local elections are fundamental in devolved systems but they are a relatively blunt instrument of accountability and require supplementation. Most countries covered here (except Cambodia and the Philippines) have passed right-to-information laws to improve transparency. There are, however, sometimes exclusions, and laws may not be strongly promoted or embraced. Other measures to foster local accountability include processes that give citizens a way to engage in subnational decision making.

**Table 4: Subnational Accountability: Elections, Competition, and Participation**

	<b>Elections</b>	<b>Political Competition</b>	<b>Civic Participation</b>
Bangladesh	Elections at <i>upazila</i> , union, <i>pourashava</i> , and city, not <i>zila</i>	Two dominant parties, but others participate in elections	Ward committees represent citizen interests, handle requests, and accept feedback (non-binding)
Cambodia	Direct commune elections; higher levels indirectly elected	Officially multiparty, but competition limited by dominant CPP	Open planning forum; open council meetings and councils required to respond to comments
India	Elections in <i>panchayati raj</i> in states exceeding 2 million population	Many parties but variation by state; some council members are nominated	Participation encouraged but use uneven; some feedback means, including civil society
Indonesia	Elections for local and provincial assemblies occur every 5 years	Many parties compete; some parties are national, others regional	Citizen input is required but uneven in practice; also some surveys and feedback mechanisms
Pakistan	Regular provincial/local elections required under new system	Multiparty competition robust; some parties linked to tribes or clans	Citizen consultation mandated prior to budget passage, but generally limited; some feedback means
Philippines	Directly elected councils at all levels; size varies by population and type (province, city, etc.)	Competitive multiparty system, but parties are relatively weak; dynastic politics are important	Participation mechanisms are used but uneven in practice; provision for citizen charters, report cards, etc. taking root
Sri Lanka	Councils are directly elected at provincial, municipal, and village levels	Multiple political parties (often an ethnic/religious basis); national parties control local nominations	Citizens may submit requests and input for planning and budgeting; center adopted a citizen charter to collect and address grievances
Viet Nam	Local direct elections at all levels, but candidates vetted by the VCP.	VCP dominates but pluralistic (internal factional competition)	Participation adopted for 2006–2010 plan; some provinces are promoting local participation and feedback

VCP = Vietnamese Communist Party; CPP = Cambodia People's Party.

Source: References listed in footnote 10.

Some participatory mechanisms target initial steps (such as providing inputs into plan and budget priorities in Cambodia) while others allow citizens to comment on plans and budgets prepared by local governments (as in Pakistan). Feedback on subnational government performance—complaint bureaus, citizen surveys, and other measures—are also used, at least in limited ways, in most of these countries. Evidence on the impact of participation on local government behavior and performance, however, is limited and mostly anecdotal. It shows positive effects as well as perfunctory or corrupted experiences. Thus, the extent to which such mechanisms meaningfully promote accountable local governance remains an open question.

### 3.7 Summary Comments

Although all countries covered here are technically decentralized and many have at least some features of devolution, there is striking variation in terms of how subnational levels are empowered, the relationships among levels, and the types and quality of accountability mechanisms. Few robust generalizations can be drawn. Casual observation suggests that weak and poorly articulated policy frameworks reduce the

likelihood of effective performance. Even more robust frameworks, however, provide no guarantee that the system will work as designed and produce intended results.

An important limitation of the mainstream approach to decentralization is its inability to explain why an intergovernmental system takes its current form. Without delving more into that question, analysts typically fall back on conventional policy advice that often produces compromised systems and mediocre results. It is time to consider how to transcend the status quo in thinking about this important element of public sector reform.

## 4. NEGLECTED CONSIDERATIONS

The mainstream fiscal decentralization and intergovernmental relations framework and other relevant literature provide useful guidance on how to design and assess relevant systems. The brief review of selected Asian countries above suggests they often do use this knowledge, yet some systems have features that seem inconsistent with core principles. Several considerations beyond the norms of traditional analysis, as suggested above, can help to illuminate the forces behind system design and performance.

### 4.1 National and Intergovernmental Political Dynamics

The mainstream framework is based on the premise that the primary goals of decentralization are to improve service delivery, increase efficiency, promote development, and reduce poverty, among others. In reality, many countries adopt reform more for political reasons than developmental ones.<sup>15</sup> Such efforts can be part of a staged process of comprehensive public sector reform, but they are often responses to political or economic crises that create demands or open doors for change. In the urgency of dealing with crisis, policies may be adopted quickly with insufficient analysis or consensus.

