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Decentralisation and Subsidiarity: Concepts and frameworks for emerging economies

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ABSTRACT

A global trend towards decentralisation, particularly in emerging and transitional economies, is well underway. At the same time, there are many different meanings assigned to the concept, and it is frequently left undefined, even while it is being implemented. Written under the auspices of the University of Technology Sydney, Centre for Local Government, this paper argues that enhanced understanding of concepts and theories can contribute to improved practice during decentralisation reforms, and consequently be of benefit to governments and to their citizens. Drawing on the theoretical, research and policy literature, an approach is adopted that aims to draw benefits from this literature for public policy and administration in particularly the emerging and transitional economies. The material in the paper is used as a foundation for putting forward a recommended synthesis-framework for decentralisation implementation that draws attention to: appreciating the theoretical scope of fiscal decentralisation; focusing on the country and its goals; considering the design of the system of multi-level governance; focusing on central and local capacity; and adopting flexibility, supported by feedback mechanisms, in the process of decentralisation.



The Centre for Local Government based at the University of Technology, Sydney is the leading university-based centre in Australia delivering an extensive program of local governance research, teaching and specialist national and international consulting services. The centre's activities are directed towards improving the capacity of governments at all levels to deliver quality services, good governance, strong leadership, public value and improved democracy. UTS:CLG has formal links with key international organizations to enable collaborative and country based development and delivery of capacity building programs.

Conceptualising decentralisation and subsidiarity

Even a cursory examination of the world's states reveals a dizzying array of relationships between central and subnational governments...This already diverse mixture of systems has been further enriched by a recent global trend toward decentralization, most strikingly in the developing world.

(Hankla 2009: 632)

Decentralisation

There is strong evidence in the literature that many different meanings have been assigned to the concept of 'decentralisation', and also that it is frequently left undefined (Sharma 2006: 54; Kim 2008: 4-7; Dubois and Fattore 2009: 706-707). Part of the difficulty lies in the fact that the concept is used by scholars from different disciplines – amongst others Public Administration, Political Science and Economics – and that there is 'too little interaction between their respective bodies of work' (Hutchcroft, cited in Pina-Sanchez 2014: 12). Many, but by no means all, authors refer to 'decentralisation' as 'fiscal decentralisation' when they are debating the issues discussed in this paper. This is possibly to distinguish the concept from discourse in which it is used not to theorise governance but to consider the distribution of population in a given territory. The focus here is on the balance of population in the 'centre' and the 'periphery', and particularly on the dispersal of people from the centre. This has been an important issue in Australia. As Borrie (cited in Productivity Commission 2011: 137) notes, 'concerns about the distribution of the Australian population and the 'balance' between the urban and rural areas go back to the early years of federation'. Although strong arguments can be made that the level of decentralisation of a population is a key factor in shaping governance of that population, this aspect of the concept will not be explored in this paper.

Based on analysis of more than 40 definitions of decentralisation in the literature, Dubois and Fattore (2009: 707-711) conclude that the concept refers to both a structure and a process; that it focuses on questions of authority, responsibility and power, as well as functions and resources; and that it draws attention to the transferring entity (central government) and the receiving entities (sub-national government). These authors point out that existing definitions generally neglect to include 'silent' or 'unintended' decentralisation, which they refer to as the situation in which decentralisation, or indeed centralisation, is not pursued as an active reform (Dubois and Fattore 2009: 717).

Many countries have begun to undertake decentralisation as a response to 'government failure' and as a means to make government

more efficient, responsive and accountable (Kim 2008: 8). Decentralisation is particularly favoured by theorists who favour small government and free markets, and who regard privatization as a key means of contributing to the decentralisation of the public sector (Kim 2008: 8). The argument is frequently made that if government can perform closer to the people it is meant to serve, the people will get more out of it and be more willing to accept government authority (White 2011: 1). A justification for decentralisation is therefore to enhance the legitimacy of government power, which is one of the defining features of good governance (see Stoker 1998).

By better matching the preferences of individual citizens and increasing their individual welfare, there may be flow-on effects for economic growth through impacts on work effort, savings and private investment. Decentralisation may additionally enhance economic growth through providing sub-national officials with the ability to actively pursue economic development policies, thereby contributing to the balanced distribution of resources across regions – a feature of macroeconomic stability (Martinez-Vazquez and McNab 2003). Other authors point out that decentralisation may serve to deter people from migrating into the ‘shadow economy’ by reducing the distance between bureaucrats and economic agents. It can serve to increase the probability of detection, and therefore, ‘lowers the expected net gains from activities in the shadow economy’ (Buehn, Lessmann and Markwardt 2013: 2569).

Dimensions of decentralisation

Fiscal

Fiscal decentralisation, according to several conceptions in the literature:

- represents the ‘transfer of competencies, responsibilities and financial resources from the central (state) level to the lower levels of government’ (Finzgar and Oplotnik 2013: 654);
- can be said to exist when sub-national governments have the decision-making power to raise revenues and perform spending activities (Kim 2008: 7);
- refers to the ‘proportion of fiscal impact’ at levels other than the central government (Schneider 2006: 348); and
- is the ‘pillar of public administration decentralisation’ (Halaskova and Halaskova 2014: 625).

Measurement of fiscal decentralisation includes expenditures of lower levels of government as a percentage of total expenditures or Gross Domestic Product (GDP); revenues of lower tiers of government as a percentage of total revenues or GDP; division of tax revenues between central and local governments; and the level and extent of tax authority and share of expenditures in selected public sector areas – such as education, health, social security – as a share of total expenditures of lower levels of government (Halaskova and Halaskova 2014: 627).

Administrative

Administrative decentralisation focuses on granting the responsibility for planning, financing and ordering of specific public functions to sub-central governments, in short, ‘granting local jurisdictions autonomy from central control’ (Schneider 2006: 348). Higher levels of administrative decentralisation suggest that there is a greater level of independent decision-making by sub-national governments and can occur even if most taxes are raised by central government (Halaskova and Halaskova 2014: 625). Dennis Rondinelli (see Rondinelli and Nellis 1986: 6-10; Rondinelli, McCollough and Johnson 1989) has provided a contribution to the debates which suggests that there are three major types of administrative decentralisation, and this framework has been used by several authors (see e.g. Chattopadhyay 2013: 423; Rees and Hossain 2010: 583; Schneider 2006).

Deconcentration refers to a central government dispersing responsibility for a policy to its field offices or regional branch offices (Schneider 2006: 349; Chattopadhyay 2013: 423). Put differently, it implies the ‘shifting of workload from centrally located officials to staff or offices outside the national capital’ (Rondinelli and Nellis 1986: 6). This transfer changes the spatial and geographic distribution of authority, but ensures that the central government retains authority over the field office and exercises that authority through the hierarchical channels of central government bureaucracy (Schneider 2006: 349).

With a focus on the transfer of managerial responsibility, **delegation** implies that local governments or agencies carry out certain functions on behalf of the centre (Chattopadhyay 2013: 423). Ultimate responsibility is nevertheless retained by the central authority (Rees and Hossain 2010: 583). Under delegation, the central government has to exercise its control through an arm’s length contractual relationship that ‘enforces accountability on the part of local government’ (Schneider 2006: 349).

Devolution implies ‘the creation or strengthening, financially or legally, of sub-national units of government, whose activities are substantially outside the direct control of the central government’ (Rondi-

nelly and Nellis 1986: 8). Both the implementation and the authority to decide what is done is shifted to local bodies, who are accountable to the central government in so far as it is able to ‘impose its will by threatening to withhold resources or responsibility that the local unit needs’ (Schneider 2006: 349). Devolution is regarded in most of the literature as ‘the purest or at least the most extensive form of decentralization’ (White 2011: 2).

Schneider (2006: 348-349) suggests that viewing these three aspects of administrative decentralisation in categorical terms has been superseded in later debate by viewing them along a continuum of administrative autonomy, presented in Figure 1.

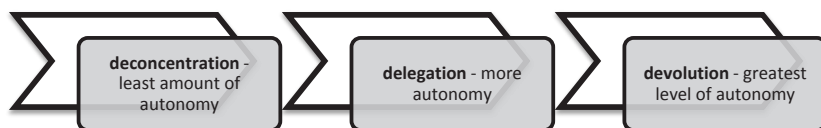


Figure 1: Administrative autonomy continuum

Source: based on Schneider (2006: 348-349)

Political

Political decentralisation focuses on ways in which political activities in a territorial state are conducted at the local as opposed to the national level. A decentralised political system is one in which ‘political actors and issues are significant at the local level and at least partially independent from those at the national level’ (Fox and Aranda, cited in Schneider 2006: 349-350).

Political justification of decentralisation formalises a ‘causal chain of devolution leading to more active citizen involvement and voice in the formulation and implementation of public policies’ (Chattopadhyay 2013: 426). Accountability plays a key role in this, since it is presumed that a strongly decentralised system can make governments more responsive in terms of the speed and quality of their responses to the citizenry, as well as having an impact on the quantity of response. Sustainability of the system comes into play, since a heightened sense of accountability infuses ‘greater sense of ownership among the citizenry and therefore make the projects more sustainable’ (Chattopadhyay 2013: 426).

According to Prud’homme (2002: 4-5), the ‘political efficiency’

which results from decentralisation policies relates to issues such as local participation in political decision-making, local governments being an effective training ground for politicians, and decentred power providing an additional protection against authoritarianism from the centre (Prud'homme 2002: 6). Ideally, under highly politically decentralised systems, 'citizens define interests and form identities on the basis of local concerns, and organisations such as parties and social movements operate locally and compete over local issues and in local elections' (Schneider 2006: 350).

