

Fiscal Decentralization and Citizen Participation in East Asia¹

Introduction

East Asia's success at promoting economic growth and poverty reduction is well known. Since the early 1980s, sustained economic growth rates in the order of five percent have reduced poverty rates by half. But it is a clear fact of contemporary geopolitics that not all areas are equally well connected with newly expanding economies or regions, nor are basic entitlements to publicly provided goods and services accessible by all. As economic growth progressed, poverty came to manifest in pockets of exclusion, often accompanied by growing inequalities, both across the region and within countries sharply differentiated by urban- rural, upland- lowland, and other ethnic, geographic and place-based divides.

Across Asia Pacific, and most marked in East Asia, one common feature of the policy and institutional package applied by governments keen to foster growth alongside poverty reduction has been to assign state powers, responsibilities and resources to sub-national authorities and to private and civil society agencies under various forms of contract, partnership or principal-agent relationship. Decentralization has become the catch-all term for what proves in practice to be a highly differentiated, and differently motivated, range of practices and institutional forms. Despite assertions to the effect that in East Asia decentralization has heralded major political restructuring and “dramatic steps ... of dispersing or decentralizing the highly centralized power structure” (Kurosawa et al., 1996, p. vii), the region's experience defies any single application of the concept ‘decentralization’. At the same time, although central – local relations are being reconfigured in many different ways, it is quite clear that local, sub-national areas are now overwhelmingly regarded as the site for effective governance. To this scale of governance is pinned the hopes of better service delivery and private enterprise promotion, and increasingly the sub-national scale is seen as the site for the exercise of new forms of participation and citizenship emerging throughout the region.

In its present form, this paper is intended as a backgrounder to orient separate case studies of five contemporary experiences with decentralization, namely Thailand, Cambodia, the Philippines, Indonesia and the People's Republic of China (PRC). The special interest of these case studies is to gauge the impact of different country approaches to fiscal decentralization on what broadly can be referred to as ‘state – society’ relations. Here, the particular interest includes how decentralization may support the near universal policy commitments to increase public access to the affairs of government; bring about greater responsiveness and accountability of locally elected leaders; better match resources for public services with locally defined, and often highly specific, needs; and in large frame, investigate how decentralization is associated, positively or negatively, with achievement of commitments made every government in the region to poverty reduction and sustainable economic growth. The relationships between political participation, democracy, and decentralization have of course been debated since John Stuart Mill and are still not entirely clear (Breton 1998; Litvack 1998).

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But our intention, as requested by INDES, the sponsors of this research, is to identify problems, challenges and innovative experiences in ways that contribute to building fair societies and democratized public policies that work for poverty reduction within the framework of fiscal discipline.

There are four parts to this paper. Part I looks to some basic definitions of decentralization and within this, sets some preliminary limits on the case studies to follow and places them in an international context. We then set out broad parameters against which different country experience can be mapped without compromising the rich variety of 'decentralizations' in Asia Pacific. Part II briefly surveys how decentralization appears in the five countries. The Asian Development Bank (ADB) has done little comparative, cross-country research and analysis on decentralization, though center – local relations and patterns of state-society relations very often feature in ADB's technical assistance and lending operations. This being so, the findings of this paper are only preliminary, and will be revisited following the detailed country case studies. Part III, draws some conclusions from the five country cases. Part IV lists the critical questions to be pursued by the detailed case studies.

Part I: Fiscal Decentralization: Some Definitions and Features of Context

On definitions

Decentralization means transferring fiscal, political and administrative functions from higher to lower levels of government, and can take on different forms depending on the degree to which independence of action is assigned to lower levels of authority. Deconcentration involves central agencies assigning certain functions to lower-level branch offices. Delegation takes place when authority for defined tasks is transferred from one public agency to another agency or service provider that is accountable to the former, but not wholly controlled by it. Devolution takes place when authority for defined tasks is transferred from a public agency to autonomous, local-level units of elected leadership holding corporate status, granted, for example, under legislation². Mark Turner, in a volume dedicated to decentralization in Asia Pacific (Turner 1999) provides a useful framework to understand both the territorial and functional dimensions of decentralization, as well as its common public and private sector manifestations – which serves to remind that fiscal decentralization is merely one manifestation of an on-going restructuring of nation state – market relations throughout the region in the past thirty years (Table 1).