The importance of political motivations does not mean that economic, social, and other conventional goals are not important in practice—indeed, attaining such results can promote and reinforce political aims that drive reform. It is, however, reasonable to state that in planning immediate measures, the conventional goals of decentralization that often serve as official public justification may take a back seat to political imperatives related to political credibility, conflict mitigation, and power consolidation, among others.

The political forces underlying the evolution and form of decentralization in the countries reviewed in the previous section are powerful and diverse. Since Bangladesh attained independence from Pakistan in 1971, there have been various attempts to decentralize, but the parameters of the system have changed as the political landscape shifted between more and less democratic regimes.<sup>16</sup> When the national government changes, there has been a tendency to create new subnational structures and reverse the outgoing government's reforms as the new party in power seeks to secure a local electoral base. This persistent instability has left local governments on balance fairly weak.

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<sup>15</sup> Examples of broader work on the political economy of decentralization include Bardhan and Mookherjee (2006); Smoke, Gomez, and Peterson (2006); Connerley, Eaton, and Smoke (2010); Altunbas and Thornton (2012); Ojendal and Dellnas (2013); Romeo (2013); Faguet (2014); and Ponce-Rodriguez et al. (2016).

<sup>16</sup> See Fox et al. (2011); Fjeldstad (2014); and Barkat et al. (2015).

As a small, relatively ethnically homogeneous country that has endured significant conflict, Cambodia was long centralized with hierarchical administration. Decentralization was first pursued as a political strategy by the Cambodian People's Party (CPP) under Hun Sen in 2001 when the party's national dominance was perceived to be under threat.<sup>17</sup> Experts advised starting reform at higher levels, but CPP began with lower-tier communes to consolidate support at the grassroots level (its core base) while avoiding urban areas (where opposition was strong). Furthermore, only minor resources were allocated, alleviating perceived threats to the power of central ministries and provincial governors. When CPP dominance was again challenged as new elections approached in 2008, reform was expanded upward to district, provincial, and municipal levels. Political realities, however, led to defining a system with heavy central oversight and control.

The intergovernmental system in India is a product of its long history and reflects traditional governance as well as colonial and post-independence political and institutional dynamics.<sup>18</sup> Contextual realities led to power sharing in a federal system, constraining what the federal government can do to push state governments to empower lower levels (if it were so inclined). Constitutional amendments in the 1990s did provide a framework for stronger substate governments, but necessarily left definition of specifics to the states. Thus, the political dynamics in each state determine the extent to which local bodies are empowered. On balance, there has been more willingness to promote political relative to administrative or fiscal decentralization.

Powerful political realities also shaped Indonesian decentralization. After independence, a strong center was created to build national unity in the ethnically diverse country.<sup>19</sup> Deconcentration established provinces as national agents—local governments were not elected and accountability was upward. When the Suharto regime succumbed to the 1990s Asian economic crisis, a proposed antidote to centralized crony capitalism was devolution. Reform, however, mainly empowered local governments given concerns that strong provinces with elected governments could fuel conflict, federalism, or separatism. Although there have been attempts to rebalance the system to some extent, local governments remain the main empowered level of the subnational government system.

Pakistan has cycled between military regimes and civilian governments since independence. Local government empowerment was largely promoted by the military to build local support. Civilian regimes, in contrast, have generally seen local governments as competitors for political space and have instead favored stronger provinces.<sup>20</sup> The current federal system has strengthened provinces and placed local governments largely under their control. The intergovernmental system uses a mix of institutions responsible for public functions including local governments, deconcentrated administrative units, and provincial governments, but the power lies substantially with the higher tiers.

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<sup>17</sup> See Blunt and Turner (2005); Smoke and Morrison (2011); and Ojendal and Kim (2013).

<sup>18</sup> See Rao and Bird (2010); Kaliappa and Otsuka (2012); Mathur (2014); World Bank (2014); Murthy and Mahin (2015); and Venketesu (2016).

<sup>19</sup> See Alm et al. (2004); Eckhardt (2008); Lewis (2010); Decentralization Support Facility (2012); and Holzhacker et al. 2016.

<sup>20</sup> See Khattak et al. (2010); Musarrat and Azhar (2012); Shah (2010, 2012); and Cheema et al. (2014).

