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## Understanding decentralization theory, evidence and method, with a focus on least-developed countries

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Understanding Decentralization  
Theory, Evidence and Method, with a Focus on  
Least-Developed Countries

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# UNDERSTANDING DECENTRALIZATION

## Theory, Evidence and Method, with a Focus on Least-Developed Countries<sup>1</sup>

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January 2021

### Abstract

What is decentralization, what is its underpinning rationale, and why might it matter for least-developed countries? This chapter has two goals: (i) to distill the enormous academic and policy literature on international experiences of decentralization into clear empirical conclusions; and (ii) to derive policy lessons relevant to least-developed countries. It first reviews the different definitions of decentralization employed in the literature before proposing one best suited to countries with the lowest levels of development. It reviews the most important theoretical arguments in favour of decentralization in low-income nations with low levels of human development that are often ethnically and religiously diverse. It then reviews empirical evidence on decentralization's ability to overcome some of the key obstacles holding back such countries' development, before concluding with key questions still to be answered, for which additional research is required.

*Keywords:* decentralization, local government, democracy, accountability, civil conflict, least-developed countries

*JEL:* H41, H75, H77, O1

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## **1. Introduction**

Beginning slowly in the 1960s, but then with gathering speed, decentralization has become one of the broadest movements, and most contentious policy issues, in development. Around the late 1970s it seized the imaginations of policy reformers, and has never really let go (Bardhan and Mookherjee 2006, Faguet 2004a, Manor 1999, Rondinelli 1981, Rondinelli et al. 1983, Ter-Minassian 1997). Many of us who began studying the phenomenon three decades ago assumed that the decentralization wave was cresting across the world. To our surprise, the wave has continued to build and shows no signs yet of subsiding.

A 1999 study by the World Bank estimated that between 80-100% of the world's countries were implementing decentralization in one form or another. This includes not only well-known reforms in developing countries such as Bolivia, India, and South Africa, but also, under the guises of subsidiarity, devolution, and federalism, deep reforms in some of the world's most developed countries and regions, such as the EU, UK, and US. Since then, new or deepening reforms have been announced in more than 35 countries as diverse as South Korea, France, Cambodia, Turkey, Japan and Kenya. It is not just the breadth of reforms across countries that impresses, but also their depth. Campbell (2001) shows that across Latin America, between 10-50% of all central government revenues are now spent by subnational governments. Hence we can summarize that decentralization is happening, or has recently happened, in the vast majority of countries across the globe, with significant effects on these countries' fiscal accounts, and (as we shall see below) on how they are governed.

Worldwide policy experimentation has been accompanied by a huge outpouring of research attempting to ascertain the effects of decentralization on different aspects of economic, political and social development. As we detail below, these studies often find contradictory outcomes across different countries, and even within countries. From the late 1980s onwards, study after study bemoaned the decentralization literature as indeterminate, confusing, and of limited use for reforming policymakers. Policymakers were left little wiser about whether they should pursue reforms, or how they should carry them out if they do. But more recently, more sophisticated empirical approaches have combined with fundamental methodological insights to find a way through this tangle of apparently contradictory evidence.

What relevance does decentralization have for small, least-developed countries with weak state capacity? Many such countries have made tentative steps towards decentralizing that are partial and still incomplete. What role, if any, should further decentralization play in the poorest countries' attempts to improve public sector effectiveness and the provision of local goods and services? The question is particularly important because the larger part of the decentralization literature focuses on middle and high-income countries. This is for understandable reasons: many of the earliest decentralizations happened in such countries, where data are abundant and comparatively high-quality, facilitating empirical study further.

But policy lessons from this literature need, at a minimum, serious translation before being applied to least-developed countries like, for example, Comoros, Haiti or Myanmar. The reasons for that are similarly straightforward. Higher-income countries tend to enjoy stronger tax revenues and higher levels of human capital. These combine to produce governments that are more capable, with more policy options and greater policy flexibility, compared to countries near the bottom of the income distribution. But interestingly, least-developed countries may have stronger traditions of self-government at the local level, especially in rural areas, than more urbanized middle and high-income countries. This may give least-developed countries certain countervailing advantages that well-designed decentralization programs can take advantage of.

In sum, decentralization is not the same at the bottom of the development distribution as it is in the middle or top. The purpose of this chapter is to provide some 'translation' by reviewing theory and international evidence on the ability of decentralization to address state weaknesses in ways that promote human and economic development in least-developed countries. In the sections that follow we first review the various definitions of decentralization that researchers have put forward, and examine the key theoretical arguments in favor of decentralization that are most relevant for least-developed countries. We then outline the methodological advances that have allowed researchers to put order in this previously confused literature. We use these insights as a lens through which to review international evidence on decentralization's ability to overcome some of the key obstacles holding back a

country's development. We conclude with key questions still to be answered, which require additional research.

## **2. Understanding Decentralization**

What is decentralisation? What is its underpinning rationale? Why might it matter for a least-developed country? This section briefly reviews the most important definitions of decentralization in the academic literature, along with the underlying logic of each, in order to arrive at the most relevant definition. We briefly outline the principal arguments in favour of this kind of reform, which have to do with deepening democracy and improving accountability of public officials to the governed. Lastly, we consider the particular relevance decentralization has for a country like Comoros, Haiti or Myanmar.