Market

Market decentralisation refers to issues relating to deregulation and privatisation, and thus moves beyond government to the involvement of the non-government (and particularly the private) sector (Halaskova and Halaskova 2014: 625). Under privatisation or deregulation, governments divest themselves of their functional responsibilities 'either by transferring them to voluntary organisations, or by allowing them to be performed by private enterprises' (Rondinelli and Nellis 1986: 8). While not included in all texts as a dimension of decentralisation, there are strong arguments for suggesting that its importance is increasing in the age of 'governance'.

The changing social and economic environment of recent decades, linked to factors such as globalisation and demographic shifts, has contributed to vigorous debate and action on new forms of governance (Treib, Bahr and Faulkner 2007). In the political dimension, governance is a decision-making system that generally involves state actors sharing power with private actors within inter-organisational networks (Treib et al 2007: 3). This means that government in the context of governance has to learn an appropriate operating code which challenges past hierarchical modes of thinking (Stoker 1998: 24). As described by Orr and Vince (2009), this approach regards power as inevitably dispersed and emphasises the significance of networks rather than hierarchies and bureaucracies.

The task of government in governance is not merely to rely on its power to command or to use its authority, but rather to engage in a new governing style that includes making use of the following methods:

- Composition and coordination – defining a situation, identifying key stakeholders and developing effective linkages between the relevant parties.
- Steering – influencing and steering relationships in order to achieve desired outcomes.

- Integration and regulation – thinking and acting beyond the individual sub-systems, avoiding unwanted side effects and establishing mechanisms for effective coordination.

(Stoker 1998: 24)

Decision-making and implementation processes may be distinguished according to the degree to which they are formally institutionalised in terms of who is involved, how decisions may be reached, how they have to be implemented, and who is in charge of monitoring compliance (Treib et al 2007: 3). These all suggest a portfolio of governmental decision-making that is inextricably interconnected with the other dimensions of decentralisation discussed earlier.

The principle of subsidiarity

The principle of subsidiarity has its roots in ‘the social doctrine of the Catholic church’ (Ranjault 1992: 49). Put forward by Pope Pius XI in his 1931 *Quadragesimo anno*, it was cast as ‘a fundamental tenet of Catholic social teaching’ and created to describe an approach to the problems of modern society that reflected ‘a broad understanding of human nature, government, and social structures’ (Vischer 2001: 108-109).

The principle embodied a notion that the health of a society is in great part a function of the ‘vibrancy and empowerment of individuals acting together through social groupings and associations’ and it consequently promotes a tendency toward solving problems at the local level and on fostering the ‘vitality of mediating structures in society’ (Vischer 2001: 109-116). The doctrine was explicitly anti-Communist and was put forward as an alternative to principles of ‘solidarity’ and ‘collectivism’ (Vischer 2001: 110).

The principle of subsidiarity has been widely adopted in Europe and beyond. In political debates in the USA it has been regarded, especially by more conservative commentators, as representing ‘an aspect of the original theory of American federalism which held that state governments will be more responsive than the national government to the public will [and] better informed about local circumstances’ (Huffman, cited in Vischer 2001: 123).

In the past few decades, the principle has become incorporated into the political, economic and public administration understandings of decentralisation. Kim (2008: 11) fuses the normative principle with existing decentralisation theory and synthesises this as federalism:

The subsidiarity principle and decentralization in federalism should produce the optimal allocation of resources and consequently maximize welfare.

In the Australian context, Fenna and Hollander (2013: 221) similarly see the fusion of the two as granting federalism a stronger values or normative base:

Subsidiarity is a normative concept, one expressing the view that governance arrangements ought to be organised in as thoroughly devolved a manner as possible. This is the principle that underlies the principle of federalism and it is justified on the basis of values that federalism helps preserve or benefits it can deliver.

Taking the historical and current context into consideration, Vischer (2001: 128-142) suggests the following as issues to consider when focusing on subsidiary as a principle of governance, here briefly summarised:

- Application of the principle is closely associated with particular areas of law, such as constitutional law.
- Consideration of the principle draws attention to (central) government, the individual, and the mediating structures which are bulwarks against government authority. Subsidiarity calls both for the recognition of mediating structures and for their empowerment.
- Subsidiarity places greater value on mediating structures than it does on megastructures, but this implies that any policy that purports to apply the principle needs to draw a meaningful distinction between the two. The role of corporations is particularly salient here, since they may function as megastructures as they increase in size and power.
- Subsidiarity mandates the localisation of societal problem-solving, including the obligation to ensure that individuals are equipped to participate fully in collective decision-making regarding issues that affect them and their communities.

Notwithstanding the fact that the subsidiarity principle only entered the discourse long after federations were in place, Ranjault (1992: 50) asserts that ‘the concept of subsidiarity is essential to a definition of federalism and of any decentralized political organization’. His reasoning is that it presupposes an organised society consisting of hierarchical or concentric groupings, and the establishment of ‘a necessarily dynamic equilibrium between liberty and authority, or between autonomy and equity’ for each of these groups (Ranjault 1992: 50). Connections can

also be made to the philosophical issues raised by de Tocqueville more than a century earlier.

When applied to a supranational political organisation, in particular the European Union (EU), and the relationship between the EU (the centre) and its constituent parts, the principle increased in importance and utility. The EU looked toward subsidiarity as an organising principle from the mid-1970s, and it was incorporated into the 1992 Treaty of Maastricht as a guideline for further European integration. Within the Maastricht Treaty, the principle is expressed as follows:

In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the member-States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.

(*Treaty Establishing the European Community*, 1992, Article 3b, 63, cited in Vischer 2001: 121)

At a conceptual level, a key aspect of synergy between decentralisation and subsidiarity relates to the advantages that local government, or the constituent parts of a supranational organisation, have with regard to the allocative function i.e. the quest for allocative efficiency. The principle argues that taxing, spending and regulatory functions should be exercised by lower levels of government ‘unless a convincing case can be made for assigning them to higher levels of government’ (Kim 2008: 11).

In making this ‘convincing case’, subsidiarity draws attention to the condition of comparative efficiency. If the central government is to hold on to given functions, it needs to justify these decisions on the basis that it would ‘secure the desired outcomes better than the sub-units’ (Follesdal 1998: 193). The onus would be placed on central government to provide the grounds for its justifications to hold on to power. It could do so by drawing on the condition of effectiveness (differential ability, willingness), the condition of necessity and/or that proscriptive or prescriptive conditions apply. In the EU, for example, the principle regulates how the central unit is to act so as to respect sub-unit autonomy, known as the *Minimal Intervention Condition*. The EU employs directives which stipulate results, while leaving choice of means to member states (Follesdal 1998: 193-195)

Writing in particular of the situation in the USA, Vischer (2001: 142) notes the ‘partisan baggage’ that may be associated with the real-world application of the principle of subsidiarity, but suggests that it offers a model that it ‘rooted in a social justice tradition that stresses both individual liberty and communitarian values’.

Underlying theoretical precepts of decentralisation

Support for decentralisation in the writings of Alexis de Tocqueville

The writings of Alexis de Tocqueville in *Democracy in America* and *The Old Regime and the Revolution* explore, amongst others, perspectives on the relationship between equality and centralisation in nations (Pittz 2011: 797). In his work, he argues that centralisation had led to greater equality in France, and was therefore a major cause of the French Revolution; but also that democratic ideas and passions for equality would lead Americans to concentrate (centralise) power. De Tocqueville's overriding concern was with 'liberty' and 'decentralization' and the suggestion from his writing is that 'to keep administrative power decentralized – or at least slow its momentum towards centralization – the moral force of equality must be combated by a love of liberty' (Pittz 2011: 806). De Tocqueville's works have been influential in debates on democracy since their publication, and the debate he has engendered has included considerations of the relationship between the centre and the local, and the impacts of this relationship on liberty and on equality.

Decentralisation of power and 'localism'

The effective representation of locality in national politics, which can be described as 'political localism', is well recognised as a justification for local government in many countries – it matters to people where they live and work. This raises questions about the relations between the central and the local, which includes consideration of the devolution and decentralisation of power. Debates on 'localism', which have been in the public discourse since the early 1800s, focus *inter alia* on the relative power of the local vis-à-vis the central and on central-local relations (Powell 2004).

In 1861, John Stuart Mill had argued that 'the very object of having local representation is in order that those who have any interest in common, which they do not share with the general body of their countrymen, may manage that joint interest by themselves' (cited in Watt 2006: 8). Mill accepted that administrative decentralisation was essential for efficient government, but also argued that local government promoted stability for the national liberal democratic system, which could not allow every citizen to seriously expect to influence national policy (Chandler 2010: 6-7). He maintained that local institutions of democracy are the most accessible locations for political skills to be acquired and practised, and that local democracy not only provided greater opportunities for political participation but also that it was an instrument of

social inclusion (Watt 2006: 11; Pratchett 2004: 360; Chandler 2010: 6-7).

Arguments for the decentralisation of power were put forward even more forcefully by activists such as Joshua Toulmin Smith, the major theorist behind the Anti-Centralization Union, who argued in the mid-1800s that those elected to national eminence are too far removed from local understanding and sympathy with any specific community to make effective decisions for a community. At this time, enthusiasm for decentralisation in the United States gained currency among liberals in Britain through the writings of de Tocqueville (discussed earlier) and were themselves reflected in a European tradition sustained from the works of Rousseau and others (Chandler 2010: 8).

More recent justifications for local government include that the institutions of local democracy provide for a diffusion of power within society and that local democracy supports diversity and difference in the face of an otherwise constrictively uniform set of central policies. Arguments in favour of local responsiveness also come into play (Pratchett 2004: 359-360). In short, local government can be regarded as the 'institutional embodiment of local democracy' (Pratchett 2004: 359).