Another large and diverse country, the Philippines had subnational administration during the colonial period, and this continued after independence.<sup>21</sup> During the Marcos era, policies promoted improved subnational administrations that were heavily managed by the center. After Marcos fell in 1986, a consensus arose to reestablish democracy, and the new Constitution promoted decentralization, local autonomy, and civic participation. The system that emerged resulted from hotly debated political compromises, including pleasing municipal mayors by empowering them, limiting provincial finances to constrain electoral competition from provincial governors, and creating a (recently abolished) constituency development fund that gave members of Congress resources to provide local projects that often infringed on local government functions, among others. As in Indonesia, there have been attempts to rebalance power, but local governments remain its anchor.

Sri Lanka's decentralization of central power to subnational provincial governments was primarily pursued to mitigate the considerable ethnic conflict between the Tamil minority in the north and the Sinhalese majority residing elsewhere, although achieving balanced regional growth was also cited as a factor.<sup>22</sup> Local governments are firmly under the provinces, and power overall remains fairly centralized, with the central government executing or overseeing many functions officially intended to be more significantly managed at the provincial and local levels. The direction of the new government that came to power in 2015 with respect to decentralization remains unclear, with mixed signals.

Local administrations in Viet Nam are hierarchical arms of the central state in a unitary system dominated by the Vietnamese Communist Party (VCP).<sup>23</sup> At the same time, demands of economic reform (including better services) and a need to reinforce political legitimacy created a situation in which provinces, and to a lesser extent districts, have since the mid-1980s benefited from more autonomy. Some analysts portray the VCP as functionally pluralist, such that factions compete for power, wealth, and autonomy for their jurisdictions. This has led to a form of *de facto* political decentralization, which has been gradually reinforced by formal policies that are empowering subnational actors.

In short, national politics substantially shape the structure of intergovernmental systems and decentralization policy. Political considerations can influence which levels are empowered, the extent of subnational autonomy, and the process and support structures through which reforms occur on the ground. Stronger decentralization often reflects a need to build political support or to reduce ethnic or other conflicts, while reluctance may reflect an aversion of central actors to ceding functions and resources to lower levels. Thus, those seeking to rebalance the intergovernmental system and support decentralization reform need to be aware of historical and political influences, so as to better understand if, how, and where there might be national political space to do so.

A final critical point is that the dynamics underlying decentralization are not fixed. Some countries have cycled between more and less decentralization and modified its form. Even without formal policy changes, reform can stall or be reversed through official or informal government actions. Situations can change rapidly in unstable or competitive political environments or if a crisis abates or a new one emerges, producing incentives to shift course by recentralizing or decentralizing (or appearing to do so). In some cases, even with no major changes in core political conditions, key central actors may

<sup>21</sup> See Hutchcroft (2004); Capuno (2007); Matsuda (2011); and Yilmaz and Venugopal (2013).

<sup>22</sup> See Herath (2009); Leitan and Tressie (2010); Liyanahetti (2012); and Gunawardena (2013).

<sup>23</sup> See Kolko (2004); Malesky (2004); Nguyen–Hoang and Schroeder (2010); and World Bank (2015b).

challenge implementation of formally adopted reform. Such actors may not value decentralization or may over time develop active resistance if they decide reform is detrimental to them. These latter dynamics often emerge in the response of government agencies to political decisions to decentralize, to which we now turn.

## 4.2 Central Government Bureaucracy

National political economy dynamics may determine the main goals and the basic characteristics of intergovernmental relations, but the detailed efforts involved in designing and executing reforms is managed by often diverse central agencies. These agencies, however, rarely have common perspectives on subnational governments, leading to potentially great divergence in visions about how the system should function and the nature and extent of their role, even if a strong national mandate seems to be in place.

A range of national actors typically plays a part in determining, executing, and overseeing reforms.<sup>24</sup> There is usually an agency in charge of subnational government, such as a ministry of local government or interior. Various agencies are often charged with specific elements of public management, such as finance, civil service, planning, etc. Such actors are often wary of subnational autonomy. Finally, sectoral bodies—for agriculture, education, health, water, etc.—tend to focus more on service delivery than on supporting decentralization. Any of these actors may obstruct or delay local empowerment, sometimes with good intentions but sometimes as a matter of pure self-interest.

Given this diverse cast of characters, some interagency means of managing reform is needed, but this has been elusive.<sup>25</sup> Without coordination or well-constructed incentives for national agencies to meet individual obligations and to work harmoniously, they often function at cross-purposes and develop inconsistent policies. For example, a local government ministry policy may empower local governments, while a finance or a sectoral ministry may adopt policies that reduce the discretion of local governments over functions for which they are legally accountable to constituents.