The huge scale of policy experimentation with decentralization has provoked an equally huge research literature examining its effects. This includes literally hundreds of published academic papers in peer-reviewed journals; if we add to this rigorous “grey literature” studies conducted by multilateral organizations such as the World Bank, IMF, and IDB, as well as reputable think tanks, NGOs, and government agencies, the number ascends into the many thousands. But attempts to summarize the lessons of this research have left many scholars frustrated. The empirical literature appears to be broadly inconclusive, with many contradictory findings on any specific question of importance, regardless of region or countries’ level of development.

As examples, consider three prominent surveys that sought to summarize the state of knowledge on decentralization. Litvack et al. (1998) found that “one can prove, or disprove, almost any proposition about decentralization by throwing together some set of cases or data.” A follow-on study by Shah, Thompson and Zou (2004), which reviewed 56 newer, more quantitative studies, found that decentralization sometimes improved, but other times worsened, service delivery, corruption, macroeconomic stability, and growth across a large range of countries. Most pessimistically of all, Treisman (2007) found that the empirical literature's results are inconclusive, weak and contradictory. “To date,” he concludes, “there are almost no solidly established, general empirical findings about the consequences of decentralization.” This leaves us in a bizarre paradox: after 50 years of policy experimentation

and hundreds or even thousands of studies, we appeared to know very little about whether decentralization is good or bad for any policy outcome that we care about. And yet enthusiasm for policy reform not only persists but continues to grow.

More recent research has found a way through the empirical and conceptual thicket that has characterized the decentralization literature (Faguet 2014). The solution contains three components: (i) definitional, (ii) empirical, and (iii) conceptual. On the **definitional** side, much of the literature's indeterminacy arises from the word's very different meanings. Slater (1989), Faguet (2012), and others have pointed out that 'decentralization' is polysemic, meaning very different things to different people and in different countries where it has been implemented. A number of studies, particularly from the 1980s, begin by delineating different kinds of decentralization, as if they were different flavors of the same underlying product. The typical taxonomy would include: deconcentration, delegation, devolution, and privatization.

As we shall see below, these distinctions are highly relevant for least-developed countries, and hence it is worth our while to consider them briefly now. *Deconcentration* is when central government shifts personnel, equipment, and offices from the capital city to cities and towns elsewhere in the country. Chains of command, reporting, and accountability, as well as fiscal flows in terms of expenditure and taxation, remain largely unchanged. The main point is to get public officials out of the centre and into the periphery. This can be beneficial when it brings more accurate and detailed information on local needs and conditions to bear on government decision-making. By spreading central government salaries and expenditures more evenly around the country, it can also be politically popular, and may contribute to reducing centre-periphery inequalities.

*Delegation* is when central government shifts managerial responsibilities for certain expenditures or service provision to organizations outside the regular bureaucratic structure, such as quasi-autonomous public agencies. Chains of command, reporting, and accountability are somewhat altered for the services in question, but public officials' incentives continue to point upwards, and the central government monolith may not be overly disturbed.

By contrast, *devolution* (or sometimes 'democratic devolution', see Manor 1999) is a much more fundamental reform. It shifts power and resources from central government

officials to local government officials with independent mandates whom the center cannot control. Its effect is to fundamentally, and accountability for those resources and responsibilities that are decentralized. Instead of the central Ministry of Education being responsible for the operation of the particular primary school, for example, authority over that school passes to an elected local government. Rather than petitioning distant central bureaucrats, parents and other local citizens seeking to improve the school's operation can take their demands to local officials, whose electoral prospects they hold in their hands. The incentives of education-providing officials are thus shifted from upward-pointing towards senior officials in the ministry, to downward-pointing to voters.

Lastly, *privatization* is the divestiture of public functions to the private sector via the sale or transfer of related assets. Is justified on the basis of improved innovation and managerial efficiency, which should result from the reorganization of public services on a for-profit basis. Public goods and services that are privatized are typically subjected to careful regulation, as they may constitute essential services (e.g. health, water) or natural monopolies (e.g. water, electricity). Privatization is the most radical of these four "types of decentralization". Without elaborating further for lack of space, I will simply assert that privatization – while an interesting and important phenomenon in its own right, and certainly worthy of study – is sufficiently different from the other three types that it should not, in my view, be classed as a form of decentralization. It is better understood as one of a menu of additional measures often undertaken alongside decentralization by reformers eager to reduce the size of the central state, rather than as a reform that is analytically comparable to deconcentration or devolution.

The deeper problem with this definitional dissonance is that the literature has often treated these measures as if they were minor variants of the same underlying reform, akin to different flavors of ice cream. But in fact, deconcentration, delegation, devolution, and privatization differ fundamentally in organizational terms. They establish incentives that are fundamentally different from one another, which public officials – being rational – respond to in fundamentally different ways. We should not expect their effects to be similar, and indeed they are not. Studies that compare countries that deconcentrated with others that devolved or delegated are committing a basic methodological error. It is no wonder that their empirical



findings are indeterminate; the studies themselves are confused. Happily, the solution to this problem is straightforward: pick one form of reform and compare only examples of that. This is the first key to making sense of ‘the cacophony of decentralization results’.