The Tiebout model

In 1956, Charles Tiebout described a model of mobile households that select a community of residence based on their preferences for local public goods – people effectively sort themselves into groups that are homogenous in their demands for local services (Oates 2005: 354).

In putting forward this model, it is argued that 'Tiebout launched the modern study of decentralisation' (Hankla and Downs 2010: 762) since he had defined a situation in which 'public goods and services are provided primarily through the revealed preferences of individuals by market mechanisms' (Rondinelli et al 1989: 59). Since taxpayers are mobile, and can migrate or sort themselves among the jurisdictions that best match their preferred tax-expenditure package, promotion of individual choice results in a 'Pareto-efficient outcome' (Oates 2005: 354). The Italian economist and sociologist Vilfredo Pareto had suggested in 1906 that the individual is the best judge of their own welfare and that any change that makes at least one person better off, without making anyone worse off, is an 'improvement'. When all possible Pareto improvements have been made, the economy is said to be at a 'Pareto optimum' (Watt 2006: 6). If an economy is perfectly competitive, equilibrium or 'Pareto-efficiency' exists, and while this has implications for individual welfare, it does not address the broader and socially desirable objective of equity (Kim 2008: 9).

The Tiebout model supports the decentralisation process by bringing to the public sector some of the allocative benefits that a competitive market brings to the private sector and hence ‘produces a market-like solution to the local service provision problem’ (Chattopadhyay 2013: 425). Recognising the mobility of tax-payers, it provides grounds for arguing that ‘the level of welfare achieved through a uniform provision of public goods by a central government is inferior to that which can be attained by a decentralized provision’ (Martinez-Vazquez and McNab 2003: 1599).

Fiscal federalism

The mainline or ‘first-generation’ theory of fiscal federalism ‘lays out a general normative framework for the assignment of functions to different levels of government and the appropriate fiscal instruments for carrying out these functions’ (Oates 1999: 1121). In fiscal federalism theory, ‘pure’ decentralisation as an ideal-type construct would refer to ‘a system in which pure local governments raise pure local taxes and undertake pure local expenditures without the benefit of central government transfers’ (Prud’homme 2005: 201).

As it was conceived, fiscal federalism was embedded in the view of public finance that prevailed in the 1950s and 1960s (Oates 2005: 350). Wallace E. Oates himself was influential in bringing about the theoretical synthesis, based on numerous publications, including *Fiscal Federalism* (Harcourt Brace Jovanovich, New York), published in 1972. The theory drew strongly on the works of Richard Musgrave, who put forward an active and positive role for the government sector in correcting various forms of market failure in a basically Keynesian framework; Kenneth Arrow, who conceptualised the roles of the private and public sectors; and Paul Samuelson, who described the nature of public goods (Oates 2005: 350).

Richard Musgrave wrote *The Theory of Public Finance: A Study in Public Economy* (McGraw-Hill, New York) in 1959. This text acknowledges that there are situations in which the private market system fails due to various public goods problems, and that the government should step in and introduce appropriate policy measures to correct the failures. It lays out a framework for the assignment of functions to different levels of government and discusses the fiscal instruments that are appropriate for carrying out these functions (Oates 1999: 1121). The functional categories Musgrave defined at the fiscal level are ‘stabilisation’, ‘allocation’ and ‘redistribution’. Fiscal federalism is often measured in terms of the role of sub-national units in these key fiscal policy areas of stabilisation, allocation and redistribution (Schneider 2006: 348).

Fiscal federalism perceives governments at different levels providing efficient levels of output of those public goods whose spatial patterns of benefits are encompassed by the geographical scope of their jurisdictions. The tendency is to regard central government as having basic responsibility for the macroeconomic stabilisation function through its fiscal and monetary policies, and based on the fundamental constraints that lower levels of government would have in doing so (Oates 1999: 1121). Central government is also best placed to deal with income redistribution, since local attempts to address income disparities are likely to induce inefficient migration, that is, to encourage individuals from disadvantaged socio-economic backgrounds who are eligible for benefits to migrate into the locality and wealthy residents to move out (Chattopadhyay 2013: 424).

Within this model, therefore, central government would take the lead in macroeconomic stabilisation policy, introduce basic measures for income redistribution, and provide efficient levels of output of national public goods (Oates 2005: 352). On the other hand, local governments would be in the best position to undertake the allocative function, since they have greater information regarding people's preferences. There is a presumption in favour of the decentralised provision of public goods with localised effects (Oates 1999: 1122). Put differently, 'the main economic argument for decentralisation is largely based on allocative efficiency grounds' (Chattopadhyay 2013: 424). A deeper discussion of 'efficient government' is provided in section 1.3.6 of this paper.

The model also devoted attention to taxation in a federal system. Fiscal federalism theory contends that

[E]conomic efficiency is enhanced and the quality of service delivery therefore improved when citizens pay for the cost of public services they consume...[S]ervice providers are better able to discern demand for and adjust supply of local public services when consumers can indicate their preferences by directly paying for services.

(Lewis 2010: 651)

This perspective suggests that local governments should place primary reliance on benefit taxes such as property taxes and user fees, while the central government has greater scope for the use of progressive income taxes as part of a 'broader program for the redistribution of income' (Oates 2005: 352). There is also room for lump-sum grants from the central government to sub-national units, justified on equity and efficiency grounds. These grants serve to correct distorted migration patterns and provide desired assistance to poorer jurisdictions (Hankla 2009).

Growing in importance since the 1990s, ‘second-generation’ fiscal federalism incorporates a theoretical focus upon:

- the trade-offs between centralisation and decentralisation with regard to issues such as accountability, fiscal autonomy and co-ordination of policies;
- local governments turning to the central government for fiscal relief;
- the role of central government in performing an insurance function in the intergovernmental fiscal system; and
- what occurs when there is disintegration of the federal system, whether through explicit disintegration of the nation state or undermining of the workings of a federal government.

(Oates 2005: 357-367)

In short, theorising has shifted to considerations also of the evolution of federal structures and the stability of institutions – ‘a successful system of fiscal federalism must be able to sustain itself over time’ (Oates 2005: 368).

The Leviathan hypothesis

According to Oates (2005: 355), the mainline view of fiscal federalism has been influenced by public choice perspectives, grounded in the view that ‘public decision-makers are utility maximizers with their own objective functions’. This perspective focuses on issues in government such as budget maximisation, enhancement of power and influence, a large and growing workforce, and higher salaries, all of which suggest a critical view of the institution of government.

The perspective has gained impetus since the 1980s with the ‘Leviathan hypothesis’ of Brennan and Buchanan (cited in Oates 2005: 355), within which fiscal decentralisation was seen as ‘a mechanism for constraining the expansionary tendencies of government’. Competition among decentralised governments was viewed positively as being able to place a limit on the capacities of a monopolistic central government. In many respects, the Leviathan hypothesis extends the Tiebout model (discussed above) and suggests that, ‘other things being equal, the overall size of the public sector should be inversely related to the level of fiscal decentralisation’ (Bodman et al 2009: 9).

Efficient government and the optimal level of decentralisation

More efficient government is an underlying justification for fiscal decentralisation (Oates 2005; Kim 2008; Prud'homme 2005). The presumption is that the tailoring of goods and services to the particular preferences and circumstances of localised constituencies leads to an increase in economic welfare 'above that which results from the more uniform levels of such services that are likely under national provision' (Oates 1999: 1121-1122). Put differently, the same amount of funds spent at the sub-national level rather than at the national level can result in increased individual welfare (Martinez-Vazquez and McNab 2003: 1603). In *Fiscal Federalism*, Wallace E. Oates had described the theory of the 'optimal level of decentralization'. This suggests that there is a trade-off between the responsiveness of central government to sub-national preferences and its ability to internalize externalities and achieve economies of scale (Hankla 2009: 633-634). When sub-national governments enjoy significant fiscal autonomy, the result is a diversity of taxation and spending policies which serves to enhance the efficiency and responsiveness of government in the aggregate. The key is to establish, in every situation, an 'efficient level of decentralization where the benefits of policy diversity are balanced by the drawbacks of non-internalization' (Hankla 2009: 634).

The literature views efficiency from at least two perspectives:

- Productive efficiency follows 'when the economy is working on its 'production possibility frontier: this is when production of one good is archived at the lowest cost possible, given the production of the other good(s)' (Kim 2008: 8). If more output is produced with a given set of inputs, then productive efficiency will be increased (Prud'homme 2002: 5). Productive efficiency would be undermined when cost-saving technologies and policies are not adopted (Kim 2008: 18).
- Allocative efficiency refers to a market situation in which the limited resources of a country are allocated in accordance with the wishes of consumers producing an optimal mix of commodities. 'Resources are used allocatively efficiently if they are spent for producing the right mix of goods for the right people at the right price' (Kim 2008: 8-9).

Since a decentralised system can be more responsive to 'differences in demands among taxpayers and to their basic needs' (Martinez-Vazquez and McNab 2003: 1603), decentralisation should have a positive effect on allocative efficiency. The argument goes that the efficient level of output of a local public good is likely to vary across jurisdictions as a result of differences in both preferences and costs and

thus, in order to maximise overall social welfare, local outputs should be varied accordingly. This is also described as the *decentralization theorem*: ‘local governments are in a better position to more efficiently provide public goods because they possess knowledge of the local costs and benefits’ (Oates, cited in Goel and Saunoris 2014: 4).