Decentralization is not necessarily a spatial concept requiring reassignment of service delivery responsibilities from higher to lower orders of administration, though this often is the case. Cohen and Peterson (1999, p. 61) emphasize that it is rather the broadening of institutions producing and providing needed goods and services at efficient cost, where ever they are located and whether they are public, quasi-public or private. Indeed, that decentralization often manifests in a plurality of agencies, public and private, operating at different scales of jurisdiction providing overlapping services

² This categorization as defined by Rondinelli et al (1983, pp. 13-31), Leonard and Marshall (1982, pp. 27-37), and others, is the most widely accepted in the recent literature, although Cohen and Peterson (1999, pp. 52-61) list a long array of alternative definitions

gives rise to debate about the consequences for efficiency, through competition, and accountability, through unclear, overlapping mandates.

Table 1: Forms of Decentralization

Nature of Delegation	Basis for Delegation	
	Territorial	Functional
Within formal political structures	Devolution - political decentralization, local government, democratic decentralization	Interest group representation
Within public administrative or parastatal structures	Deconcentration (or delegation) - administrative decentralization, field administration, indirect rule	Establishment of parastatals or quangos
From state sector to private sector	Privatisation of devolved functions (deregulation, contracting out, voucher schemes, etc)	Privatisation of national functions (divestiture, deregulation, economic liberalization)

Turner (1999, 5).

It is fallacious to presume decentralization indicates an inexorable policy progression from 'more' to 'less' centralized governance structures, but by conventional measures, decentralization is in its early stages of adoption in East Asia, despite common commitment in most countries to intensify it and the fact that various 'decentralizations' are underway. Measuring fiscal decentralization entails two conceptual choices, revenue decentralization and expenditure decentralization. Though both are limited as comparative measures, Table 2 contains data on six countries for which comparable data are available. Bearing in mind the limitations in using such data (Ebel and Yilmaz 2001), only China and Mongolia have a sub-national share of public expenditures over 30 percent, while Malaysia and Indonesia are under 20 percent, and Philippines and Thailand under 10 percent.

Table 2: Subnational share of public expenditure and revenues in selected countries

Country	Sub-national Share of Expenditures	Year	Sub-national Share of Revenues	Year	Sub-national Expenditures as Share of GDP	Year	Sub-national Revenues as Share of GDP	Year	Tax Share	Year	Vertical Imbalance	Year
China	53.85	1998	51.34	1998	10.68	1998	6.56	1998	52.68	1998	38.94	1998
Indonesia	10.08	1998	3.1	1998	2	1998	0.52	1998	16.69	1998	74.24	1998
Malaysia	19.14	1997	15.18	1997	5.06	1995	4.7	1995	9.51	1997	17.21	1997
Mongolia	32.16	1999	22.8	1999	12.11	1998	6.94	1998	42.69	1999	42.6	1999
Philippines	8.7	1992	4.69	1992	1.87	1992	0.88	1992	26.77	1992	62.66	1992
Thailand	8.4	1998	7.99	1998	2.06	1998	1.4	1998	59.6	1998	32.33	1998

Source: calculated using the IMF's Government Financial Statistics yearbook as reported on OECD-DAC Indicators page
http://www.bellanet.org/indicators/index.cfm?fuseaction=dsp_indicator&indicator_id=7

Context

In almost all countries of the Asia Pacific region, decentralization has appeared an attractive policy option for national governments at one point or other in their recent history. In their mildest form, decentralization policies are advocated on the grounds that increased popular participation in planning and implementing nationally sanctioned development policies and priorities will occur. The country case studies will examine the association between decentralization and citizen participation more thoroughly, though it is immediately apparent that any intuitively positive association will be contestable, as Tanzania's experience with Nyerere's *ujamaa* policies in the 1970s, or decentralized planning under Marcos' martial law Philippines and many other experiences will suggest. But explicitly stated or not, the various forms of decentralization adopted in current practice tend at the highest level to be pinned to the twin imperatives to reduce poverty whilst sustaining rapid rates of economic growth. Whether the association between decentralization and these aspirations is as robust as hoped for occupies a central place in policy debates, but any study of this type needs a firm appreciation of the Asia-Pacific region's comparative success over the last two decades in promoting economic growth and poverty reduction. While this success has varied between and within individual countries, the region overall has dramatically changed, as Quibria (2002, 1) notes 'the dramatic improvement in the quality of life that accompanied this miraculous economic transformation has virtually abolished extreme poverty in these societies'. Table 3 shows comparative data on growth in major developing regions, showing the relatively strong and sustained performance of the Asia-Pacific region.