Henceforth we define decentralization in a restrictive way that is clear and conceptually discrete, so as to facilitate analytical precision. *Decentralization is the devolution by central (i.e. national) government of specific functions, with all of the administrative, political and economic attributes that these entail, to democratic local (i.e. municipal) governments that are independent of the center within a legally delimited geographic and functional domain.*

With respect to **empirical evidence**, Channa and Faguet (2016) point out that all empirical evidence is not created equal. Studies differ significantly in terms of the sectors they examine, the questions they ask, and the strength of their empirical identification. By classifying empirical results according to these three criteria, the authors show that the evidence does indeed speak with a more unified, less confused voice. Higher quality evidence indicates that decentralization increases technical efficiency across a variety of public services, from student test scores to infant mortality rates. Decentralization also improves preference matching in education, and can do so in health under certain conditions, although the evidence for the latter two is somewhat weaker at this stage.

The third key to making sense of our evidence is **conceptual**. For too long, we have asked the wrong questions of our evidence, along the lines of ‘Is decentralization good or bad for X?’, where X may be any policy output or outcome of interest, such as primary education provision or PISA scores. The problem with this approach is that it assumes decentralization is a relatively simple reform with symmetric effects across different subnational units. This misunderstands the nature of decentralization, which involves the transfer of power and resources to subnational jurisdictions that differ from each other in important ways. We should expect such jurisdictions to behave in ways that are as different to one another as are their underlying characteristics.

Hence the correct answer to the question, ‘Is decentralization good for primary education?’ is ‘Yes, of course it is’. And the correct answer to the question, ‘Is decentralization *bad* for primary education?’, in the same country, under the same decentralization reform, is

‘Yes, of course it is’. In the presence of decentralization, some municipalities will behave in ways that improve primary education outcomes. But other municipalities will behave in ways that worsen it, and many other municipalities will muddle along without great improvement or decay. Such heterogeneity is in the very nature of decentralization; it is built into the reform.

A better class of decentralization research questions admits heterogeneity from the start, and asks ‘Why are the good cases good, and why are the bad cases bad?’. And more importantly, ‘How can we shift the balance of outcomes away from bad realizations, towards good ones?’. To do so is to acknowledge that the outcomes of decentralization are simply the aggregation of hundreds or thousands of local dynamics across a country. Hence to understand the effects of decentralization we must first understand how local government works.

Understanding decentralization in this way highlights the importance it could have for a least-developed country. Consider, for example, Comoros. An ethnically and geographically heterogeneous country composed of distinct island societies, Comoros has – like many low-income countries – a long tradition of informal community self-government, and a central state that is weak and underfunded. Subnational units in Comoros differ significantly from one another in terms of their subjective identities, objective needs, and economic potential. As an archipelago nation, it is ripe for decentralization reform. But its very heterogeneity raises the premium on understanding the different ways in which formal and informal governance operates at the local level in advance of designing further decentralization reform. Done well, decentralization could work with the grain of Comoros’ local governance traditions to improve the quality of public services and public investment in the country. But done badly, decentralization could exacerbate dysfunctions in a troubled democracy.

### **3. The Benefits of Decentralization**

Why might decentralization be a good idea? What are the key opportunities and constraints around which it should be designed to best suit a least-developed country? How might it help a country overcome some of its biggest development challenges? This section examines key arguments in favour of decentralization through the lens of least-developed countries’ typical social and political-economic characteristics. We then review empirical

evidence on the extent to which reform has helped other countries overcome the sorts of obstacles that are holding back such countries' development.

Enthusiasm for decentralization has an enviable pedigree. Arguments about the benefits of devolving authority to subnational units of government stretch at least as far back as Montesquieu (1748) and *The Federalist Papers* (Madison, Hamilton and Jay 1788). The belief that the natural or most advantageous organization of society involves multiple hierarchical tiers goes back much further. Aristotle (350s-340s BC) deconstructed the Greek city-state "into a three-tier hierarchy of households, villages, and the polis, each of which aims at a different good".<sup>3</sup> Building on classical reasoning, Dante (c.1314-20) argued that "Only in a pyramid of different-sized, nested communities could the full multiplicity of human potential be realized all at once".<sup>4</sup>

Modern claims about the advantages (and disadvantages) of decentralization follow this gist but are far more numerous, typically framed in terms of economic and political variables. Although they span a number of disciplines, and use distinct terminologies and catchphrases, we can summarize them as follows. We divide them into arguments for vs. arguments against decentralization. Decentralization can...

*Arguments for*

- i. improve information re: local wants and needs
  - ii. increase citizen voice and participation
  - iii. improve government accountability and responsiveness
  - iv. deepen democracy
  - v. improve the efficiency of government and public services
  - vi. improve economic performance
  - vii. strengthen the liberties of individuals and groups
  - viii. reduce the risk of civil conflict
- } 'Closer to the people'

*Arguments against*

- ix. decrease efficiency in public goods production

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<sup>3</sup> Treisman (2007), pp. 7-8.

<sup>4</sup> Treisman (2007), p. 8.

- x. decrease the quality of policy-making
- xi. increase graft and corruption
- xii. facilitate elite capture of government
- xiii. increase fiscal deficits and hence macroeconomic instability.