Kim (2008: 9) writes that, in the context of decentralisation, a Pareto efficient allocation of resources alone may not necessarily lead to the optimal allocation of resources to meet the collective interest of citizens in a particular jurisdiction. Instead, and drawing on the work of both Musgrave and Oates, this author suggests that the ideal would be ‘perfect correspondence’ in the provision of public goods – a perfect match would exist between the jurisdiction of each government unit and the groups that collectively consume the goods (Kim 2008: 10). Each level of government would be responsible for activities based on four criteria:

- Economies of scale – for example, the unit cost per good drops as the quantity of the good increases.
- The presence of externalities – provision of a good or service may have spillover effects beyond a particular jurisdiction. When externalities are expected to be greater, provision by government at a higher level would be more desirable.
- Heterogeneity of preferences and of circumstances – welfare would be maximised if each local government provides a particular good or service tailored to citizens’ preferences instead of uniform centralised provision across the country.
- Emulation – competition facilitates the introduction of best practices, but requires that at least two jurisdictions are involved in any given activity, which is another argument in favour of the decentralisation of government activities.

(Kim 2008: 11-12)

There is less support for the proposition that fiscal decentralisation can contribute to productive efficiency. In particular, there are questions as to whether local governments operate on the same production frontier as the central government and whether issues relating to productive efficiency are different in developing and transitional economies (Martinez-Vazquez and McNab 2003: 1604).

Dangers of decentralisation

Several commentators (see e.g. White 2013; Sharma 2006; Hank-

la 2009) discuss the pitfalls and unintended negative consequences of decentralisation. In this section, the work of Remy Prud'homme, professor of economics at the University of Paris XII, who has been influential in the decentralisation debate including in his role with the World Bank, will be used to frame issues relating to, as he describes it, the 'dangers of decentralisation' (Prud'homme 2005).

Increasing disparities and inequality

The conclusion reached by Prud'homme (2005: 202-203) on the basis of his analysis of the economic and public finance literature is that attempts by local governments to redress income disparities are likely to be unfair – socio-economically disadvantaged people in well-off regions will fare better than those in more deprived regions. Furthermore, attempts at decentralised redistribution would be self-defeating, because if jurisdictions adopt policies to redistribute income, wealthier people are likely to leave for more lightly taxed areas and those with fewer resources will move in to take advantage of the benefits, hence compounding the area-based disparities. This draws on the Tiebout model of mobile capital (discussed earlier).

According to Prud'homme (2005: 202), concerns that decentralisation may lead to increased inequality lend support for the view that 'central government must have the responsibility for redistributive programs and thus must control a large share of taxes and public expenditures.'

Macroeconomic instability

There is a danger that under fiscal decentralisation the fiscal policies of subnational governments will run counter to those of the central government. There are many examples in recent decades – Argentina, the United Kingdom in the early 1980s, Brazil and the former Yugoslavia – where the 'fiscal perversity' of subnational governments led to destabilisation of macroeconomic management (Prud'homme 2005: 206-207). Sub-national governments may engage in profligate spending, thus undermining the macroeconomic environment of countries, and there is some empirical evidence that decentralised systems can be linked with higher inflation (Hankla 2009: 637).

A key macroeconomic policy instrument is fiscal policy, that is, control over the amount and structure of taxes and expenditures and the management of the budget deficit or surplus. This is 'an instrument that only the central government can manipulate, because local authorities have few or no incentives to undertake economic stabilization policies' (Prud'homme 2005: 205).

Decentralisation can undermine efficiency

Prud'homme (2005: 207-208) questions whether, particularly when applied to developing countries, decentralised provision makes it possible to give residents with different tastes in different localities what they want to better match demand, and therefore increases welfare. He argues that developing countries do not meet most of the explicit or implicit assumptions of the model of fiscal federalism, since the problem is not about revealing differences in preferences between jurisdictions, but to satisfy universal and basic needs, which are well known. Furthermore, the model assumes that taxpayers of each jurisdiction will express their preferences through their votes, whereas local elections are usually decided on the basis of personal, political party or tribal loyalties, and say little about local preferences. Locally elected members, especially mayors, may not be able to fulfil locally-expressed preferences because of a gross mismatch between available resources and promised expenditures. Officials often lack incentives to keep their promises.

Prud'homme (2005: 209) also points out that 'the standard decentralization model says nothing or next to nothing about production efficiency'. Central bureaucracies are more likely than localised ones to operate closer to the 'technical production frontier', linked to the fact that they are more likely to attract a more qualified workforce. They offer better careers, including having greater diversity of tasks and more possibilities of promotion, and are better able to invest in research and development, technology and innovation (Prud'homme 2005: 209).

Decentralisation and corruption

There is a debate in the literature as to whether the implementation of inter-regional competition through decentralisation can serve as a means to tackle one of the most serious obstacles to economic development in particularly the emerging economies, namely corruption and proliferation of the 'shadow economy' (Prud'homme 2005; Lessman and Markwardt 2010: 631; Goel and Saunoris 2014). Some argue that competition for mobile capital between jurisdictions strengthens the accountability of bureaucrats and thus puts pressure on rent extraction; others point out that local politicians and bureaucrats are more likely to be subject to the pressing demands of local interest groups, have more discretionary power, and are likely to increase the supply of services for which kickbacks are higher, not necessarily which are locally needed, leading to greater levels of corruption (see Lessman and Markwardt 2010; Prud'homme 2005). There are thus conflicting views as to whether the implementation of inter-regional competition through decentralisation can serve as a means to curtail corruption and proliferation of the shadow economy.

The empirical basis for decentralisation

Much work remains to be done on the potential direct effect of fiscal decentralization on economic growth and the hypothesized indirect effects of decentralization on growth through macroeconomic stability, economic efficiency, and the distribution of resources.

(Martinez Vazquez and McNab 2003: 1608)

There is a large and growing body of literature that seeks to provide an empirical basis for the theory of fiscal federalism and the decentralisation it promotes. Does it result in improved public service delivery or is it inefficient due to issues such as multiple intergovernmental transfers? Does it limit or increase the size of the public sector? Does it induce or control corruption? These are some of the many questions that have been addressed in the research literature. The evidence from the literature is equivocal and conflicting (White 2011). Decentralisation is defined and therefore measured in different ways, and this contributes to inconsistencies in the outcomes of research studies (Sharma 2006: 53; 55). Problems with the measurement of decentralisation include that it involves the quantification of power and the distribution of power, both of which are complex phenomena and not easily amenable to measurable categories (Pina-Sanchez 2014: 12).

The implications of decentralised governance structures are multidimensional. They do not only have fiscal influences, but also affect economic development, social equity and environmental planning processes and outcomes in complex ways. Many studies tend to look at these dimensions in isolation (Kim and Jurey 2013: 120-121). These researchers also note that many studies have found no statistically significant evidence for the hypothesis that more decentralised governance is favourable to fiscal efficiency. The advantages of decentralisation and inter-jurisdictional competition do not necessarily outweigh disadvantages such as administrative inefficiency and regulatory inconsistency. Several studies have also found that environmental planning and resource management outcomes can be worse in decentralised governance settings (Kim and Jurey 2013: 120-121).

The potential impact of decentralisation on economic growth is one of the arguments for countries to pursue fiscal decentralisation policies and this argument has gained in significance in recent years. Questions over whether decentralisation affects economic growth 'have become an important policy issue for developing and transitional countries' (Martinez-Vazquez and McNab 2003: 1608). These researchers find that the empirical evidence is mixed, further complicated by 'several potential problems with the methodological approaches followed to

derive those tests' (Martinez-Vazquez and McNab 2003: 1608). While studies have failed to establish a direct link between fiscal decentralisation and growth, they do illuminate the potential of indirect effects on enhanced consumer or allocative efficiency, which in turn can lead to flow-on effects that contribute to economic growth, such as increased private investment; distribution of resources; and impacts on corruption and the 'capture of local governments'.

Based on a review of studies up to the early 2000s that have tested for the effects of decentralisation on economic growth indicators, these researchers point to the paucity of research either on the indirect effects of decentralisation, on whether decentralisation improves efficiency in developing and transitional economies, or on whether it induces or controls corruption, leading them to summarise that 'we are uncertain as to the specific and aggregate effects of decentralization on growth, equity and macroeconomic stability' (Martinez-Vazquez and McNab 2003: 1609).

Debates on fiscal decentralisation and its impact on public spending have been prominent in the literature since the 1970s, and there are three competing hypotheses with regard to this relationship, namely that decentralisation is negatively associated, that it is not systematically associated, and that it is positively associated with increased public spending (Busemeyer 2008: 451-452). Based on a study that uses panel data estimation techniques on a sample of 28 countries for the period from 1976 to 2000, Ashworth, Galli and Padovano (2013) find that the amount of revenue raised by sub-national governments leads to a long-term fall in the size of government; that grants between different levels of government lead to growth in the size of the public sector; that having a parliamentary as opposed to a presidential system of government leads to a rise in the size of government, although these influences do not work immediately; and that greater decentralisation of expenditure leads to greater overall spending (Ashworth et al 2013).

Based on an analysis of studies carried out on decentralisation in 64 countries, Lessman and Markwadt (2010) find that decentralisation counteracts corruption in countries with high degrees of freedom of the press, whereas the tendency in countries without a free press is for the positive effects of decentralisation to be outweighed by negative effects, with increasing corruption as a result. The implication is that decentralisation is a suitable instrument for controlling corruption in countries with an appropriate information infrastructure, while countries without these necessary information flows may not benefit from decentralization (Lessman and Markwadt 2010: 633).

Ebinger, Grohs and Reiter (2011) evaluated the impact of differing decentralisation strategies on the administrative performance of lo-

cal governments subsequent to reform, focusing on six reform ventures carried out between 2006 and 2009 in France, Germany and England. The study found that direct relations between decentralisation strategies and performance effects on certain dimensions are not warranted, calling into question the effects of certain decentralisation strategies (Ebinnger et al 2011: 572). Based on a study of 66 countries, Treisman (2006) finds that economic development increases decentralisation of expenditures more than revenue decentralisation ‘rendering local governments in richer countries more dependent on central transfers’ (Treisman 2006: 289).