Table 3: Per capita real growth of GDP, 1980-1999, by region, low and middle income countries

<i>Region</i>	<i>1981-90 (percent)</i>	<i>1991-00 (percent)</i>
East Asia and Pacific	6.1	6.0
South Asia	3.5	3.3
Latin America and Car.	-0.9	1.6
Middle East and N. Africa	-0.6	1.0
Sub-Saharan Africa	-1.	-1.4
E Europe and CIS	2.6	-2.5

Source: World Bank, 2001, Table A3.2

Going along with this growth has been significant progress in poverty reduction. In the early 1970s, more than half the population of the Asia Pacific region was poor, average life expectancy was 48 years, and only 40 percent of the adult population was literate. Today, the percentage of poor people has decreased to around one third of the population, life expectancy has increased to 65 years, and 70 percent of the adults are literate (ADB, 1999). Comparative regional trends in poverty reduction are shown in Table 4.

Table 4: Percentage of population living on less than \$1 per day (head count index) by region, low and middle income countries

Region	1987	1999
East Asia and Pacific	26.6	14.2
South Asia	44.9	36.9 ³
Latin America and Car.	15.3	15.1
Middle East and N. Africa	4.3	2.3
Sub-Saharan Africa	46.6	46.7
E Europe and CIS	.2	3.6

Source: World Bank, 2001, Table 1.8. and World Bank, 2002, Table 1.8

Part II: Country experiences

Cambodia

Cambodia's government signaled its commitment to a mild form of fiscal devolution with the passage of key legislation in 2001 and the election of commune councils in February 2002. However, until systems and procedures for decentralized planning, financing and service delivery are promulgated in full, and extended across the more than 1600 communes in the country, it is fair to characterize Cambodian practice as a limited form of fiscal deconcentration. Certain expenditures made by provincial and district branches of central ministries are paid through provincial treasuries, subject to tight, pre-audit controls from the Ministry of Finance. That said, there has been some success on a pilot basis with greater degrees of fiscal deconcentration at province level, and the delegation of powers, functions and resources to commune authorities emulating various kinds of devolution.

Any analysis of Cambodia needs to be viewed in the light of its tragic, recent history, including the death of more than 1 million people who were killed or starved to death during the period 1975-9 (Chandler 1991). Although the Khmer Rouge was formally removed from power in 1979, factional fighting continued sporadically until 23 October 1991, when the four main political factions signed the Peace Accords in Paris. This laid the groundwork for general elections in 1993 and the development of a liberal, multiparty system and a market economy. One of the provisions of the accords was a commitment to democratically elected local government, a pledge that was fulfilled on 3 February 2002.

Because of the recent, tragic events in Cambodia, statistics on economic growth and poverty reduction between 1980-1992 are not available. Based on the available data, it can be said that Cambodia achieved an average per capita growth of real GDP from 1992-1996 of nearly 7 percent, and from 1996-2000 of 4 percent. There was

³ Recent studies argue that the Indian performance in poverty reduction has been much greater than reported by this source, with poverty being reduced by 10-13 percentage points in 10 years, rather than 4 percent. If true, then the South Asian performance would be correspondingly greater. See Ahluwalia, 2002 and Deaton 2001.

modest success in addressing poverty during this period, with a reduction of poor households as measured by a headcount index from 39 percent in 1993/4 to 36 percent in 1997. Analysts attribute this success to improvements in security, sound macro-fiscal management, large aid flows, and growth in new businesses such as garment exports and tourism.

Current situation on fiscal decentralization.

The situation and challenges for fiscal decentralization should be understood in the wider context of ongoing, improvements in fiscal management. There is an extreme shortage of qualified and competent public finance specialists and line managers. While a small but dedicated group of specialists has been able to bring down the fiscal deficit, they have yet to achieve transparent and accountable fiscal operations to ensure budget execution is in accordance with budget allocation. Programs to raise social well being through improved health, education and welfare services are among the least effective, as a result of major institutional problems in program design, resourcing, delivery, and evaluation. Although a reasonable legal framework is in place for budget management, governance structures at the provincial and local level tend to exacerbate the misallocation of resources, and waste and abuse of public monies.

The Government is heightening efforts to monitor budget implementation in the priority areas of health, education, agriculture and rural development building on earlier efforts to improve the management of externally assisted projects. Government has declared that line ministries will be provided with quarterly spending plans, more timely transfers, and that quarterly budget allocations and disbursements will be published. A partial MTEF is planned for 2002.

Major progress has been made toward setting up an effective audit function. The Audit Law was passed in March 2000 establishing the National Audit Authority (NAA) as the Supreme Audit Institution in Cambodia. The law empowers the NAA to conduct financial, performance and compliance audits of government ministries, agencies, loan projects, state enterprises, joint venture undertakings in which the government has a financial interest, non government organizations and foreign investor businesses that have received financial concessions from the government. Other important features of this law relate to its independence of reporting directly to the national assembly, the rank equivalent to a senior minister for the Auditor General position, two Deputy Auditor General positions with the rank of a minister and the authority vested in the Auditor General to determine the remuneration of the NAA staff.