### **3.1 Improve democratic accountability and responsiveness**

Arguments (i)-(iv) are tightly intertwined, and can be bundled together as ‘improving democratic accountability and responsiveness’. In my view, these are the most important and powerful of all the arguments concerning decentralization. In various forms and with different language, Mill (1895-61), Montesquieu (1748), Rousseau (1762) and Tocqueville (1835-40) all debated these points. This is what policy advocates refer to when they claim decentralization will take government ‘closer to the people’. The latter is more slogan than argument, although there is an unfortunate tendency in that literature to present it as an argument. The more serious version of Wallis and Oates (1988), widely cited, holds that decentralization makes government more responsive to local needs by “tailoring levels of consumption to the preferences of smaller, more homogeneous groups” (p.5). While this account is descriptively correct, it is analytically insufficient. Why does homogeneity imply responsiveness? Is the fundamental problem one of scale? It is my view that the sources of responsiveness lie deeper, in the incentives that officials face in decentralized vs. centralized government regimes.

The fundamental logic is as follows: By devolving power and authority from upper (usually central) to lower (regional or local) levels of government elected by their respective constituencies, decentralization fundamentally changes the incentives that local authorities face, and thus – not surprisingly – their behavior. (For ease of exposition, all subnational levels of government are henceforth referred to as ‘local’ government.) Under centralization, those who hold authority over local matters are not elected by local citizens but rather *selected* by higher-level authorities, regardless of whether they are physically located locally or in the capital. Immediate accountability for their performance is thus upwards to the central government officials who have power over their salaries, careers and broader professional prospects (Riker 1964). Accountability does not run downwards to the citizens who consume the public goods and services they are meant to produce except at one or more removes, in the

sense that central government officials are ultimately beholden to national electorates. ‘Local’ officials thus face clear, strong incentives to respond to central government priorities and concerns, and weak, muffled incentives to respond to local citizens’ needs.

The most important effect of decentralization is to re-orient these incentives. ‘Local’ officials become local officials, whose tenure and career prospects are in the hands of the local citizens they serve, who elect them. The incentives that govern their performance are no longer received from on high, but rather determined by those most directly affected by what they do. And accountability to local citizens is direct, no longer running through a national administration or various layers of bureaucracy.

This supply effect in the constitution of local authority generates a complementary demand effect. Citizens see the change in local officials’ performance, understand the incentive change that has occurred, and become more involved in local politics. They vote and exercise voice more because both tools are more powerful than before. Elected officials, being largely rational, respond better to citizens’ demands – not just because they ‘should’, but because it is in their interests to do so. The net effect is to shorten and tighten the loop of accountability between those who produce public goods and services and those who consume them.

One of the main points of this paper is that decentralization works – if and when it works – through a fundamental effect on officials’ incentives, and thence on government accountability to the governed. Surprisingly often, both enthusiasts and critics of reform omit this basic point in favor of second and third-order arguments about whether decentralization can increase growth or reduce ethnic conflicts, points to which we return below. Many of these things, such as inflation, the fiscal deficit, and ethnic conflicts and political stability in a nation more broadly, are important, and decentralization may indeed affect them. But it does so via incentives and accountability; there is no direct effect. In the best cases, the new equilibrium that emerges after reform features greater citizen voice and participation and greater government responsiveness. It is one in which democracy has been both deepened and strengthened.

### **3.2 Greater public sector efficiency and faster growth**

Arguments (v) and (vi) are also closely related. The case for decentralization improving public sector efficiency follows directly from greater accountability and responsiveness. A public sector that is more responsive to citizens will tend to produce public goods and services better suited to local conditions and to citizens' needs (Khan, Faguet, Gaukler and Mekasha 2014). Such services will tend to be more effective in terms of solving real problems. More effective public services in areas such as education, transportation, and water and sanitation, will, in turn, better support private sector activity. Private firms will find it easier to operate in such environments, and hence will be more likely to invest. This will lead to better economic performance and higher economic growth.

A separate logical chain posits that by increasing local governments' share of tax revenues, decentralization gives them a larger stake in the performance of the local economy. This motivates local officials to implement policies that support businesses and promote growth for two reasons: (1) economic growth increases local tax receipts and hence officials' freedom of action, and (2) growth increases officials' popularity. The effect is to make local governments compete for mobile capital by reducing public sector waste, inefficiency and corruption, and by providing infrastructure. When this happens nationwide, efficiency rises and the economy grows faster (Brennan and Buchanan 1980, Hayek 1948, Jin, Qian and Weingast 2005, Roland 2000).

### **3.3 Strengthen individual and group liberties**

Scholars from Tocqueville (1835-40) and Hamilton (1769-1804) to Weingast (2014) have argued that in a decentralized or federal system of government, strong, legitimate local governments can protect individual freedoms by checking central government abuses. They can use their resources to resist or counteract specific government actions (e.g. by suing central government, or implementing a countervailing tax or credit), and can threaten the center financially by withholding tax receipts, in defense of their citizens. Diaz-Cayeros (2006) relates how, in late 19<sup>th</sup> and early 20<sup>th</sup> century Brazil, repeated attempts by the center to encroach on state power and independence were resisted using such means plus the credible threat of

violence. In Brazil state-level police forces, especially of Minas Gerais and Sao Paolo, “constituted true armies that could effectively challenge the federal government” (p.211).