Research conducted in Australia finds that fiscal decentralisation tends to enhance microeconomic stability, to increase the size of the Australian public sector and, on some but not all measures, to increase the inequity of income distribution across the States and to retard economic growth (Bodman, Campbell, Heaton and Hodge 2009: 33-34). On the basis of the study, the researchers conclude that ‘now that some of these effects have been empirically identified the next step is a better theoretical understanding of why these relationships exist and what policy lessons can be learned from them’ (Bodman et al 2009: 34). This is in keeping with calls from other researchers, whose work is reviewed in this paper, that the empirical foundation for fiscal decentralisation needs to be strengthened.

Decentralisation in the context of emerging economies

Decentralization has become a byword associated with Public Sector Reform in developing and transitional countries...Yet despite its emergence as an ubiquitous term that cuts across disciplinary lines in international development, the nature, practice, and benefits of decentralization remain unclear.

(Rees and Hossain 2010: 581)

Key themes

A strong, interventionist central state was considered by early development economics as necessary to correct market failures and to ensure growth, stability and social development in emerging economies (Mohan and Stokke 2000). During the 1970s and 1980s, and in contrast to this early theory, there was increased support for decentralisation in theory and in practice, and many countries began with decentralising reforms (Rondinelli and Nellis 1986: 3).

The result is that there has been a profound re-examination of the public sector in emerging economies that has led to a shift from the

emphasis on development strategies based on centralised modes of planning and resource allocation, to viewing local government as being more efficient in providing public goods and services according to the tastes and preferences of individual residents (Chattopadhyay 2013: 422). Programs were rolled out across countries in Africa, Asia and Latin America and decentralisation became 'one of the broadest movements and most debated policy issues, in the world of development' (Faguet, cited in Rees and Hossain, 2010: 582).

In keeping with the theories presented above, arguments in favour of decentralisation for emerging and transitional economies have consistently been put forward as, amongst others:

- cutting red tape and waste associated with highly centralised, hierarchical public sector bureaucracies;
- tailoring of services to the requirements and preferences of local people;
- harnessing local diversity to foster innovation;
- increasing effective democratisation; and
- using local labour to provide local services more cheaply and effectively.

(Vries, cited in Rees and Hossain 2010: 584)

In addition, support for decentralisation in the emerging and transitional economies has come from a range of seemingly opposed theoretical stances. Neoliberals (the 'new Right') argued that the state was a barrier rather than a driving force in the development process. Proponents argued not only for a smaller, de-centralised state, but also for including identified and targeted non-governmental groups in the development process. The view was promoted that 'power resides with individual members of a community and can increase with the successful pursuit of individual and collective goals' (Mohan and Stokke 2000: 249).

Radical development studies (the 'new Left') questioned the centrality of class as the locus of political consciousness and argued for 'the collective mobilisation of marginalised groups against the disempowering activities of both the state and the market' (Mohan and Stokke 2000: 249). Various strands of populism emphasised the role of social movements and community organisations, while more radical versions were rooted in attacks upon Westernisation and capitalism. In both cases the position was that the 'post-development era is to be founded upon localised, non-capitalist practices' (Mohan and Stokke 2000: 249).

While the outcome has been a ‘paradoxical consensus’ that values the role of decentralisation and local participation in enhancing development, there has often been a shortage of critical analysis of the political use of ‘the local’, local inequalities and power relations. There has also been neglect of the role of national and transnational economic and political forces (Mohan and Stokke 2000: 247). Rees and Hossain (2010: 582) caution that an emphasis on the process of decentralisation often seeks to hide the fact that the ultimate goal is political: it is about achieving an end state that has ‘potential to fulfil the various organizational, societal, and ultimately the political objectives of, for example, the revolutionary left, or the reformist right’.

Martinez-Vazquez and McNab (2003: 1597) assert that, due to confusion over terminology, decentralisation in many countries may be no more than geographical deconcentration of central government bureaucracy and service delivery, so that ‘decentralisation may actually appear to be more popular among developing and transitional countries than it truly is’.

Researchers such as Rondinelli et al (1989), Guess (2005) and Hankla and Downs (2010) have discussed the issues relating to implementing decentralisation programs in emerging economies. The link between economic development and decentralisation has been made by several authors and the trend is assumed to be strong – the more economically developed the country, the more fiscally decentralised it tends to be (see Treisman 2006: 295). Factors that come into play here include that decentralisation itself may be a ‘superior good’ in that, as people become wealthier, more educated and more urbanised, they may have more time and greater motivation to participate in local affairs, in addition to being more skilled at organising (Tanzi, cited in Treisman 2006: 295). Higher levels of development may induce a shift in tastes towards public goods and services that can be provided locally with greater levels of efficiency.

The degree of decision-making centralisation in a federation is also likely to vary with the centralisation of the main parties or party. What may be more difficult to measure is whether fiscal decentralisation is more common in countries moving toward greater democracy (Treisman 2006: 313). According to Hankla and Downs (2010: 761), ‘researchers largely agree that local democratic elections are necessary to realise the benefits of decentralisation’. Administrative decentralisation on its own does not improve service delivery or reduce corruption. Electoral competitiveness threatens dishonest or incompetent officials with removal and tends to improve fiscal responsibility and governance quality (Hankla and Downs 2010: 761-762). Scholars agree that when elected local governments are empowered, ‘strong executive authority should be coupled with effective local council oversight’ (Hankla and

Downs 2010: 778). Drawing on case studies of Pakistan, the Philippines and Indonesia, Guess (2005) highlights the need for top-level regime support, which should exist in three forms: the authorisation of legal and regulatory frameworks; the provision of adequate local financing; and the authorisation of oversight and control structures over 'tendencies to interfere and control' (Guess 2005: 221).

Commitment and support is needed from national leaders, central government agencies and ministries and within the broader polity (Rondinelli et al 1989: 77). Amongst others, this implies that political leaders need to accept that participation in planning and management should be out of the direct control of central government or the dominant political party; that line agencies of the central bureaucracy need to have strong administrative and technical capacity to support their field agencies and the lower levels of government in performing decentralised functions; and that effective channels of political participation and representation would need to be developed, including allowing citizens to express their needs and demands (Rondinelli et al 1989: 77).

In a paper focusing on transforming the public sector in Indonesia, Horhoruw, Karippacheril, Sutyono and Thomas (2012) point to research which suggests that high performance of government institutions can be linked to key drivers of performance that can be grouped into three pillars:

- Internal effectiveness, which is driven by the quality of the human capital in the institution, how the human capital is structured and motivated and the resources deployed to support the human capital;
- Alignment, which is driven by the quality of leadership, robustness of strategy and how leadership and strategy are translated into the overall culture of the institution, driving its people to higher performance; and
- External impact, driven by the way in which the institution engages with its main stakeholders, including citizens, other government institutions and suppliers and collaborators.

In considering the dynamic process of decentralisation, the concept of 'technical design and sequencing' refers to the many processes that are required to creating new institutions and building on existing practices (Guess 2005: 223). Guess (2005: 221) suggests that the most immediate issue is 'whether the newly empowered tier of local government can absorb its new revenue-raising and expenditure assignments'. This is promoted through mechanisms such as transferring of tasks, skills and systems from higher-tier to local governments; shifting reporting and control system to local accountability; and dealing with resistance to

decentralisation, especially concerns about trust and capacity problems.

Focus needs to be placed on the ‘behavioural and psychological conditions’ supporting decentralisation (Rondinelli et al 1989: 78) as well as on the culture of political institutions (Guess 2005: 221-222). These include distrust of government, the strength and nature of family and tribal loyalties, and traditions of having arbitrary power over underlings. ‘Culture may be turned from a static obstacle to the dynamic foundation on which a decentralization program can be built’ (Guess 2005: 222). Amongst the cultural factors are those relating to ethnic heterogeneity, and perhaps more importantly, the degree to which ethnic divisions are politicised and ethnic groups territorially compact. Following the basic fiscal decentralisation argument, and since tastes for public goods and services are likely to vary across ethnic groups, there are arguments by some that more utility will result if services are indeed provided in different, ethnically homogenous regions. As Treisman (2006: 293) cautions, this may not always be borne out in practice, since it assumes that central governments can only provide goods uniformly.

Since ‘most countries of the world were colonised within the last two centuries by one or other of the major powers’ (Treisman 2006: 294), it is important to consider the legacy of colonial history. Research suggests that former colonies of Britain, France and Russia – as well as countries never colonised in the modern era – are significantly more decentralised than former Spanish or Portuguese colonies (Treisman 2006: 309-311).

Moving beyond the decentralisation-centralisation dichotomy

It is evident that there is debate as to whether decentralisation is good for emerging economies or, at least, whether the ‘benefits of decentralization for developing countries outweigh the potential drawbacks’ (Hankla 2009: 633). Several of the key issues of contention have been discussed earlier in this paper. In many transitional and developing economies, however, these are not the key issues. As pointed out by Prud’homme and Shah (2002: 2-3; emphasis added), in these settings **‘decentralization is a political must**. In most countries, it has been politically driven’. In other words, it is not a question of whether or whether not to decentralise but rather that ‘since decentralization will take place anyway, what kind of decentralization is most appropriate?’

Recommended considerations are put forward next, drawing on the works of key theorists and researchers.

Consider the design of the system of multi-level governance

Several instruments and policy variables can be used when designing a system of governance involving two or more levels of governments (Prud'homme 2002: 3-4). These include the allocation of responsibilities for the provision of public goods and services between the various levels of governments; allocation of taxes between the different levels of government; central government controls, guidelines and constraints upon local government behaviour; and local government election rules.