Improvements in government performance will also require improvements in terms and conditions for civil servants. Cambodian Government salaries have been seriously eroded in recent years due to revenue shortfalls, inflation, and currency devaluation. To partly alleviate the problem, donors are paying salary supplements to counterpart staff. For example, a recent study (Godfrey et al., 2000) found that a sample of 38 counterparts received an average government salary of US\$18 per month, and average donor supplements of \$194. When the respective donor projects were completed, some found other projects, which continued the supplements. Those that did not had to find income from other sources, and thus became, in effect, part-time government employees. This roller-coaster income stream is seriously hindering the buildup of capabilities in key government functions.

To address the problem, the Government is implementing an Administration Reform Program, with assistance from UNDP, the World Bank, and the European Commission. This includes consideration of setting up a Priority Missions Group that will be managed and paid differently from the rest of the civil service. As part of the PRGF, Cambodia will develop a strategy to increase overall pay levels, and reduce the size of the civil service, within the context of the MTEF.

Despite massive, across-the-board reform challenges and limited capacity, the government has been able to make some progress on fiscal deconcentration and some degrees of devolution on a pilot basis. Most government expenditures at any level are subject to pre-audit control of spending. Ministries must seek MEF approval for spending requests including a commitment visa from MEF, DBFA (up to 10 signatures, can take months), and a payment order from MEF, leading to payment by national treasury (or donor funded account of NBC), via provincial treasury, in cash. The advantages of present system is that it maintains tight control of spending, clearly defines roles, ensures that basic financial reporting is carried out, and provides severe sanctions for incorrect behavior. The disadvantages of the present system include: slow budget execution (in the first 8 months of 1999 only 23 percent of health budget was disbursed, compared to 66 percent of defense budget); multiple steps may strengthen control, but diminish accountability; many pre-audit signatures perfunctory, and add no value to final decision; budget expenditures uneven, and tend to surge in November and December; and finally, absence of formal mechanisms for participation in planning or monitoring from villages/communes/districts.

To address these problems, there are three alternative systems being tried on a pilot basis. The Accelerated District Development system, introduced in 1996, is presently being tested in 27 districts, and 5percent of health expenditures. Funds are allocated on a post-audit basis direct to the district level. There is flexible reallocation of funds between categories. A problem is the need to collect cash in Phnom Penh (since checks cannot be cashed outside of major centers), and a limit of 500,000 riels (about US\$125) per spending request

Priority Action Programs (PAP) were introduced in 2000 in Education and Health, and there are plans for introducing them in Agriculture and Rural Development in the future. Under PAP, funds are made available at the provincial level on a post-audit basis, budgeted funds are protected, Provincial Departments of Health and Education spend and account for funds through Budget Management Committees, and payments are made by the national treasury (or donor funded account of National Bank of Cambodia), via provincial treasuries, In 2001, 25 billion riels of the education budget (14 percent) were to be disbursed through this system, plus around 40 billion of the health budget.

A third system, the government's Seila Program to promote rural development through decentralized planning, financing and management of investments in basic services and infrastructures. Seila, introduced in 1996, is the most ambitious decentralization initiative implemented to date, resulting in the creation of commune development committees in six provinces encompassing over 1,000 villages and 100 communes. Key features of decentralization policy and laws, as noted below, reflect the Seila experience. Over the next five years, the government has committed to expanding

the Seila Program to all provinces and communes. Under the Seila program funds are made available at the provincial level on a post-audit basis, Provincial Rural Development Committees (PRDC) sets priorities based on consultations at provincial and local level; an Executive Committee of the PRDC spends and accounts for funds, withdrawals from Treasury account require Governor's signature; from donor accounts, one or two signatories depending on account, and payment is by national treasury (or donor funded account of NBC), via provincial treasury. In 2000, 2.1 billion riels of government funds were disbursed through this system, plus donor funds (about \$8.5 million), rising to 5 billion riels of government funds in 2001.

While there is evidence that these pilot exercises are improving disbursement and effective targeting of public expenditures in rural areas, and that they are making positive contributions also to citizen participation in governance, decentralization in Cambodia is in its infancy. From 3 February 2002, for the first time in its history, Cambodia has elected local government corporate entities. With over 1,600 newly created rural and urban commune councils, with over 12,000 local councilors, the task of establishing and internalizing appropriate legal, administrative, fiscal and supervision mechanisms is immense, particularly in view of the known weaknesses in skills and institutional capacity throughout the public sector. There will also be a need to house and equip the new councils, build communication networks, and review commune boundaries. Government officials responsible for the decentralization process are very anxious for a substantial program of medium-term support to complement the mainly short-term aid inputs provided to date.