As for individuals, so too for ethnic, religious, and other identitarian groups (Faguet 2019). Many developing states were born out of international agreements, often with arbitrarily defined borders based on colonial partition more than internal political factors, with little to hold them together beyond guarantees by the international system (e.g. Jackson and Rosberg 1986, Englebert 2000, Herbst 2001). They exist *de jure* but, unlike European states in which power over a territory and its population generally came first and sovereignty and international recognition followed, many developing countries have not been able to consolidate power in order to achieve the internal consent or territorial reach necessary to exert authority over the entire state (Jackson and Rosberg 1986). This is a fundamental problem facing many African leaders (Herbst 2001, Englebert 2000).

The state may instead be made up of different ethnic groups spread over sometimes vast geographic areas, each with its own customs, language, and culture. A consciousness of common nationality is often lacking. Citizens do not feel represented by the government and perceive that leaders cater mainly to people of their own tribe or region, rather than to all citizens equally. In addition, parallel or rival forms of authority (e.g. traditional chiefs, religious leaders, or drug lords) may supersede the authority of the state (Myrdal 1968).

How might decentralization affect these challenges? First, bringing locally elected subnational leaders from different segments of the country into government, and thus giving representation to people of different groups, may incite parts of the population that formerly felt excluded from the state to feel represented and included (Faguet 2019). Indeed, federal, decentralized institutions have long been recommended as a mechanism to hold together fractured, “multi-national states” (Lijphart 1977; Stepan 2001; Horowitz 2003; Brancati 2004; Zuazo et al. 2012). Where divisions are defined territorially, decentralization is said to promote the formation of multiple but complementary identities where citizens can simultaneously carry both an ethnic identity and a national identity (Stepan 2001). Decentralization can thereby act as a pressure valve for nationalist aspirations. In Canada and Spain, for example, decentralization has been deemed a success in keeping fractious provinces like Quebec and

Catalunya from seceding. In the UK, the devolution of regional powers to the Northern Ireland Assembly was the critical element that made successful peace talks with the Irish Republican Army possible.

But there are also many opposing arguments. Some claim that decentralization will build a federalist mentality, undermining efforts to build national unity and identity. It may even deepen divides between groups and intensify conflict by reinforcing cultural or ethnic identities. Second, decentralization may lead fractious groups to want ever more autonomy. In this vein, former British Prime Minister John Major argued against devolving powers to Scotland, claiming it was “the Trojan horse to independence” that would lead to friction and eventually demands for full independence (Major 1995, quoted in Brancati 2009). With more power and independence, decentralized areas may realize they can manage their affairs better on their own. Decentralization may give subnational leaders experience in governing. Several decentralized regions have seceded after first setting up their own decentralized institutions. South Sudan is one recent example.

The key theoretical issue is whether decentralization will stoke centripetal or centrifugal forces. Opponents of decentralization claim devolving power and resources will empower those who seek secession, and – if they prove reasonably competent – assuage citizens’ ill-formed fear of the unknown by showing them local authorities who provide services and manage public budgets adequately. Proponents claim that the same stimulus – the devolution of power and resources to even secessionist politicians – will generate the opposite response. Like an onion, it will peel away the outer layers of support from such leaders and parties, stripping them of constituents whose demands can be satisfied by more limited measures of autonomy, such as local control over public services, minority language rights, and symbolic goods such as public art and celebration, so isolating the hard secessionist core that seeks full independence from the mass of citizens.

Which side of this argument is correct is not an issue of decentralization per se, but rather depends on the nature of the secessionist impulse and the source of such parties’ and leaders’ appeal. Where groups are distinct, geographically concentrated, and highly mobilized against one another through violence, it may be difficult to imagine continuing cohabitation



within a single nation, barring the comprehensive defeat of one group. But where groups are harder to distinguish, or where they comingle, or where mobilizations are only partial, decentralization may offer the “steam valve” required to satisfy those who actually demand autonomy, not full secession, and hold a nation together.

In practice, the more important factor is likely to be the regional specificity of elite interests. If coherent regional elites (1) exist, and (2) have more to gain from secession (greater control over resources at the cost of lost markets and lost influence) than autonomy (partial control over resources, continued access to national markets and policy-making), then national integrity is in much greater peril. Regional elites will have an incentive to invest in creating conditions propitious to national schism. Beyond funding political parties and campaigns, this may well extend to supporting armed insurgencies and investing in the sorts of violence against civilians that peace talks cannot later reconcile. The recent history of the Balkans richly and sadly illustrates this dynamic.

On the other hand, the evident success of both developed and developing federations that have strong regional identities but much stronger national identities, such as the United States, Germany, India, and Brazil, demonstrates that decentralized government can stitch together diverse countries in ways that lead to neither subnational tyranny nor secession. One of the keys is regionally diverse elite interests. There are undoubtedly powerful elites in California, North Rhine-Westphalia, Uttar Pradesh and Sao Paulo. Any of these would rank as a medium-sized to large independent country in both population and GDP. It would be a perfectly respectable country of important weight in the international system. And yet secession is not seriously debated in any of these places. Why don't these states' elites agitate for secession?

