Notes on Empirical Evidence
on the Impact of
Decentralization

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Introduction

If we examine the literature on decentralization it is striking how evidence has lagged behind theory. The fact that a large number of countries are involved in some form of decentralization gives rise to the concern that these are “shots in the dark”. In terms of concrete empirical evidence we are not in a good position to answer critical questions such as a decentralized system more efficient than a centralized system. The empirical basis for choosing decentralization over centralization (or vice versa) is thus weak. In these notes I do three things. First I briefly examine the economic and institutional arguments for decentralization debate as a means of identifying the conditions under which decentralization may or may not be successful. This theory makes it clear there is no a priori case for preferring decentralization over centralization. Second, through this analytical lens I then examine the available, mainly case study, evidence on efforts to decentralize the social protection function in different countries. This allows me to classify the decentralization performance of countries according to the extent to which key conditions were met. For the social protection case I find a mixed bag, which is in line with what we would expect from the theory. The conditions under which decentralization occurs seems to be critical in determining the success of experiments with decentralization. In the third part of the notes I offer some thoughts on how empirical evaluation of decentralization episodes can be improved and refined.

Analytical Framework

The modern theory of public finance which incorporates considerations of political economy, institutions and information, provides some initial guideposts on how to compare centralized and decentralized social protection systems. On the whole the arguments for decentralization of provision tend to be more compelling than arguments for decentralization of revenue generation due to the advantages of central government in terms of redistribution, risk-pooling and the stability of revenue. The modern consensus emerging from the literature as regards decentralization of provision may be summarized as follows. In the older models which assume benevolent government the case for decentralization hinges on there being high heterogeneity and limited spillovers (see Oates, 1972; Brown and Oates, 1987). The reasoning behind is simple: preferences and the nature of risks are likely to vary across jurisdictions and decentralization allows citizens to express their preferences over the level and composition of spending. In this context a ‘one size fits all’ allocation with typifies decentralization in these models may not be optimal. In models where allocation is decided via a political process there is an inefficiency associated with bargaining between representatives of different jurisdictions over spending needs (see Besley and Coate, 1998). This implies that the resulting allocation may not reflect local preferences if there is heterogeneity across jurisdictions. This is not a problem in a decentralized system where voters get what the median voter wants in that jurisdiction. Models with political economy thus reemphasize the importance of heterogeneity and spillovers but also highlight the importance of the
political mechanism through which preferences are aggregated and allocation decisions made. They assume that functioning democratic systems of government are in place both at the central and local levels which allows voters preferences to be expressed. This may not be the case. As the analysis by Bardhan and Mookherjee (2000) makes clear corruption and limited accountability imply that citizen preferences are often not reflected in final allocations. Their contribution is to suggest that decentralization may have role to play in reducing corruption and strengthening accountability because administrators (and politicians) may be easier to monitor and control at the local as opposed to central level. This is, however, subject to local government not being captured by a local elite. Understanding what determines the level of capture at the local level is thus critical to understanding whether decentralization will represent an improvement over centralization. Whether citizens are informed about the actions of politicians and whether there are free, open and fair elections at the local level will be important considerations here. A final set of arguments points to how local institutions work may be affected by the decentralization process (see Manor, 1997 and Blair, 1997). In the best case scenario decentralization encourages the emergence of institutions which more are both more accountable and more effective at reaching the needy. Local participation is seen as critical to this process of institution building. In the worst, decentralization represents an added opportunity for corruption and elite capture (see Fiszbein, 1997 and Uphoff, 1997).

Empirical Evidence

Taking these ideas together we have an analytical framework within which we can examine the available evidence on decentralization. The conditions for decentralization to be successful may be summarized as follows. (i) Sufficient revenue generation and devolution by the centre. (ii) Heterogeneity in local needs. (iii) Limited spillovers. (iv) Local institutional capacity. (v) Responsiveness and accountability of local government. (vi) High degree of political participation.

When one examines the empirical evidence it becomes clear that countries may be arrayed along a continuum depending on their success in meeting these conditions. When we do this we see that three groups of countries appear: (i) low performing countries where virtually none of the conditions are satisfied, (ii) middle performing countries where some conditions are satisfied and some are not and (iii) high performing countries where most of the conditions are satisfied.