The government's decision to hold local council elections in 2002 has been an authentically national initiative. Although the Government received much less external support for the commune elections than it received for the national elections in 1998 (and vastly less than for the process organized by the United Nation's Transitional Authority for Cambodia in 1993), it financed the voter-registration process and preparatory work from its own resources. However limited the powers and capacities of commune councils were in the early years, the decision to elect local councils is an important step toward deepening the concept of democracy and popular understanding of democratic rights and freedoms in a country that - until the last decades - had known only autocratic rule. Although the direct service role of elected local councils will be modest, they offer great opportunities for increasing local voice and representation in issues such as land-use rights, common property and natural resource use, and the efficiency of government service delivery. Increased transparency and accountability over resource use will help to promote investment and reduce vulnerabilities, in addition to the intrinsic value of democratic systems in promoting participation and social inclusion.

To underwrite decentralization, the National Assembly and Senate have passed two major pieces of legislation. The Law of Commune Administrative Management broadly defines the nature, functions, and powers of the commune councils and defines a modest form of decentralization of responsibilities and resources to elected commune councils. The Commune Election Law regulates commune elections. A policy of deconcentration of powers and functions to the provincial and district levels is also under consideration within the framework of the National Program for Administration Reforms, presented to the aid community at the consultative group meeting of February 1999 in

Tokyo. Government policy recognizes the essential complementarity and the need for a parallel implementation of decentralization reforms. Decentralization of government to the communes will only work if supporting functions are also deconcentrated to the provinces and districts. The Seila Program, mentioned above, is planned to cover all rural provinces by 2005. Under the Seila Program, commune development committees (CDCs), chaired by a commune chief and including representatives from all villages, are responsible for the development of the commune. After the elections, commune councils will progressively replace the CDCs. The commune councils will have 4-8 elected representatives with a five-year mandate. For at least the first year, planning and priority setting mechanisms in place for the CDCs will be carried forward by the commune councils including the Local Planning Process, Commune Development Plans, and Commune Investment Plans and Budgets.

The Law on Commune Administrative Management called for the establishment of a National Committee to Support the Commune Councils (NCSC), comprising representatives from six ministries and the Council of Ministers, chaired by the Ministry of Interior (MOI) and supported by the MOI's Department of Local Administration (DOLA) as secretariat. The life of the NCSC is limited to the first term of office of the elected commune councils (2002–2007). The composition and duties of the NCSC are set out in the Royal Decree issued in May 2001.

Indonesia

Given its large and diverse population and geographical spread, international experience would suggest Indonesia to be a decentralized country⁴. However, Table 2 (page 4) indicates that when Soeharto stepped down, Indonesia was highly centralized. The Soeharto government regularly postponed any major reforms in fiscal decentralization. Although Law No. 5/74 on regional government was drafted in the late 80s, adoption required the revision of Law No. 32/1956 on fiscal balance, and a political deadlock prevented this from happening. Yet in the late 1990s, pressures were mounting for action, not least motivated by claims for secession by West Papua, Aceh, Riau, East Kalimantan, and certain districts in Maluku. Given the lack of legitimate institutions, the manner in which concerns were raised was frequently not a very orderly one. Although there were frequent demonstrations, sometimes violent, against the existing political system down to the village level, precise concepts of an alternative system were largely missing. Decentralization terminology did not play a major role until the recent unitarism/federalism debate. This makes it difficult to identify the major proponents of the decentralization reform.

What seems clear is that provincial interest groups used the atmosphere of reform following the downfall of Soeharto to raise their demands for improved human rights and sharing of national wealth. These discussions took place behind the curtain and were not transparent to the general public. The November 1998 MPR⁵ decision, which provided the political mandate for the administration to reform the decentralization framework,

⁴ The following draws from Buentjen (2000)

⁵ The MPR is the highest state institution. It usually meets once every five years. It consists of 1000 representatives, including the 500 representatives from the Parliament, and 500 others nominated by the provinces or appointed by the President as representative of various groups in the society.

seems to have been influenced by the provinces. Since then, three new laws have been enacted:

- Law No. 22/1999 on Regional Government (UU Pemda/Undang-undang Nomor 22 tentang Pemerintahan Daerah), which replaces Law No. 5/74 on Regional Government and Law No. 5/1979 on Village Administration. The law revises the assignment of functions and redefines the roles of institutions at all levels of government including the villages;
- Law No. 25 on Fiscal Balance (UU PKPD/Undang-undang Nomor 25 Tahun 1999 tentang Perimbangan Keuangan antara Pemerintah Pusat dan Daerah), which replaces Law No. 32/1956 on the Fiscal Balance between the central level and the regions. The essence of the new law is the definition of sources of finance for decentralized, deconcentrated and co-administered functions;
- Law No. 34/2000 on Regional Taxes and Regional Levies, amending Law No. 18/1997.