Because their political and economic interests span state boundaries. Business and political leaders in California and Uttar Pradesh have more to lose than to gain from splitting from the other 49 US or 28 Indian states, despite the fact that all of them are smaller. Pulling up the drawbridges would leave elites in North Rhine-Westphalia and Sao Paulo unambiguously in control of a non-trivial country instead of a state. But from their leading positions in these states, elites in all four exert considerable influence over much larger and more important countries. And they have access to considerably larger internal markets, and can influence

international treaties that give them better access to the world economy and a stronger voice in international affairs. They benefit from the unity of a nation they can expect to sway and perhaps even lead. They would lose from its breakup. So they invest in unity, not division.

Interestingly, Stepan (1999) argues that another deciding factor in the ability of federalist states to hold together fractious groups is the timing of elections. When elections are introduced in the subunits of a new federal polity prior to countrywide elections, and in the absence of countrywide parties, the potential for subsequent secession is high compared to when national elections are held first. National elections produce a sense of common nationality whereas subnational elections can generate fractious local parties. Of the nine states that once made up communist Europe, six were unitary and three were federal. Yugoslavia, the USSR, and Czechoslovakia are examples of countries that first held subnational elections prior to national elections, and subsequently broke up into 22 independent states.

Can decentralization be designed in ways that hold fractious groups together rather than promoting secession? Yes – by decentralizing power and authority to a level *below* that of major ethnic, linguistic, or other identity groups. In this way, empowered subnational units will tend not to be identified with group identity or privilege. Rather than stoking divisive tensions, local government will instead become identified with issues of efficiency and service provision. In a country where an ethnic minority is concentrated in one region, decentralizing to the regional level is far more likely, all else equal, to reinforce ethnic divisions and place authority and resources in the hands of those with most to gain from national breakup. Decentralizing to the local level, by contrast, will create many units of any given ethnicity, and most likely others that are mixed. No level of government will be associated with any particular ethnicity, nor with ethnicity per se. Comparisons across local governments will tend to focus more on issues of competence in service provision than identity, revindication, or pride.

Complementary reforms that promote a single internal market for goods and services nationwide can also help by preventing the development of elites with regionally-specific economic interests who might gain from national schism. These would instead be substituted by elites whose assets or historical bases might be in a particular region, but whose economic interests are multiregional, and who therefore have a strong interest in national integrity and

growth. Specific measures such as improved infrastructure and transport links can help bring this about, in addition to facilitating the flow of people and ideas across an economy, so binding it together from the bottom up.

### **3.4 Reduce the risk of conflict and facilitate power-sharing**

The relationship between decentralization and conflict has long been a topic of debate (Green 2008). Arguments overlap significantly with those on self-determination and secession, since the failure to integrate regions and minorities into the state is a key source of conflict. As argued above, decentralization can accommodate diversity by giving territorially concentrated groups the power to make their own decisions about issues that most interest them (Tsebelis 1990; Lijphart 1996). This may diffuse social and political tensions and prevent conflict (Bardhan 2002). Giving groups control may protect them against abuse or neglect from the centre or from one another, which can cause conflict. For instance, if a group is experiencing economic disadvantage, it could be given the power to control its own resources and decide how to allocate resources. If fear of social extinction is the cause of conflict, it could be granted control over issues such as education, religion or culture in order to protect its language and customs (Brancati 2009).

Others take the view that decentralization will instead lead to increased conflict with fractious groups. Roeder and Rothchild (2005), for example, contend that decentralization will give subnational leaders the resources and 'institutional weapons' they need to mobilize the local population and demand more political power from the center, thereby elevating tensions. Subnational leaders may also gain prominence and followers, and subsequently threaten the power of national political elites, again causing conflict. Some note that decentralization has produced local leaders who discriminate against minorities in their own regions (Horowitz 2003; Lijphart 1993). Brancati (2009), for example, points out that allowing parts of northern Nigeria to adopt their own (Sharia) law has aggravated rather than defused tensions between Christians and Muslims, when the Christian minority was forced to comply. This underlines the importance of protecting minority rights, which theorists going back at least as far as the Federalist Papers (Madison, Hamilton and Jay 1788), and including most major contributions

since (see e.g. Dahl 1971 and 1989), have considered critical to the stability and sustainability of democracy as a form of government.

How can decentralization be implemented so as to dampen, and not promote, conflict? Decentralized governments that are responsive to national minorities will drain tensions from the polity. But local governments that become 'little tyrannies', ignoring or oppressing local minorities, will stoke tensions, threatening not just particular governments but the notion of democracy itself. Hence decentralization should be designed with strong local accountability mechanisms that align local leaders' incentives with the will of local citizens and allow voters to hold politicians responsible for their decisions. And central government should enact strong safeguards of minority rights nationwide, to which individuals and groups can appeal in any locality.

In a post-conflict environment, or one where the risk of conflict is high, decentralization can underpin power-sharing arrangements that settle power struggles and stave off violent conflict. This operates by creating or empowering subnational levels of government to which political power and responsibility, and resources, are devolved. In doing so it also creates new fora for political competition, and hence new prizes over which opposing parties can compete. This solves the winner-take-all problem inherent to centralization, where parties in government wield huge central government resources and reap huge rewards, and opposition parties are left to wither. In a federal system, by contrast, opposition parties can still win power over states and local governments (O'Neill 2003), and hence enhanced voice in national debates and opportunities to display competence in government. The penalty of losing national elections is much less steep, and so the temptation to win at any cost greatly lessened. This can help cement the peace in a post-conflict environment.