Low Performing Countries: Decentralization in a number of countries has just meant abandonment of the social protection function by central government in the sense of neither providing nor funding social protection. Abandonment of this function is often driven by fiscal crises which make funding of social protection systems untenable. When budget deficits are of sufficient magnitude central government cannot afford to retain control over the social protection function and may try to deal with this problem by devolving responsibility for funding and providing social protection to lower levels of government.
This has been the approach adopted in a number of countries undergoing transition. It carries a multitude of problems. Delinking social protection from central revenue sources typically means that local tax bases are inadequate to maintain social expenditures and as a result these systems are either severely scaled back or dismantled altogether. Though various laws and decrees may be passed which vest responsibility for social protection in the hands of oblasts/municipalities as has been the case in Russia for example these are typically not heeded as there is no financial or other incentive for local governments to comply. Localities differ in their capacity to raise revenue and this tends to lead to the emergence of dramatic regional inequalities in levels of social sector spending. Funding bases tend to be weakest where social protection needs are greatest so that there is mismatch between local demand for these measures and funding capability and because labor is relatively immobile, migration often does not represent a viable means for improving the matching between demand and supply. Local governments in these transition economies often do not have much experience with administering social protection programs and as a result there are often no institutions in place to administer programs. Limited institutional capacity is thus a major constraint on this form of decentralization. Local governments also tend to be under the control of local elites. In this situation the local budgetary process which determines local levels of spending is typically non-transparent and there are limited means to ensure that, even where resources are available, these are directed towards social protection measures either through a local democratic process or through pressure being exerted from the center. These features typify the experience with decentralization in a large number of transition economies which have experienced sharp output falls, large-scale restructuring of industry and employment, rapid price increases and extreme budgetary crises such as Russia (see Grafe and Richter, 1998), Kyrgyzstan, Kazakhstan, Uzbekistan and Tajikistan (see Falkingham et al, 1997). Similar though less severe problems have been encountered in Central Europe (see e.g. Graham, 1994 and Subbarao et al, 1997 on Poland). The failure of these decentralization experiments is reflected in rapidly deteriorating social indicators.

Middle Performing Countries: This category covers the bulk of countries which have attempted some decentralization of the social protection function. India typifies the problem of trying to decentralize when there is pronounced variation in local institutional capacity and accountability. The move to decentralize provision of local public services to local village or municipal governments as legislated in the 73rd and 74th constitutional amendments in India (the ‘Panchayat Raj’ amendments) was in part motivated by these services functioned poorly due to the centralized, hierarchical and non-participatory nature of their management (see Dreze and Sen, 1995, 1996). As part of this legislation measures were introduced to revitalize local representative institutions. These included mandatory elections at regular intervals, reservation of seats in village panchayats for women and members of scheduled castes and tribes and some devolution of government responsibilities to local authorities. As Dreze and Sen (1995, 1996) point out this form of decentralization has been successful in improving local democracy and resource allocation in states such as West Bengal where local institutions function well and there is limited capture by local elites. In other states such as Uttar Pradesh, where local government is under the control of upper-caste men from privileged classes who are only
weakly accountable to the local community and who use local public services as instruments as local patronage, decentralization has been much less successful and may have even worsened the position for the poor.

Decentralization is thus unlikely to be successful unless it is accompanied by other programs of social change such as those concerned with expanding literacy and basic education which improve awareness of rights, aid political organization and assist individuals in understanding how the system functions. In India partial decentralization of the social protection function has also suffered from inadequate devolution of funding by the center. Problems with decentralizing the social protection function to local governments which vary both in institutional capacity and in their accountability to the local community have also hampered decentralization experiments in various sub-Saharan African countries such as Tanzania, Uganda, Zambia and Senegal (see Graham, 1994; Subbarao et al, 1997) and in Indonesia (see Yusuf and Beier, 1997).

The situation in the world’s other most populous country, China, is somewhat different. Decentralization of local public services and taxes and devolution of power began in 1979 (Lin et al, 1997). Here, in part due to years of collective action, decentralization took place against a background of reasonably well functioning local institutions. Decentralization of local public services, however, has run into problems for two main reasons. (i) Decentralization of power over spending has only been to the provincial as opposed to lower (country, village) levels of government. (ii) Devolution of spending powers has not been matched by revenue contributions from the center and as a result local taxes have to be heavily relied upon. As Lin et al (1997) point out this has led to a host of related problems. (i) Because Chinese provinces are very large there is limited political accountability at the provincial level and there is a tendency for these governments to invest in production related activities which generate revenues rather than in programs which foster social protection. (ii) Political institutions do not exist to allow individuals in villages of municipalities to express their preferences over social expenditures at the provincial level. (iii) Variations in local revenue bases have been reflected in growing regional inequalities in living standards which are a source of growing social tension. Lin et al (1997) record that because it has not gone far enough, decentralization of local public services has had insignificant or detrimental effects on social indicators directly related to provision of local public social services. Excessive centralization and bureaucratic control of the social protection function, twinned with inadequate devolution of central revenues, have also been problems with the decentralization experiments carried out in various sub-Saharan countries (see Graham, 1994; Subbarao et al, 1997).