Box 1 summarizes the major changes in administrative and political decentralization stipulated in Law No. 22/1999 on Regional Government.

Box 1: Major changes from Law 22/1999

- The principle that all functions that are not specifically assigned to central and provincial level automatically belong to the districts has been introduced. However, the functional assignment to the central level and the provinces is vague and open to interpretation. Much depends on implementing regulations.
- Regions are to be given more control over their finances, planning process, civil service organizations and cooperative bodies.
- Central ministries are in general no longer allowed to maintain independent deconcentrated offices in the Provinces or in the rural and urban districts for purposes of executing central level projects/programs. The deconcentrated offices will be absorbed into regional organizations.
- Rural and urban district heads are now fully autonomous and no longer report hierarchically to provinces. They function solely as the head of the autonomous local government and are directly and solely responsible to the local parliament.
- The regional executive arm is to be more accountable to the regional legislature, particularly at the district/city level where the regional parliament will elect the head of the district/city and their deputies with no interference from the center.
- A two-year implementation time frame is foreseen in the laws, with subsidiary legal instruments ready by May 2000 and field implementation realized by May 2001.

Law No. 34/2000 introduces new regional taxes and regional levies, and specifies allocation amounts for each jurisdiction. Previously, Law No. 18/1997 on regional taxes and levies had limited the number of provincial taxes to three, and the number of district taxes to six. In addition, the number of provincial and districts levies to was limited to thirty. Earlier studies showed that the revenues of the more than 200 regional taxes and charges which were abolished by Law No. 18/1997 did not contribute meaningfully to regional revenues. Yet, the large number of taxes and levies contributed to a lack of transparency and thus greatly facilitated corruption at regional level.

Although Law No. 34/2000 potentially allows for new taxes and levies, the results are not yet clear. Competition among the regions for limited investment resources, and a working political process is likely to moderate the eagerness to tax over time, but in the short run, excesses may occur. Beyond taxes, charges and user fees can become a fertile ground for raising more revenues. While increasing fees and levies may be good policy to reduce (implicit) subsidies that burden the budget, they could also deprive the poor of the services they need to help themselves. Therefore, any revenue mobilization strategy that relies heavily on user charges must be accompanied by measures that protect the poor.

The regulatory framework for revenue sharing (natural resource revenues and land and building taxes, general-purpose grants (dana alokasi umum/ DAU) and specific-purpose grants (dana alokasi khusus, DAK) is provided by Law No. 25 of 1999 and Government Regulation 104 which was passed into law on 10 November 2000. The precise provincial and Kabupaten allocations of the DAU for 2001 were authorized by presidential decree (KEPPRES 181) on 23 December 2000 (Lewis, 2001).

The 2001 allocation of the general-purpose transfers is based on an allocation mechanism approved by DPOD in 2000 and outlined in PP 104 of 2000. In total, Rp. 60, 514 trillion were allocated to provinces and kabupaten of which Rp. 6.052 were allocated to the provinces and Rp. 54.465 were allocated to the kabupaten. Compared to the 2000 allocation kabupaten received additional Rp. 24 trillion, while the allocation to the provinces remained almost constant. Although the amounts actually required by regional governments to finance the delivery of decentralized services are not known with any degree of certainty, according to first studies (Lewis 2001) these amounts appear to be sufficient to fund both provincial and kabupaten requirements, in the aggregate. This statement is made with somewhat less confidence regarding the provinces than regarding the kabupaten⁶.

Also, while the statement can be made in the aggregate, it appears that only 20 percent of the DAU have been allocated based on the formula which has been designed with an equalization effect in mind. This poses risks to the Government's equalization goals. 80 percent of the DAU were in fact allocated according to the "hold-harmless condition". Although not explicitly acknowledged anywhere in DAU regulations and guidelines, the idea is first to ensure each Kabupaten and Kota that it receives at least as much as it did last year in SDO and INPRES grants. Second, the "hold-harmless condition" ensures that the possible new expenditure requirements that result from the transfer of staff from the central government and its deconcentrated agencies (Kanwil and Kandep) to kabupaten and kota. These new requirements are assumed to be covered by a 30 percent increase in SDO and a 10 percent increase in INPRES grants from the previous year. As a result, mismatches between fiscal capacities and expenditures needs are problematic in many individual provincial and kabupaten governments. These horizontal imbalances across regional governments can be most clearly seen in the large DAU transfers to resource rich provinces and kabupaten relative to other, perhaps more needy, places.