Situations along these lines are common, and some examples were suggested above. In Bangladesh, Pakistan, and Sri Lanka, for example, use of conditional transfers (for budgeting and/or staffing) has been prominent. There may also be turf wars between ministries, especially if roles are unclearly specified. In Cambodia and Indonesia, for example, competing local financial regulations were separately issued by the ministries in charge of finance and local government.<sup>26</sup> There can even be battles within ministries, as there was between different directorates in the Indonesian Ministry of Finance during debates over the (eventually accomplished) devolution of the property tax and the (still in process) development of an improved subnational borrowing framework.

National ministries may even engage directly in providing locally assigned functions, as, for example, in the Philippines. Central actors may also empower special districts, parastatals, or private actors to manage legally devolved services. Such measures may be justified—the need to balance national and local objectives, to maintain standards, etc. were noted above. Even if justified, it is important to understand the consistency of

<sup>24</sup> Various aspects of the bureaucratic dynamics surrounding decentralization are elaborated in Tendler (1997); Litvack, Ahmad, and Bird (1998); Smoke (2007); and Eaton, Kaiser, and Smoke (2011).

<sup>25</sup> Eaton, Kaiser, and Smoke (2011) discuss coordination approaches.

<sup>26</sup> Eaton, Kaiser, and Smoke (2011) discuss these examples, with which the author has a personal familiarity.

such efforts with the formal framework, how decisions are made (criteria based or arbitrary), and whether there is sufficient coordination to limit policy incoherence that may harm the overall fiscal system.<sup>27</sup>

Another consideration is the actions of international donor agencies as supporters of government agencies, particularly in aid-dependent countries.<sup>28</sup> Donors may privilege their own priorities and accountability systems, even creating parallel mechanisms. This can damage unified system development and burden counterpart governments. Despite public claims to promote alignment and build institutions, such initiatives are challenging and time consuming, a risky combination for donors in the prevailing development assistance climate, which privileges documenting positive results more than developing improved systems and processes.

Equally important, donors, like government agencies, have diverse priorities. A donor committed to decentralization may not prioritize service delivery. A finance ministry concerned with overall public resource use will prioritize central oversight over subnational autonomy. Sectoral agencies tend to privilege service delivery, valuing decentralization only insofar as it promotes their goals. Some donors may even prefer to bypass local governments in favor of community or private sector empowerment. If donors seek out country agencies that share their views, they can reinforce the type of government policy inconsistency noted above. For example, one donor may assist a local government ministry working to support devolved health as per a decentralization law, while another may support a health ministry with a tendency toward a more centralizing approach.<sup>29</sup>

Such situations cannot be completely avoided—governments and donors are not homogeneous entities. They can have different priorities, and indeed they are supposed to do so. Finance or health ministry reforms supported by like-minded donors may even appropriately rebalance intergovernmental relationships when decentralization has gone too far.<sup>30</sup> Still, it is important to be aware of the potential for such behavior and how it might affect the organization, financing, and sustainability of public sector action.

### 4.3 Local Political Dynamics

Although not the core concern of this paper, how subnational governments ultimately use any powers and resources they are given under decentralization and intergovernmental reform substantially depends on the structure of local political power. Available empirical evidence is limited, conflicting, and hard to interpret; there is general recognition that conducive conditions can support decentralization benefits, but elite capture, patronage, corruption, etc. are also possible.

Accountability mechanisms in place at the local level affect how these dynamics play out.<sup>31</sup> Fiscal decentralization theory assumes a means for citizens to discipline how local governments raise and use public resources, but it says little about the details.

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<sup>27</sup> The political economy of decentralization and public sector reform is discussed in Eaton, Kaiser, and Smoke (2011). Green (2005) and Fedelino and Smoke (2013), respectively, considered civil service and public financial management reform in the larger context of public sector reform.

<sup>28</sup> A review of donor behavior related to decentralization is summarized in Development Partner Working Group (2011), Smoke and Winters (2011), and Dickovick (2014).

<sup>29</sup> See Eaton, Kaiser, and Smoke (2011) and Development Partner Working Group (2011) for examples.

<sup>30</sup> Dickovick (2011) and Smoke (2013b) examined cases of recentralization and stalled decentralization.

<sup>31</sup> Yilmaz et al. (2010), Grindle (2013), and Ribot (2013) reviewed accountability from various perspectives.