On the basis of the understanding that the design of a given country's system of multi-level governance has an important role to play in decentralisation-centralisation decisions, Hooghe and Marks (2003) draw on a wide range of literature to distinguish two types of multi-level governance, namely territorial multi-purpose jurisdictions and specialised task-focused jurisdictions. While the chief benefit of multi-level governance is 'scale flexibility', its chief cost lies in the transaction costs of coordinating multiple jurisdictions, which is a necessary task since the policies adopted in one jurisdiction have spillover effects (negative or positive externalities) for other jurisdictions. Consequently, 'coordination is necessary to avoid socially perverse outcomes' (Hooghe and Marks 2003: 13). In territorial, multi-purpose jurisdictions, a chief strategy is to limit the number of autonomous actors who have to be coordinated by limiting the number of autonomous jurisdictions. In specialised, task-specific jurisdictions, coordination costs are best contained by constraining interaction across jurisdictions (Hooghe and Marks 2003: 13-15).

Hankla (2009) provides a conceptual framework for considering decentralisation and good governance in the context of emerging economies. This framework, consisting of three political economy categories and nine design principles, puts the focus on ensuring that decentralisation is genuine and effective, on promoting better sub-national representation and governance practices and on strengthening national public goods and political stability.

Focus on both central and local level capacity

Based on a review of decentralisation and recentralisation in health systems, Mosca (2006: 119) concludes that the following capacity-building principles are essential for the success of reforms:

- The decentralising of responsibilities from the centre to the local is a long-term project and requires clear guidelines, including definition of the roles and functions of different actors.

- A built-in split between the funding function (kept at the centre) and the management function (devolved to the local) inevitably leads to a form of weak decentralisation and heightens opportunities for a ‘blame game’ between jurisdictions. It should, wherever possible, be avoided at the design stage.
- Decentralisation must necessarily be accompanied by devolution of knowledge and capabilities, which must be present in the sub-layers of government.

A study by Chattopadhyay (2013: 438) provides empirical evidence that countries which successfully undertake decentralisation had the local level capacity to properly implement the decentralisation process or took steps (including investment) to build local capacity. Local technical capacity is a key concern and ‘ultimately the success of decentralisation policies hinges on institutional capacity-building’ (Rondinelli et al 1989: 78).

Adopt flexibility

Diverse understandings of decentralisation and its contributory components suggest the need to adopt flexibility and openness towards decentralisation approaches and desired outcomes in any given context. Prud’homme (2005: 213) suggests that flexibility should be adopted in several areas. There is a strong case for differential treatment of taxes and expenditures, for example. Whereas much public expenditure lends itself to decentralisation, this is not the case for taxation. It remains inevitable therefore that sub-national government will rely to some extent on transfers from the central government. The policy focus could shift to better design of the system of transfers, which includes accepting the need for trade-offs and compromises. Decentralisation should not ignore geography and should take account of the concept of the ‘critical mass’ (Prud’homme 2005: 215).

The size of both the population and the country matters – decentralisation is more likely to be warranted in heavily populated as well as larger countries. Large cities should be treated differently from smaller jurisdictions in that they too are more able to benefit from decentralisation. Decentralisation should not shrink central governments to below a certain quantitative and qualitative level i.e. the critical mass. Consideration could be given to finding out which services or sectors lend themselves more readily to decentralisation. The characteristics of public goods and services come into play, including the quantity and types of external effects and geographical spillovers associated with the service; the ease with which the service can be financed by charges as opposed to taxes; and the degree of technical and managerial expertise required to provide the service (Prud’homme 2005: 215-216). Similar-

ly, functions may also be treated differently, for example considering different degrees of decentralisation for functions such as construction, operation and regulation (Prud'homme 2005: 217-218).

Country examples

Indonesia

As of 2012, the population of Indonesia was 244,769,000. On the Human Development Index (HDI) scale, Indonesia ranks at 121st out of 186 countries, with an HDI score of 0.629 (UNDP 2012). Indonesia is the fourth most populous country in the world, with a national poverty rate of 16.7% (2009 figures) and a rapidly growing share of people (30% in 2005) living in urban areas (Rokx, Giles, Satriawan, Marzoecki, Harimurti and Yavuz 2010: 25).

Throughout most of its history, Indonesia's public sector 'has been counted among the most centralized in the world' (Lewis 2010: 648). From the late 1990s, the country pursued a relatively dramatic shift from the highly centralised state, which reached its apex under the 'New Order' regime of President Suharto (see Rosser 2012: 255), to deep decentralisation of most government functions to the district level. Under the 'decentralization principle', matters referred to lower levels of government become the full responsibility of regional governments, including authority for policy formulation, planning, implementation and funding (Prosojo, Kurniawan and Holidin 2007: 88). Following this trajectory, 'local government reforms have dominated the country's policy agenda since 1999' (The Hunger Project n.d.)¹.

Implementation of the decentralisation and regional autonomy law, *Law No. 22/1999 on Regional Governance*, which strengthened regionalisation, has been described as 'Big Bang Decentralization' due to the sweeping changes it brought about. When it came into effect in 2001, it led to the transfer to the regions of authority over most government functions except for foreign policy, security and defence, justice, monetary, fiscal and macro-economic policies, and religious affairs (Prajojo et al 2007).

These changes were spurred on following dramatic changes to the nation's economic situation as a result of the Asian Financial Crisis, and concern over issues of transparency, accountability and professionalism in government affairs that led to the introduction of free and fair

1 The Hunger Project is working in partnership with the UN Democracy Fund on a two-year project to cultivate a global community of practice among individuals working to build capacity for effective, responsive local governance with a particular focus on impoverished rural areas. The website at <http://localdemocracy.net/about/> provides an overview of local governance and the decentralisation reforms in Indonesia.

elections and democratic governance in 1999 – ‘given such a situation, it became necessary to demonstrate that change in the way local governments run their affairs is possible’ (UNDP 2002: 1). Decentralisation policies and principles were revised and reformed with the passing of the *Revised Autonomy Law, Law 32/2004* (Prasojo et al 2007: 86) and *Law No 12 /2008* (Bandur 2012).

Horhoruw, Karippacheris, Sutiyono and Thomas (2012) characterise the public sector reforms that accompanied these processes of decentralisation in three waves, drawing on a model one developed in the United Kingdom by Michael Barber in 2007. It includes a post-crisis response, which in Indonesia emphasised the role of the overall strategic direction, leadership and change management in galvanizing a coalition for transformation; consolidating reform, reflected in Indonesia through the challenges to defining a culture of performance for the delivery of public services; and a shift from devolution and transparency to quasi-markets, including the setting of performance indicators and targets are being set for the government as a whole and for individual institutions.

The Revised Autonomy Law of 2004 stated that local elections were to be conducted by the Commission for District Election. This means that the head and the vice head of local governments are elected directly by the local citizens. Representatives serve for five years, and there is no limitation on re-election (UCLG 2007). Indonesian local government is divided into provincial as well as city/district levels of government. Provinces and city/districts have their own legislative bodies and their own government system (United Cities and Local Government [UCLG] 2007). The local parliament elects a Governor who heads the provincial level of government; city governments are led by a Mayor; and district governments are led by a Regent. Regional heads at both the provincial and district levels are accountable to the regional legislative bodies that elected them, rather than to higher levels of government (Kristiansen and Santoso 2006: 251). Mayors and governors are directly elected in an open list system (UCLG 2007).

Law 25/1999 requires the central government to transfer at least 25% of domestic net revenues to sub-national levels of government. Ten per cent of this amount is channelled to provincial governments and 90% to the local governments (Fane 2003: 160). Local governments rely mainly on these transfers from the central government and have full discretion of their use. It is possible that by-passing the provinces may have been linked to fears of secessionist movements, whereas strengthening local governments may contribute to weakening those movements (Fane 2003: 160).

The central government determines local tax types and rates

(UCLG 2010). While the local governments may create new local taxes, they are subject to central government approval. The tax on electricity sales is the most important own-source revenue, making up about 20% of the total; taxes on hotel and restaurant sales comprise about 10% of own-source revenues; and public health centre charges also comprise about 10% of own-source revenues (UCLG 2010).

With decentralisation, much of the responsibility for service delivery was transferred to local governments (UNDP 2002). The most important local service in Indonesia is education – local governments spend about 35% of their budgets on primary and junior secondary school education. This is followed in importance by infrastructure – around 15% of local government expenditure is on infrastructure.

The following challenges are amongst those identified in the literature as regards the current local governance arrangements in Indonesia:

- In a paper examining Indonesia's process of moving to greater devolution of power and transparency since the late 1990s, Horhoruw et al (2012: 12) make the comment that, although the pace of Indonesia's reforms is encouraging, it remains slower than the pace of economic and technological change, and has been hampered by central controls and regulations that have outlived their usefulness.
- According to the UCLG (2010: 103), the most critical local government issues in Indonesia relate to the distribution of revenues across local governments and to the quantity and quality of spending by local governments. The UCLG notes that 'Indonesian local government's management capacity is weak, and while some municipalities have made significant improvements in this domain, across the board this translates into low spending efficiency'.
- Own-source revenues provide another set of constraints. Local governments lack access to any good source of own revenue that can be used to respond to citizen demand. Tax revenues are highly centralised, while expenditure is more decentralised – provincial and local government own-source revenues equal only about 8% of government revenue (UCLG 2010: 92). A 2009 Indonesian law mandates that sub-national governments will have authority over the urban and rural property tax as part of continued decentralisation policies within the next five years, 'but implementation during the indicated time frame is far from certain... [and]...if it does eventuate, it will be necessary to reinforce the capacity of Indonesian local governments to use the property tax effectively' (UCLG 2010: 104).