⁶ Details on the 2002 allocation can be found in KEPPRES 131/2001 which is (in Indonesian language) on www.gtzsfdm.or.id

In 2001 the DAK is not particularly important in the state budget, amounting to only Rp. 900 billion. This is actually the minimum amount of DAK, as required by law, and is based on shared portions of the reforestation revenues. These revenues are returned to the place of origin. Although routine expenditures (DIKs) have effectively been transformed to regional budgets the system of allocating development funds through central government projects (DIPs) for those government responsibilities which have effectively been transferred to the regions is still in place. There was quite some pressure from development partners for government to formulate mechanisms and criteria for DAK to channel additional funds to the regions, needed to support national priority programs. It is unclear whether that has led to any changes for 2002 DAK.

Since the decentralization program was launched on 1 January 2001, achievements have included (i) regulations drafted by majority of regions concerning authority, organization and personnel; (ii) regulatory frameworks finalized by most departments and other units in accordance with law 22 (e.g. forestry, mining); (iii) Eleven departments and agencies have completed initial development of minimum service standard guidelines; (iv) fiscal allocation criteria have been changed to address fairness and sufficiency concerns, based on recommendations of an independent, academic evaluation (but it isn't certain that these criteria will be used in determining 2002 budget allocations); (iv) ongoing work to revise and update law2 (Ministry of Home Affairs 2001).

Two surveys are underway focusing implementation of the new laws at the district/municipalities level. The first phase of the Indonesia Rapid Decentralization Appraisal (IRDA), a project conducted by the Asia Foundation and funded by USAID, was conducted in 13 districts and municipalities between December 2001 and January 2002. The second phase will add another 20 districts/municipalities to the sample⁷. The Governance and Decentralization Survey, which is supported by a variety of donors (Partnership for Governance Reform, World Bank and Partnership for Economic Growth) will be implemented between August 2001 to July 2002⁸.

There are two initial findings on fiscal decentralization at this stage. First, the transfer of large numbers of civil servants to the regions has resulted in high portions of the budget spent on salaries, squeezing the available funds for service delivery and capacity building. Second, though largely dependent on central government transfers, local governments are seeking ways to increase their own sources of income in the form of taxes and levies. In some instances local governments have imposed local taxes and levies that have become a burden to citizens and business. Citizens are demanding more open dialogue and consultations about budget allocations.

People's Republic of China (PRC)

PRC has achieved one of the fastest growth rates of any country, with an average per capita growth of real GDP of 7.5 percent from 1981-90 and 9.2 percent from 1991-1999⁹. There was corresponding success in addressing poverty during this period,

⁷ For details of the preliminary findings see GTZ decentralization notes, issue 24, 1 March 2002, www.gtzsfdm.or.id. The report is supposed to be available around the end of March (www.asiafoundation.org).

⁸ First findings should be available by April <agusdwi@cpps.or.id>. For details on the survey approach, see <www.gtzsfdm.or.id>

⁹ World Bank, 2001, 2002. Most analysts endorse these estimates. However, Rawski argues that growth has been exaggerated beginning in 1998.

with a reduction of poor households to an estimated 18.5 percent of the population (or about 250 million people) surviving on US\$1 per day or less.¹⁰ PRC achieved its rapid growth and poverty reduction in the 1980s and 1990s for many of the same reasons as other countries in the region: including sharp increases in labor-intensive exports, market-friendly policies, large inflows of foreign capital, rapid development of physical and social infrastructure, and improvements in service delivery.

Although PRC is a unitary state¹¹, there are four sub-national levels of government: 31 provinces¹², 333 prefectures, 2148 counties, and 48,697 townships, towns and city districts. Each level devolves functions to the next most subordinate level. Prior to the 1980s, no subnational jurisdiction had a separate budget: the central government collected all revenues, and prepared a consolidated budget for all subnational tiers. State owned enterprises (SOEs) remitted all surpluses to the central government, which in turn covered all their expenditures by fiscal appropriation.

Starting with the market-oriented reforms beginning in 1979, the fiscal system became increasingly decentralized, where revenues were increasingly shared by the central and provincial governments, and by successive tiers. There were three main reasons for the changes. First, the growth of township and village enterprises, joint ventures and private firms had lessened the importance of SOEs. As SOE losses mounted, the government was forced to look for alternative revenue sources. Second, the economic reforms shifted the balance of political power towards local autonomy. Third, the new awareness of the importance of markets and incentives was an impetus to provide local governments with incentives to step up revenue collections.