The democratic decentralization literature posits fair elections as the most fundamental requirement.<sup>32</sup> As illustrated above, the experience of subnational elections in Asia is diverse. Elections are conducted, but not always at all levels or at the most empowered levels. Electoral competition varies, and higher-level actions, as noted above, can constrain local government discretion, leading citizens to feel disempowered and to disengage from local politics. Such a situation can undermine even cutting-edge fiscal decentralization reforms.

Whatever the local political economy dynamics, elections are a lumpy local accountability tool. Other accountability mechanisms—participatory planning and budgeting, public meetings, complaint mechanisms, report cards, etc.—are often used to lay a foundation for better use of subnational government powers and functions.<sup>33</sup> At the same time, even well-designed mechanisms are often technical and perfunctory. If not sufficiently inclusive, if rigged by local elites, if results are ignored, or if the public does not embrace them (or fears using them), they are unlikely to improve local fiscal behavior.

As if the intricacy of subnational government institutions and politics was not perplexing enough, another factor in many countries is the convoluted array of other local actors. Deconcentrated agencies may exist in parallel with local governments, with both involved in the same services in the same locations. Other mechanisms, such as constituency or community development funds, may also finance other actors to perform local government functions. If multiple uncoordinated actors with distinct sources of funding are competing for public functions in a locality, citizens may be puzzled about what to hold their elected local governments accountable for, weakening decentralization.

## 4.4 Implementation

The decentralization and intergovernmental relations literature privileges system design consistent with mainstream principles. Although systems must be adequately designed, even a normatively flawless system must be operationalized, and in a way that reflects political economy realities and other more commonly acknowledged constraints, such as resource and capacity deficiencies. Recently there has been growing interest in thinking about how to implement and sequence decentralization in a sustainable way.<sup>34</sup>

A central concern is the complexity of reform and the need for multiple elements of the intergovernmental system to work together. This includes the various dimensions of the system (administrative, fiscal, and political) as well as the functional components of operations (civil service, planning, financial management, service delivery, etc.). There may be an urgent political logic to hold local elections or give resources to local areas quickly, but poorly empowering elected councils or developing a strong fiscal system when staffing and accountability channels are weak are not likely to support developmental or governance goals. Thus, there is a need to recognize and incorporate to the extent possible the interdependency of inherently linked dimensions and components.

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<sup>32</sup> Local elections are reviewed in Bland (2010) with a more formal empirical assessment in Ponce-Rodriguez et al. (2016).

<sup>33</sup> Boulding and Wampler (2010), Brinkerhoff and Azfar (2010), Blair (2013), and Cheema (2013) provide useful reviews of citizen engagement mechanisms.

<sup>34</sup> Approaching decentralization implementation is considered in various ways by Shah and Thompson (2004), Falleti (2005), Bahl and Martinez-Vazquez (2006), Ebel and Weist (2006), Bahl and Bird (2008), Smoke (2010, 2014), Martinez-Vazquez and Vaillancourt (2011), and Olum (2014).

Another often-underappreciated factor is the stark asymmetry of subnational governments in many countries. Decentralization reforms tend to be fairly standardized. There is often differential treatment of specific classes of government—provinces versus local governments, or urban versus rural governments, for example—but all entities within an individual category are not likely to be similarly capacitated or proven performers. Thus, giving all of them the same powers and functions concurrently is questionable policy.

Perhaps most critically, the structural and operational changes involved in reform often require major shifts in the attitudes and behaviors of all actors. Central agencies—perhaps against their instincts and perceived interests—need to cede powers and convert their role from managing and controlling to monitoring and facilitating. Local governments must perform new functions and work cooperatively (with peers and at other levels); local staff and elected officials must (under devolution) work together; and local officials (elected and appointed) must interact with constituents. Citizens must grasp their rights and duties and hold local governments to account. Donors, particularly in aid-dependent countries, need to collaborate with each other and support country systems and policies.

These behavioral shifts are politically and institutionally substantial and are unlikely to be realized rapidly or without careful effort. If too many changes are rolled out quickly without measures to influence attitudes, to create incentives, and to develop capacity, reform will be unlikely to take root, offering political validation to anti-decentralization forces. If reform is too slow and produces little visible change, local governments and their constituents will likely become frustrated and lose interest.

In practice, two contrasting approaches frame the range of national approaches to implementation.<sup>35</sup> In the traditional fiscal federalism scenario, a robust national framework is issued, and while technical assistance and training are typically offered, the main onus to comply primarily falls on relevant central and subnational actors. This could be branded as a “sink or swim” approach. On the other extreme, the center manages implementation, such that decentralization of rights and responsibilities outlined in the framework would occur as per central rules and preferences. Under this “paternalistic” approach, the implementation of official decentralization policy is neither automatic nor guaranteed.