- Drawing on a 2003 report by the United Nations, The Hunger Project (n.d.) notes that decentralisation has created greater local independence and a phenomenon of ‘local egos’ that may be unproductive when facing problems that require cooperation with other regions.

As can be seen above, challenges relating to the fiscal domain feature prominently in these commentaries. It also appears that this is well recognised at the policy level. According to Lewis (2010: 652), the general tendency for line agencies in the Indonesian central government to deal with challenges and bottlenecks in the system has been to argue that additional funds are needed to improve local public services, and these agencies have promoted an increase in intergovernmental funding. Recently, however, there has been another tendency, promoted most strongly by the Ministry of Finance. This is to reallocate existing intergovernmental resources (rather than significantly increase new funding for subnational governments) and to accompany this with the development and use of performance incentives (Lewis 2010: 653). In mid-2014, ACELG participated in a capacity-building initiative in keeping with this very objective.

Lewis (2010: 653-654) suggests that there is a third mechanism, namely a ‘civil society’ one: focus on educating citizens about their rights and responsibilities vis-à-vis local public services, thus increasing the expectations that they may have regarding to quality of services to which they have access. This approach nevertheless ‘assumes the prior existence of mechanisms through which citizens might channel their newly developed aspirations’ (Lewis (2010: 654) or the speeding up of initiatives to enhance civil society sector. This would be a long-term goal.

On the basis of research into the Indonesian public sector during decentralisation reforms, Horhoruw et al (2012: 13) draw the conclusion that ‘rapid diffusion of new technologies in the public sector could prove a catalyst for much needed performance and governance improvements’. Kannan and Morris (2014) similarly point to the importance of infrastructure, including transport, energy and information and communication infrastructure, in contributing to challenges in the implementation of decentralisation. The World Economic Forum ‘Global Competitiveness Index’ of 2011 highlighted Indonesia’s inadequate supply of infrastructure as the major problem now facing the country, for example through the waste of human capital in unnecessary travel time and road accidents (Kannan and Morris 2014: 1-2).

These researchers recommend the strengthening of the Policy Committee for the Acceleration of Infrastructure Provision (KKPPI), which has had ‘limited output’ during the 2006 to 2011 period (Kan-

nan and Morris 2014: 3). Amongst other, KKPPi could play a key role in capacity building for regional government, relocating central experts to lead regional government's infrastructure team and providing outsourcing options for regional government. This could lead to the establishment of province-wide infrastructure maintenance programs that regional governments can opt into so that they don't need to manage their own program (Kannan and Morris 2014: 11).

Pakistan

Since the establishment of the country in 1947, Pakistan has had local governments as the lowest-tier political structure, but 'the alternating pattern of political and military governments has not only affected the structure and design of local government systems, but more importantly had significant implications for the development of grassroots democracy' (Alam 2013: 44).

According to Sivaramakishnan (2000, cited in Alam 2013: 45), local government in South Asia often tends to be stronger during eras of authoritarian rule than in times of democratic rule. During democratic regimes, elected local government may be less attractive to those in power since it provides 'an additional platform for citizen participation, and hence may to some degree rival the centre'. The patronage of local governments under military regimes is not unique to Pakistan. In many countries military governments have attempted to create grassroots popularity and support, and to secure their legitimacy and a better external (and internal) image by nurturing local governments (Alam 2013: 45).

Following a coup in 1999, General Musharraf introduced a program of devolution of power and authority under the aegis of the newly-established National Reconstruction Bureau (Alam 2013: 49). The Devolution of Power Plan that ensued was explicitly based on the principle of subsidiarity, with clear responsibilities for three tiers of sub-national government:

- District governments were given responsibility for functions such as agriculture, health and education and became financially able through transferred funds and local taxes.
- Town governments were assigned most of the functions of former municipal authorities as the main providers of essential services such as water, roads and waste disposal.
- Union councils were to provide monitoring and oversight of service delivery, as well as undertaking small developmental projects.

(Alam 2013: 49)

The 18th Constitutional Amendment was passed on 20th April 2010, introducing profound changes to Pakistan's institutions of inter-governmental coordination (Shah 2012: 393). The most significant of these changes is the reassertion of two institutions of the federation, namely the Council of Common Interests (CCI) and the National Economic Council. The CCI is chaired by the Prime Minister and includes four provincial Chief Ministers and three federal government nominees as members. It has a permanent secretariat and is required to meet at least once every quarter (Shah 2012). The CCI has been entrusted with decision making, monitoring, supervision and control responsibilities over a wide range of areas, including railways, industrial policy, electricity, major ports and federal regulatory authorities. The National Economic Council has always been 'active' as a constitutional body with oversight responsibility for national economic policies. The 18th Amendment has tilted the balance of power on the Council in favour of the provinces by mandating two members each, including the Chief Ministers of each province, and four federal members appointed by the Prime Minister (Shah 2012).

The 18th Amendment has deleted the list of federal/provincial concurrent responsibilities and reassigned selective functions to the federation to be guided by the CCI, while devolving others to the provinces. The 18th Amendment ensures that almost all direct public services become a provincial responsibility. As a consequence, 17 central government ministries have been devolved to the provinces, key amongst which are education, health, labour and human resources and population welfare (Hashmi 2014: 52). As Shah (2012: 403) notes, '[F]or all economic and social services, the provinces will assume a dominant role in policymaking and service delivery. For the average citizen, the government that will then matter is the provincial government'.

The Amendment has constrained the federal government in terms of its authority over banking, finance, and insurance. Its regulatory authority no longer extends to provincially-owned entities or private entities operating in a single province. In addition, it has expanded provincial borrowing privileges to include domestic and foreign loans – subject to limits and conditions imposed by the National Economic Council – and expanded the provinces' tax domain to include a sales tax on services (which could yield revenues equivalent to 0.5–1% of GDP) (Shah 2012: 400-401)

In a study of five 'fragile countries', Anten et al (2012, cited in Alam 2013: 54) conclude that Pakistan offers the most detailed example of a process of decentralisation that has only partially achieved its objectives. Institutional reforms that do not 'align with the interests and incentives of power-holders' are unlikely to lead to robust new arrangements. Civilian governments have tended to be 'shy of nurturing grass-

roots democracy', raising significant questions about their democratic values and commitment to empowering citizens (Alam 2013: 56).

Local governments are often managed by non-elected administrators and local government elections are often postponed (Alam 2013). Linked to changes brought about by the 18th Amendment (discussed next), the Ministry of Local Government at the federal level has been abolished.

The following critiques of the changes to the Constitution are by Anwar Shah, writing in 2012 in *The Lahore Journal of Economics*. According to this academic, the 18th Amendment neglects the role of local governments in public service delivery (Shah 2012). At the same time, functions that should be core to a federal government – such as a harmonised tax system, protecting minorities and disadvantaged groups, and dealing with natural disasters – have been taken from the federal domain. It has empowered provinces to borrow from domestic and international sources, subject to conditions imposed by the National Economic Council. However, the Council may not be able to discipline such borrowing.

The changes have strengthened opportunities for tax evasion by enabling 'tax arbitrage' by potential taxpayers, who can now shift their income to agriculture and business expenses from higher-taxed sectors or sources of income. The Amendment has opened up the potential for barriers to goods mobility across the country by recognising provincial authority to discriminate against non-residents. Article 27(2) of the amendment overrides the safeguard against discrimination in employment by empowering provinces and local governments to institute a three-year local residency requirement. 'This poses a serious risk to economic union in Pakistan' (Shah 2012: 408).

According to Shah (2012), potential consequences include the following:

- In the absence of fundamental reforms in the governance of political parties, political finance, land reforms, and devolution to the local levels, provincial empowerment may not necessarily lead to greater participation and accountability, while corruption and abuse of power may continue unabated. There is significant potential for federal–provincial and inter-provincial conflict.
- The international trend is for globalisation to empower supra-national regimes and local governments at the expense of national and provincial governments. Under the changes in Pakistan, empowered provinces could create incentives for weaker and numerous local governments and block the rationalisation

of local government functions.

- There is strong potential for a ‘tragedy of the commons’ situation, in which all federating units out-compete each other in wasteful spending and giveaways in taxes and subsidies. The provinces might create barriers to trade and factor mobility, thereby fragmenting the internal common market.
- Greater duplication of government structures and processes at central and provincial levels are likely to lead to increased costs for the Exchequer, higher transaction costs for citizens, and ‘overgrazing’ by politicians and bureaucrats.
- Having decision-making far removed from the people implies that provincial governments have incomplete contracts with their citizens and cannot be held to account by the latter.

(Shah 2012: 410-419)

Towards a synthesis-framework

There has been a growing acceptance that it is not a question of whether decentralisation will or will not take place in a given country, but rather to move beyond the centralisation-decentralisation dichotomy, consider what kind of decentralisation is most appropriate and strive to maximise the benefits of decentralisation for the citizens of the country. In order to contribute to this quest, the following framework is put forward. The elements of the framework are based on the works of theorists and researchers that have been introduced in earlier sections of this paper.

Appreciate the theoretical scope of fiscal decentralisation

There is value in having a sounder appreciation of the theoretical and historical development of the concept of fiscal decentralisation, including the debates that have been generated over many decades.

On the basis of an exploration of the concept of decentralisation and the arguments in favour of it that have been put forward in the literature over many decades, the following understanding of the promise of fiscal decentralisation is put forward:

Based on the theory of fiscal federalism, decentralisation is both a structure and a dynamic process that relates to questions of authority, responsibility and power, as well as to the functions and resources, of different levels of government. Arguments in favour of decentralisation focus on the role it has in making government more efficient in the supply of local public goods and more responsive and accountable to the citizenry. Both are presumed to enhance the legitimacy of government authority through promoting the welfare of individuals and communities. Decentralisation allows for more effective and inclusive decision-making, reduces the distance between bureaucrats and economic agents, and may also be able to enhance economic growth.