**High Performing Countries:** These comprise a select group of countries where most or all of the conditions for success of decentralization have been met. The most successful experiments with decentralization of social protection provision have been found in Latin America and in particular in Chile and Bolivia. What is critical about these experiences is that they took the related issues of revenue devolution, institutional capacity building and creation of democratic local institutions seriously. The decentralization experience in Bolivia as surveyed and evaluated by Faguet (2000) serves to illustrate how this was achieved.
The design of the Bolivian decentralization (legislated as the Popular Participation Law in April 1994) had certain features which helped contribute to its success. (i) The share of all national tax revenues devolved from central government to municipalities was increased from 10 to 20 percent. Revenue constraints were thus taken seriously and the fact that financing came from a broad and stable tax base is also important. (ii) Title to all local infrastructure relating to health, education, culture, sports and local roads and irrigation was transferred to municipalities free of charge. This gave them the autonomy they needed to respond to local needs, which if spending patterns are anything to judge by, vary considerably across localities. (iii) Vigilance Committees were established to oversee municipal spending of Popular Participation Funds and to propose new projects. These are composed of representatives from local, grass root groups in each municipality and are legally distinct from the municipal government. These committees served the dual function of guaranteeing accountability (spending could be suspended if misuse of funds was suspected) and of ensuring that local preferences over projects were expressed. (iv) Guidelines were put in place to ensure fair and transparent election of municipal officials thus providing another route through which local preferences could be expressed and local accountability enforced. Though preliminary, the results from various surveys carried out by Faguet (1997) do suggest these reforms resulted in significant shifts in the composition of spending towards items which more directly benefit the poor. For example, investments in health, education and civil works were expanded at the expense of those in industry and tourism, hydrocarbons and communications. Poorer, smaller and more rural municipalities were instrumental in engineering this shift in the composition of spending.

Refinements

The approach we have adopted here is to examine the available empirical evidence within an analytical framework. This evidence is more often than not of the case study variety and presents a mixed picture. From mapping the theory on to the available evidence we get some sense that the quality of local institutions exerts a large influence on how successful different decentralization episodes have been. The available evidence however is largely impressionistic and more careful testing of the theory is needed. The lack of rigorous evaluations of the impact of decentralization means that we do not have a reliable body of evidence on which to base policy recommendations. What really is needed is more quantitative work which not only tries to assess whether decentralization experiments have had discernible impacts on outcomes (e.g. poverty) but which also tries to isolate the responsible mechanisms. Below I point to some empirical refinements which could help us move in this direction. The more casual evaluation presented here should be seen as of value mainly in terms of setting up and testing an analytical framework which can be further refined by more rigorous quantitative work in the future. Much of the analysis of decentralization has focused on cross-country analysis. Therefore there is a literature on how fiscal and political decentralization affects corruption and the quality of government (see Treisman, 2001; Fisman and Gatti, 1999; Arikan, 2000). There are various problems with this type of study. Given that whether a country is more or less centralized is often a fixed factor identification is mainly off cross-sectional
variation. This leaves open the question of whether both decentralization and outcomes are driven by some other omitted factor (e.g. political regime). Therefore one cannot interpret the relationship as causal. Given country specificity and the cross-sectional nature of the analysis the mechanisms through which decentralization affects outcomes cannot be identified. As a result the policy lessons that result from these studies are limited.

Country level studies of the types surveyed in this note are more useful in terms providing insights into when decentralization can improve accountability. Their contribution is to suggest that in line with what we would expect from theory the conditions under which decentralization takes place will strongly affect outcomes. The drawback is that much of the evidence is of the case study variety and therefore we cannot be sure how robust the conclusions drawn from these studies are. It also not possible to isolate with any precision the factors which contribute to the success of a particular decentralization program.

This suggests that the way forward is to engage in more rigorous, quantitative evaluations at the sub-national level. In this regard there are five points worth emphasizing.

**Panel data:** There is a need for more work that exploits time series variation. That is we want to look at what happens before and after a decentralization. Following the same units, whether these be households or administrative units, can help to isolate the impact of decentralization whilst controlling for a range of factors.

**Endogeniety of institutions:** One central question which can only be addressed at the micro level is whether moving decision making powers downwards affects the functioning of local institutions, resource allocation and the political process. The question of whether decentralization encourages participation and accountability is central here. This is an open question but one that seems critical in determining in which contexts decentralization is advisable.

**Determinants of institutional quality:** One the central findings from the case study country evidence surveyed here is that the quality of local institutions has a strong bearing on whether decentralization improves accountability and welfare. A central question therefore is to better understand what determines institutional quality. Papers which examine how inequality and ethnic diversity affect policy are examples of this kind of work (e.g. Miguel, 2000; La Ferrara, 2000). Variation across space of these factors can be exploited to identify the impact of decentralization and to better understand which environments are conducive to successful decentralization.

**Micro political economy and constitutional design:** Where political reforms have been introduced to improve accountability then variation in the functioning of local political institutions can be exploited to see if it helps to explain variation in policy and welfare outcomes associated with decentralization. An example of this type of work is Chattopadhyay and Duflo (2001).
**Variation in decentralization:** Decentralization refers to a whole range of reforms. Often different jurisdictions respond differently to legislation that legitimizes decentralization. This variation can be exploited to understand which types of decentralisation affect policy and outcomes.

**References**


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