Although some form of both is common, neither extreme is likely to be fruitful in most developing countries. The “sink or swim” approach may work for more capacitated provincial or urban governments with active citizens if local governments want power and central actors support this, but those without capacity will be unable to conform. A highly “paternalistic” approach, however, can be counterproductive unless well developed and structured to roll out genuine reforms. If a centrally managed approach is used to hinder capable local governments from assuming their intended roles, or if it is applied in a politicized or inconsistent way, reform is not likely to reap major benefits.

A compromise approach could be asymmetric. Local governments with more capacity can be subject to “sink or swim,” while weaker ones could take on functions more slowly, receiving support as they make progress. Such a “developmental” strategy may have common end points, but the trajectory to realizing them could be partially tailored to local circumstances, with different mixes of empowerment, transfer conditions, and development finance arrangements (e.g., the mix of grants, subsidized loans, and market loans). Critics argue that such an approach can be manipulated and get mired in bureaucracy, and conservative or obstructive managers might slow

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<sup>35</sup> Smoke (2010) discussed these models in more detail.

reform. Still, some alternative approach is worth considering given experience with the dominant options.

Another consideration in developing an implementation strategy is how the central government can use innovative mechanisms to facilitate performance.<sup>36</sup> Conditional transfers may help, although mostly to ensure spending on priority services—there is no guarantee of quality, and conditions can induce undesirable distortions.<sup>37</sup> It is possible, however, to attach performance conditions, ranging from use of specific inputs to service outputs. Experience with sectoral performance-based grants (PBGs) in developing countries, including in sectors like education and health, has produced mixed results.<sup>38</sup> A number of middle-income countries have also adopted sectoral PBGs. India's 13th and 14th Finance Commissions, for example, promote service incentive schemes,<sup>39</sup> and Brazil uses incentives in several sectors, including health. Other Latin American countries have used sectoral PBGs, including Chile (education), Colombia (education, health, water, and sanitation), and Peru (multiple sectors plus local roles in national policies, e.g., nutrition).<sup>40</sup>

A second class of PBGs is broader (non-sector specific, some unconditional). Such PBGs have been used primarily in less developed countries with weaker capacity and in the process of developing or substantially reforming subnational government systems. These have tended to incentivize adoption of new systems and procedures and faithful execution of formal plans and budgets rather than service delivery or other outputs. Such compliance grants have been used in various ways in many lower-income countries in Asia and Africa—Bangladesh, Cambodia, Nepal, Tanzania, and Uganda, among others.<sup>41</sup>

Indonesia recently adopted performance-based conditional transfers (DAK) that reimburse local governments if they realize certain physical output standards, follow procurement guidelines, and comply with environmental and social safeguards.<sup>42</sup> The Philippines developed the Seal of Good Housekeeping and Performance Challenge Fund programs to improve performance.<sup>43</sup> If local governments meet specific good governance criteria under the former, they receive resources under the latter. These programs seem promising, but they are too new to evaluate robustly.

In addition to sectoral, general compliance, and performance-based grants, other mechanisms have been used to incentivize local government performance.<sup>44</sup> Enforceable accountability mechanisms, such as the central government performance contracts with local governments used in Rwanda and other African countries, can be created.<sup>45</sup> There has also been a range of experiences with “tournament-based approaches” that bring formal recognition to local government achievements, such as competitions to reward (financially or otherwise) improved service delivery

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<sup>36</sup> Lewis and Smoke (2012) reviewed the theory and practice of performance incentives.

<sup>37</sup> Conditional transfers are discussed in Morgan and Trinh (2016).

<sup>38</sup> Lewis and Smoke (2012) reviewed some of these experiences.

<sup>39</sup> Government of India 13th and 14th Finance Commission reports (2010, 2015) provide details.

<sup>40</sup> Rojas (2011) discussed the Latin American cases.

<sup>41</sup> Steffensen (2010) provides a review of these grants and experiences in a range of countries.

<sup>42</sup> See Ellis et. al. (2011).

<sup>43</sup> Open Budget Partnership (2013) discussed this case.

<sup>44</sup> Lewis and Smoke (2012) discussed other mechanisms.