Source: author, based on synthesis of literature

There is a large and growing body of literature that seeks to provide an empirical basis for the theory of fiscal decentralisation. The evidence from the literature is equivocal and conflicting. Many studies have found no statistically significant evidence for the hypothesis that more decentralised governance is favourable to fiscal efficiency. The advantages of decentralisation and inter-jurisdictional competition do not necessarily outweigh disadvantages such as administrative inefficiency and regulatory inconsistency.

The principle of subsidiarity has been incorporated into the theory and practice of decentralisation, and is regarded as a key normative principle for federations and supranational bodies. On the basis of an exploration of the principle in the literature, the following understanding is put forward:

The principle of subsidiarity, which was developed in Catholic social theory in the mid-20th century, has become incorporated into the political, economic and public administration understandings of decentralisation, particularly as it applies to federations and to supranational entities. It draws attention to (central) government, the individual, and the mediating structures which are bulwarks against government authority. The principle argues that taxing, spending and regulatory functions should be exercised by lower levels of government unless a convincing case can be made, by central government, for assigning them to itself. Arguments for retaining powers need to be made on the basis of comparative efficiency.

Source: author, based on synthesis of literature

Support for decentralisation in the emerging and transitional economies has come from a range of seemingly opposed theoretical stances, but decentralisation reforms tend to be essentially politically

– not economically or empirically – driven. What some governments describe as decentralisation may be no more than geographical deconcentration of central government bureaucracy and service delivery.

The positive associations of decentralisation are countered by arguments that it can lead to increases in disparities and inequality and can have negative consequences on macroeconomic stability. Far from enhancing government efficiency, there is the perspective that decentralisation can undermine efficiency, particularly in emerging economies. There are conflicting views as to whether the implementation of inter-regional competition through decentralisation can serve as a means to tackle one of the most serious obstacles to economic development in particularly the emerging economies, namely corruption and proliferation of the shadow economy.

The literature suggests benefit in considering four interlinked dimensions of the concept – fiscal, political, administrative and market, with fiscal as the central indicator. This is illustrated in Figure 2.

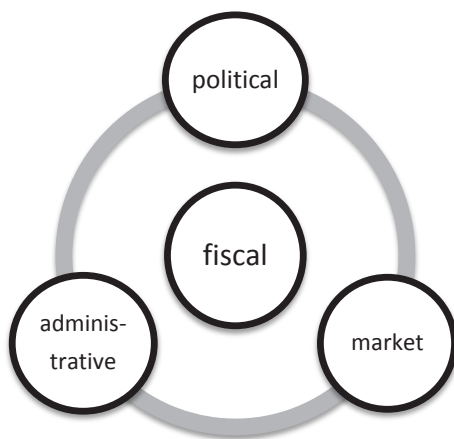


Figure 2: Dimensions of fiscal decentralisation

Source: author, based on strong correspondence in literature

The dimensions of fiscal decentralisation are dynamic and interconnected.

The theory highlights that administrative decentralisation can be placed on a continuum of administrative autonomy from deconcentration – delegation – devolution.

The subsidiarity principle has utility as a normative instrument in the process of establishing a broad, shared intergovernmental political framework.

The divestment, deregulation and dispersed power implications of market decentralisation are important in the age of globalisation and governance networks.

The potential benefits and potential drawbacks of decentralisation are well formulated in the literature, and international research from a wide range of disciplines is vigorous and ongoing.

Focus on the country and its goals

Attention can be given to the economic, political, organisational, and cultural and historical factors in the quest to build up a sound appreciation of the country at the time of reforms to the public sector.

It is valuable to aim for some level of shared agreement as to why decentralisation is being pursued in the given country and what it is intended to achieve at this time. If the decision is essentially political, consideration could be given to enriching this with insights from political economic theory and empirical research.

Focus could be given to considering what kind of decentralisation is most appropriate for the country, given its historical, geographical, political, cultural and socio-economic context. There is a range of models in the literature that can be drawn upon. Engagement with the citizens and internal and external experts is beneficial in this decision-making process.

Consider the design of the system of multi-level governance

Drawing upon a critical appreciation of fiscal decentralisation theory and of the country and its goals, an inventory can be made of the instruments and policy variables available. These include:

- the allocation of responsibilities for the provision of public goods and services amongst tiers of government;
- allocation of taxes between the different levels of government;
- central government controls, guidelines and constraints upon local government behaviour; and
- local government election rules.

Decentralisation design principles for good governance are illustrated in Figure 3.

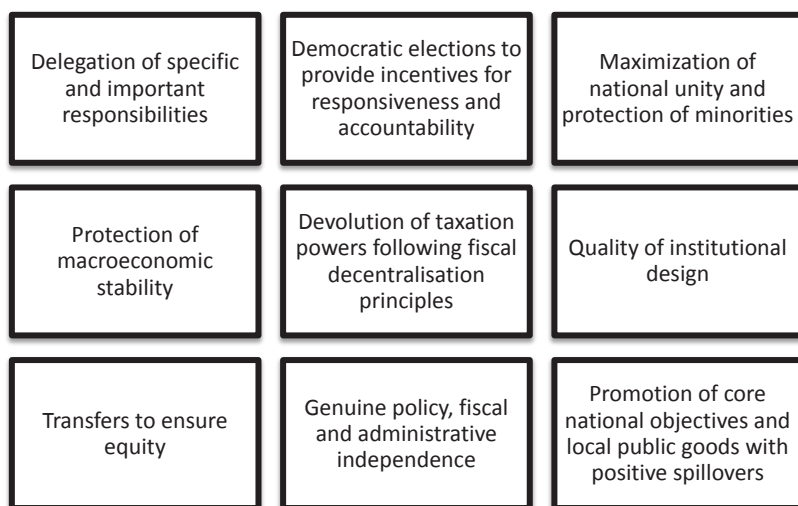


Figure 3: Decentralisation design principles for good governance

Source: adapted from Hankla (2009)

These design principles are based on past research on the governance implications of devolving power to sub-national authorities and by drawing lessons from theory and experience for designing better decentralised institutions (Hankla 2009: 646). Practical lessons can be derived from them about structuring intergovernmental relations for policy-makers in emerging economies.

In addition to territorial multi-purpose jurisdictions, including municipalities, there are models of regional shared services that could be beneficial for a range of public services including libraries and water catchment authorities.

Focus on both central and local capacity

Decentralisation is accompanied by devolution of knowledge and capabilities, which need to be present in the sub-layers of government. Capacity-building mechanisms include a phased transferral of tasks, skills and systems from higher-tier to local governments; gradual shifting of the reporting and control system to local accountability; and dealing with resistance to decentralisation, especially local concerns about trust and capacity problems.

High levels of performance in government institutions can be linked to key drivers of performance. A framework of pillars and drivers of public sector performance (Figure 4) is based on the work of Horhoruw et al (2012) in Indonesia, who themselves based the categorisations upon a body of research into public sector performance.

Quality of human capital	Quality of leadership	Engagement with major stakeholders including citizens, other government institutions, suppliers and service partners
Structuring and motivation of human capital	Robustness of strategy	
Resources to support human capital	Translation of leadership and strategy into organisational culture	
Internal effectiveness	Alignment	External impact

Figure 4: Pillars and drivers of public sector performance

Source: adapted from Horhoruw et al (2012)

A model for technical design and sequencing, based on Guess (2005) is provided in Figure 5. It is illustrated in this framework as part of the focus on building and sustaining institutional capacity, but at the same time is linked to the design of the system of multi-level governance, discussed above.

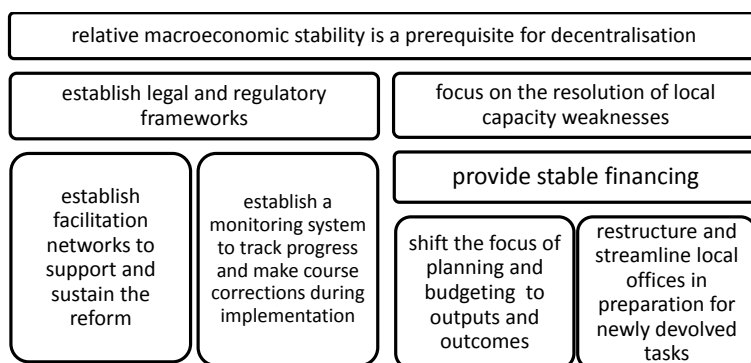


Figure 5: Technical design and sequencing

Source: adapted from Guess (2005: 223-225)

Within this framework, relative macroeconomic stability is a prerequisite, and the other elements should not necessarily be viewed in a linear fashion. A holistic approach is ideal.

Adopt flexibility, supported by feedback mechanisms, in the process of decentralisation

Feedback mechanisms include research, and the monitoring and reporting framework and facilitation networks set up within the design of the system (as discussed above).

Attention could be paid to the synchronicity of the various dimensions of decentralisation – fiscal, administrative, political and market – and taking steps to improve alignment when a lack of synchronicity threatens the stability of the reform process and of the evolving system.

Consideration could be given to differential treatment of taxes and expenditures. Certain services or sectors may lend themselves more readily to decentralisation – there are models and quantitative methods that can assist with this. There may also be value in treating the functions differently and applying mixed decentralisation settings to enhance efficiency. Functions include selecting the appropriate investment, construction (contracting and supervision), and operation and regulation.

Decentralisation should not shrink central governments to below a certain quantitative and qualitative level.

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