Decentralization, for instance, has recently been advocated for Iraq and Afghanistan with exactly this in mind (Brinkerhoff and Johnson 2009; Barfield 2011). Green (2011) explains how Ethiopia's decentralization process in the 1990's was part of a civil war settlement that successfully maintained the peace. The country was divided into 11 federal regions. This fragmented the political opposition, creating various new parties that competed against one another for power over the newly created regions, while preventing a return to conflict for

power over central government. Peace was maintained and the government in power at the federal level remained free of coups (and electoral defeat). Such shifts in power arrangements can be used to diffuse power struggles at the top. But in other cases, decentralization may merely shift conflict downward rather than eliminating it altogether. Uganda's government under President Yoweri Museveni implemented a decentralization program in 1986 in order to reduce national-level conflict. While successful in this regard, Green (2008) argues that the ultimate effect was to replace conflict at the top with conflict at the local level.

Can decentralization be designed so as to promote power-sharing? A properly operating decentralized system should naturally lead to the sharing of powers that have been devolved to different subnational levels of government. Few additional reforms are required other than the avoidance of electoral and fiscal distortions. In countries where politics is closed or captured, measures that promote open, competitive local politics will tend towards fairness and power-sharing, and away from capture and conflict. Electoral finance laws that support a level political playing field have particular importance in this regard, as one of the most powerful and prevalent ways in which democracy is distorted is through the flow of money into campaigns. Where political competition is open to new entrants and the playing field is level, elections will tend to be fought over issues of substance to local voters. In such places, political conflict and violence will tend to transform naturally into electoral contestation, which is better for a country.

#### **4. Building a Decentralization Framework for Least-Developed Countries**

How do we allocate powers and responsibilities across hierarchical levels of government? Which levels of government should we design in the first place? And is decentralization relevant not only for medium-sized countries like Myanmar, but also very small countries like Comoros, with a population of less than 1 million? If so, which services and powers, and how many resources, do we devolve to which levels?

These questions are part of a different but closely related literature called fiscal federalism. Fiscal federalism focuses on two interrelated issues: Who taxes and spends? That is, the division of taxing and spending responsibilities amongst levels of government (national,

regional, local, etc.). And what is taxed and spent on? That is, the discretion given to regional and local governments to determine expenditures and revenues.

According to the fiscal federalism literature, public services should be devolved to subnational levels of government when they have the following characteristics:

- Geographic specificity, meaning they are characterized by low externalities, or economic 'spillovers', to other regions or localities;
- Heterogeneous demand, meaning citizens across the country do not prefer the same public good or service – citizens in different locations have different preferences;
- Local information is important for their production, implying that such local information is comparatively expensive or difficult for central government to obtain; and,
- Low economies of scale, meaning it is not more efficient to produce a particular good or service in one, centralized way or location.

The broad principle of government design that fiscal federalism puts forward is the *encompassing principle*, which holds that powers and responsibilities should be assigned to levels of government such that all relevant externalities are encompassed by that level of government. Hence national externalities and public goods, such as national defense or a trunk highway system, are best dealt with by national governments, and local externalities and public goods, such as trash collection and streetlighting, are best dealt with by local governments.

Building on this, one of the crowning achievements of fiscal federalism theory is the *Oates decentralization theorem* (1972). This holds the local government should be responsible for all forms of spending that do not inflict externalities on other jurisdictions. The level and type of such spending can be tailored to the desires of local residents. This is why services like trash collection, street lighting, and fire prevention are particularly well-suited to a high degree of decentralization, i.e. to local government. But it is important to note that actual political jurisdictions across most countries will rarely encompass adequately all the relevant externalities implied by the public goods and services they manage. Hence there will always be a need for intergovernmental cooperation amongst different hierarchical levels to provide a full suite of public services.

How should decentralized tax systems be designed? Fiscal federalism puts forward five basic guidelines for designing revenue systems:

1. Local taxes should be as neutral as possible, such that they do not distort economic behavior;
2. The benefits and costs of local taxes should be clear to citizens;
3. The incidence of local taxes should be equitable across taxpayers;
4. Administration and compliance costs should be kept low, implying that complex taxes should be retained by central tax authorities;
5. Mobile tax bases should be taxed nationally, not locally.

Employing these criteria shows that the most appropriate local taxes for local governments in developing countries are property taxes and user charges. Property has the advantage of being easy to identify and assess, which is not the case for many other classes of assets or economic activity. Further, property values are linked to local prosperity and hence local policy. This provides local governments with an incentive to undertake policies that increase the size of the local economy. It also provides a channel by which local officials are encouraged to be accountable to local taxpayers. User charges include public transport fares, housing and business rents, market fees, and water and heating charges, to name a few. They help defray the costs of providing these services, and help make local officials directly accountable to the users of these services. Some highly developed countries also devolve income taxes and VAT to regional and local governments, although this is much less common in developing countries. The evidence shows that the lowest income countries, such as Haiti, are unable to mobilize much local revenue through property taxes, partly because citizens aren't used to paying them, and partly because in most localities poverty levels are high and property valuations are low.