<sup>45</sup> Versailles (2012) reviewed the Rwanda experience.

or other accomplishments (adopted in various ways in several countries, including the Philippines).<sup>46</sup>

Any of these approaches may be influenced by political economy and fiscal conditions. The bureaucratic fragmentation discussed above, for example, can be challenging to navigate. If multiple ministries create ad hoc incentives that create inconsistencies in systems or behaviors, problems may result. In a few cases, such as Indonesia, some local governments do not spend funds they receive through large unconditional transfers, which may raise questions about the value of more resources. It should be possible to determine if a local government merits additional funding, but this needs to be framed beyond target behaviors of fragmented individual incentives. Despite these challenges, it seems sensible to look for ways to create productive incentives to facilitate better implementation.

Capacity building is clearly essential for implementation. There has been criticism of the dominant “supply-driven” (by the national government) approach, which emphasizes a mechanical, standardized, and comprehensive approach to teaching skills in a traditional classroom setting.<sup>47</sup> Efforts to promote “demand-driven” (by local governments) and “on-the-job” training are less common, but on the rise. A mixture is likely needed, with both general training and efforts to meet requests for developing skills that users need for immediate purposes. In addition, there have been concerns that capacity building is unduly focused on developing technical skills of government staff. More attention to governance capacity that extends beyond civil servants to local legislators and citizens might be beneficial, and capacity building can be tied to implementation strategies by progressively targeting the development of capacities needed to improve performance as decentralization rolls out.

Finally, beyond national approaches, a local implementation strategy is also important, but would have to be framed somewhat differently. Given the demanding nature of reforms, even higher-capacity subnational governments will have to think strategically about taking steps that involve major modifications to how they do business. Modest and more politically feasible reforms could set the stage for rolling out more difficult or contentious steps in particular jurisdictions. New approaches and processes could be used experimentally and adjusted prior to full adoption. A local strategy will, of course, have to reflect the national strategy, and some type of criteria-based negotiation between central and local actors may increase the chances of successful reform.

## **5. CONCLUDING THOUGHTS: MOVING BEYOND THE MAINSTREAM APPROACH**

Central governments in developing countries often respect—if selectively and imperfectly—mainstream decentralization and intergovernmental relations principles in crafting formal frameworks and policies. These principles are rather general, so there is some space to take liberty in applying them. Such flexibility is welcome because the contexts in which they are being used vary greatly. Yet the actual intergovernmental fiscal systems that emerge often seem to exhibit problematic features, and the high expectations placed on results are often unsatisfied.

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<sup>46</sup> Zinnes (2009) provides a review of tournament-based approaches and assesses some cases.

<sup>47</sup> Capacity building in the context of human resource management in decentralizing environments is reviewed in Green (2005).

## 5.1 Recapping Dimensions of Expanded Thinking

The mainstream framework itself can explain some of the divergence between theory and practice since there are recognized trade-offs involved in applying its principles. There are also assumptions (some implicit) regarding requirements for effective systems that underlie mainstream theory but are not dealt with by it in any depth—rule of law, local political mechanisms, transparency, and minimum capacity, among others. The extent to which these conditions are met can help to explain whether systems produce expected results. The premise here, however, is that other underexplored factors also need to be considered in applying the principles and interpreting the findings from such analysis.

### Institutional Diversity

The role of context is widely recognized, but much of the literature treats it superficially. Basic fiscal federalism is framed in terms of a broad central–local distinction. Later work recognizes intermediate tiers and the centrality of states in federal systems but does not capture the intricately layered and interlinked institutional landscape that often exists. Although most observed power-sharing arrangements are not necessarily right or wrong, the operation and performance of local governments must be interpreted in terms of the larger framework and the formal and informal interactions among multiple actors.

### Policy Fragmentation

A related concern is how to integrate components of the subnational system (administrative, fiscal, political). Many reforms separately deal with individual components based on relatively narrow concerns. This may result, for example, in strong fiscal powers that are not subject to local political and administrative discipline, or elections for local councils that are not adequately empowered or resourced. If synergies are not adequately recognized and incorporated, individual efforts that seem well designed may disappoint. In the fiscal arena alone, poor harmonization among revenues—own source, transfers, and borrowing—can create perverse incentives and inhibit performance.

### National Political Economy Dynamics

Intergovernmental reforms are seldom pursued mainly to achieve developmental outcomes valued by normative approaches. Although such goals may provide the official rationale for reform, underlying drivers tend to be more political—consolidating power, responding to crisis, competing with emerging opposition, etc. The primacy of such objectives may lead to selective or superficial use of core design principles and outright violations—devolving functions to an “inappropriate” level, retaining local functions at higher levels, etc. Understanding why certain design features are chosen—and if nonadherence to norms is justifiable—is essential. Policy analysts typically push for adopting “technically superior” alternatives, but these may be infeasible. There is rarely anything reformers can do to influence dominant underlying forces; they can only be more aware of them and look for the best opportunities for productive reform within prevailing constraints.

## **National Bureaucratic Behavior**

Some of the most problematic dynamics surrounding intergovernmental relations unfold in the national bureaucracy. Agencies with different perspectives usually dominate the detailed definition of various elements of new systems and procedures. How they behave (formally or informally) in managing implementation is critical. Uncoordinated central policies produced under institutional fragmentation are often reinforced by international donors pushing their own agendas. The policy inconsistencies that emerge can collectively inhibit the performance potential of subnational governments. Thus, it is critical for reformers and external actors to understand the interests and activities of key central actors and seek ways to limit policies that push the system in divergent directions.

## **Local Political Economy Dynamics**

Even if official policies are faithful to best principles, coordinated, and enjoy strong national support, local political economy dynamics can affect implementation. The nature of local economic and social relations, the quality of accountability processes, relations between elected officials and staff, the extent of nondemocratic practices (patronage, corruption, etc.), the strength of civil society, and many other local contextual features affect whether subnational and intergovernmental systems can operate effectively. Factors may also vary within countries. If challenges are determined, there may be opportunities to alleviate the effects of negative local dynamics and build on what is positive.

## **Implementation**

There is growing awareness that effort is needed to devise more strategic approaches to implementation. Reform that is too swift and deep may stretch subnational government competencies and jeopardize central bureaucratic acceptance, but overly sluggish efforts could dishearten supporters and encourage centralizing reactions. If there is to be more strategic implementation, the first step is to be clear on priority goals and how they relate to underlying political economy and other contextual realities. Of course, this is always done in any reform effort to some degree, but experience suggests the need for more systematic and robust analysis in assessing what is desired and feasible.

Once there is some clarity, the next step is to look for appropriate starting points in the reform trajectory. Preferred options would offer a reasonable probability of success but be meaningful enough to visibly signal change. Asymmetric starting points can be constructive. It may help to negotiate—around principles and guidelines that promote consistency and fairness—individualized starting points and reform steps with subnational governments, placing direct responsibility on them for what they agree to do. Reform steps could be linked to central initiatives to develop capacity (with the caveats noted above) and provide incentives to improve performance progressively. Means to motivate local governments could include enforceable accountability mechanisms (such as performance contracts), financial inducements (such as compliance or performance-based grants), and competitions (tournament-based approaches), among others.

## 5.2 Looking Forward

The mainstream approach to fiscal decentralization and intergovernmental relations remains a sound analytical starting point, but it treats only lightly or overlooks certain vital conceptual and practical concerns, and on its own does not provide sufficient operational guidance to policy makers. This paper outlines selected concerns that could help analysts to shape better policies. Although including them is likely to push many specialized researchers and policy makers outside of their comfort zones, that is exactly what is needed. Given the diverse contexts and experiences, working through the complexity may seem overwhelming, but an all-inclusive analysis is not required. The real need is for doing “good enough” assessments that incorporate issues beyond mainstream thinking that matter in a particular case. There is also potential value in adapting strategies as experience generates lessons. Such a reflective and iterative approach is consistent with the broader evolving “doing development differently” literature.<sup>48</sup>

There is a pressing need for multi-methodology research that incorporates neglected perspectives, particularly political economy, into the mainstream. Researchers and policy makers also need to better document and evaluate how implementation strategies and supporting mechanisms have been used. Does more gradual and asymmetric treatment (based on competence and/or performance) of subnational governments improve the prospect of successful and sustainable intergovernmental systems? How can incentives and innovative capacity building support strategic reform? There is encouraging evidence that provides clues to productive avenues for reform, but it is mostly anecdotal. Considerable further investigation is needed to cultivate a fuller understanding of practice and form the basis for workable policy measures.

Additional work is needed to develop the type of approach outlined here and to illustrate its application and potential utility. In the meantime, analysts can do more to deepen their understanding of the context of decentralization. It is feasible to document more systematically relevant national and subnational political and bureaucratic dynamics, and to assess the implications of such analysis for how to pursue more pragmatic, strategic, and sustainable decentralization and intergovernmental relations reforms.

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<sup>48</sup> Examples include Andrews, Pritchett, and Woolcock (2013); Booth and Unsworth (2014); Levy, Fritz, and Ort (2014); and Rocha Menocal (2014).

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