For countries at any level of development, local taxes are likely to be greatly exceeded by local expenditure needs. This is doubly true for developing countries, and even more true for the lowest income countries. How do we square this circle? The answer is intergovernmental transfers amongst different levels of government. In practice this tends to mean revenue-sharing by central authorities, who have significant advantages in raising taxes that are

complicated or based on mobile assets, with regional and local authorities. Revenue-sharing can take one of two broad forms:

- a. *By formula*, for example on a per capita basis; or
- b. *By origin*, where tax revenues returned to the localities where they originated, e.g. oil and mineral rents, or commercial taxes.

Additionally, central governments typically choose to make grants or subventions that are either:

- c. *Targeted* to support specific expenditures, such as primary education; or
- d. *Untargeted*, for discretionary use by local governments (e.g. block grants).

Targeted grants are typically used to support priorities favored by national government, while untargeted grants allow regions and localities to choose their own priorities. Texturing and block grants generally have two main purposes: vertical and horizontal equalization.

*Vertical equalization* refers to attempts to close the gap between the costs of services devolved to subnational governments, and the revenues they are able to mobilize. *Horizontal equalization* refers to the attempts to close the gap between richer and poor districts' revenues. This is intended to ensure greater equality in public service provision, such that, for example, rich districts do not have much better schools, roads, and water provision than poor districts, thus generating a vicious circle in which wealth begets wealth and poverty begets poverty.

One of the overarching conclusions of the fiscal federalism literature, which would appear to be obvious but is seldom acknowledged and perhaps insufficiently understood, is that decentralization does not do away with the center. Decentralization literature is often portrayed as 'central vs. local'. This is mainly a rhetorical device, and is very far from capturing what actually happens to fiscal flows and public authority in countries that decentralize. The reasons for this flow naturally from our discussion above. Decentralization does not imply getting rid of one level of government in favor of another, but rather an increasing 'complexification' of public service provision in the interest of greater responsiveness, higher-quality, and greater economic efficiency (in addition to a number of potential second-order benefits discussed above).



Decentralizing the provision of education, for example, does not imply that budgets and authority over schools are transferred wholesale to local governments. Rather, it implies a new system in which central, regional, and local governments coordinate and cooperate intimately to mobilize revenues, hire personnel, define curricula, build infrastructure, and supply and maintain schools for the benefit of local children. A decentralized education system is far more complex than a centralized one, and will always involve multiple levels of government. But it is more sensitive, better informed, and more robust, and should produce better results (Faguet 2004a, Faguet and Sánchez 2008, Faguet and Sánchez 2014, Faguet, Khan and Kanth 2020, Khan, Faguet, and Ambel 2017).

## **5. Conclusions: Unanswered Questions**

Our review of decentralization theory and evidence has been able to find a great deal of signal in the noise of this immense literature. But important questions remain unanswered. A number of these are of particular relevance to countries with characteristics similar to Comoros, Haiti, or Myanmar. We conclude with a quick overview of some of the most important of these, sketching out where partial answers exist, and how additional research could build on them.

Perhaps the most pressing question is, How does informal local governance work in the least-developed countries? What are its structures across different regions, communities and ethnic groups? How does it aggregate individual preferences and take collective decisions (Faguet 2004b)? What are its methods of representation, leadership, and accountability? Countries vary greatly in such characteristics. Hence before designing any decentralization program, targeted research is required at country level to connect local institutions and practices with specific aspects of local governance and service provision. This should focus not just on subnational institutional structures, but also on extant social capital (Putnam 1993, Bourdieu 1986), and on how social heterogeneity (Alesina et al. 2003) affects local governance. Three specific questions are of special importance:

- What are the minimum requirements for informal governance systems to work?

- How do informal systems interact with formal systems of local governance, of which we do have a much better understanding (outlined above), to produce good/bad service provision?
- How are key local public services currently being provided, and how could they be provided better?

A broader set of questions are important for low-income developing countries with weak state capacity. Can we have decentralization without democracy? Can local level democracy coexist in the absence of a democratic national government? These are interesting, focused questions that are theoretically complex, for which no clear evidence currently exists. Indeed, the theory of devolution largely presupposes a functioning democracy, at least at some level of effectiveness. Hence decentralization theory is largely about the effects on structures and incentives of devolving resources and power from nationally elected public officials to locally elected ones. Suspending the assumption of national democracy while maintaining an assumption of local democracy is both theoretically and empirically interesting. It is a question with relevance for a number of countries across the globe. And it is a question for which we currently have no clear answers.

A distinct but related question is: Does it make sense to talk about decentralization in the absence of a center? Can decentralization work without a functioning central government or central resources? In the strictest terms, the simple answer is No. Decentralization is defined as the transfer of power and authority from central to subnational governments. If there is no central government, then by definition there can be no decentralization.

But a broader question is both sensible and more interesting: Can a multilayered framework of subnational units make up for at least some of the deficiencies of a weak or absent central state? This question is relevant for a number of post-conflict societies, such as Somalia/Somaliland, or Iraq and its Kurdish regions, where relatively strong and competent regional and local governments have proved capable of mobilizing resources and providing key public services in the aftermath of central state collapse or overthrow. The relevance of this topic could easily be extended to other countries with very weak centers. Is competent

subnational governance in the absence of a functioning central state feasible? Is it sustainable over the long run? More research is needed to answer these questions.

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