Like other reforms, fiscal reform started as an experiment. As early as 1977, Jiangsu province was chosen to try out an alternative fiscal arrangement with the central government. The province was contracted to remit a share of its total revenues each year to the central government. In 1980, broader revenue sharing arrangements were adopted. Revenues were classified by source and divided into central fixed revenues (e.g. customs duties and revenues remitted by centrally-owned SOEs), local fixed revenues (e.g. salt taxes, agricultural taxes, industrial and commercial income taxes, and revenues remitted by locally-owned SOEs), and central-local shared revenues (e.g. profits of large-scale enterprises under dual ownership, industrial and commercial taxes or turnover taxes).

In 1985, the tax system was again reformed, including a change calling for income taxes from SOEs rather than profit remittances. Although revenues were still divided into the same three categories, the new categories were related to type of tax collected rather than on ownership (e.g. of SOEs). 14 provinces, including 3 municipalities, were contracted to remit a specific share of their local fixed and shared revenues. Five provinces received lump sum transfers from the central government, while the remaining ones received central subsidies. Under this new system, shared revenues were by far the largest of the three categories. Thus, central government relied on local governments to increase total revenues, and local governments had an

¹⁰ UNDP, p. 149. The official poverty line in China places about 4.6 percent of the population (or about 60 million people) in poverty.

¹¹ The following draws from Justin Yifu Lin and Zhiqiang Liu, 2000. Rao, 2001.

¹² Not including the Special Administrative Region of Hong Kong, and Chinese Taipei.

incentive to boost their revenue collection (since they could retain some of the shared revenues).

The tax system changed again in 1994 due to a sharp fall in the ratio of revenues to GNP (35 percent in 1978 to 12 percent in 1996), caused by the falling profitability of SOEs and the inability of the tax system to capture the expanding tax base arising from economic prosperity. There were also disincentives to sub-national authorities to generate revenues and transfer them to the center. The differential sharing mechanism introduced in the 1980s served to enhance the powers of more affluent provinces, and reduced the central share in revenues. This reduced the ability of the center to undertake redistribution and stabilization functions effectively. It encouraged the center to push expenditure responsibilities down to adjust to lower revenues, and encouraged the use of extra-budgetary financing, with correspondingly diminished transparency and accountability.

The 1994 reforms included introduction of value added tax, changes in the distribution of shared revenues, establishment of separate tax administrations for national and sub-national governments, and earmarked transfer schemes. Yet despite these reforms, the budget still is not comprehensive, with large extra-budgetary financing and spending. This problem is greatest for sub-national levels where revenues were recentralized, but expenditure functions have continued. The result has been both underprovision of services and extra budgetary financing, both of which having adverse consequences on accountability, efficiency, and equity in spending. Tax sharing also does not address the problem that more affluent provinces get to keep more revenue than the poorer provinces. The central government has provided hundreds of types of earmarked grants to offset this, but they are allocated in an arbitrary and opaque manner, and thus don't adequately address the problem.

Analysts have tried to estimate the consequences of this series of decentralization initiatives on economic growth, with mixed results. Zang and Zou (1996) estimate that fiscal decentralization has lowered economic growth in provinces with the greatest degree of delegated spending. Lin and Liu (2000), using a different measure of fiscal decentralization, find that it has promoted economic growth at the county level, but has had an insignificant effect at the province level.

Philippines

The Local Government Code (LGC) of 1991 affects 77 provinces, 72 cities, 1,548 municipalities, and more than 42,000 villages (barangays). Between 1991-4, 61 percent of the field personnel of concerned agencies were devolved to local government units (LGUs). Regular elections were required for local officials and legislatures. Although devolution has affected particularly the health, agriculture, social welfare and natural resources sectors, all aspects of public service delivery have been affected in some way¹³.

The Autonomous Region in Muslim Mindanao (ARMM) has a separate Local Government Code of Muslim Mindanao, enacted in 1993. The ARMM code, while similar to the national LGC, includes guidelines relating to Muslim institutions and organizational

¹³ This section draws on Bauer (1998).

structures in ARMM. In practice, the regional ARMM government and its agencies maintain direct control and supervision of all devolved functions.

A Devolution Master Plan (1993-98) was formulated to further implement the devolution process. The LGC was amended to abolish unfunded sectoral mandates, improve LGU financial resources, and rationalize LGU and national government agency (NGA) functions based on the principle of subsidiarity, with the extension to LGUs of responsibilities for national roads and power generation and transmission, administrative reorganization, reform of personnel functions, bottom-up planning, and electoral reforms.

Implementation of the LGC has led to more integrated services delivery, more focused on local priorities, and more cost effective. LGUs are interested in providing more investment and maintenance support for projects they themselves have formulated and implemented. They are also more actively looking for cost-sharing arrangements with the private sector and NGOs, as well as fees or user charges for services provided.

In agriculture, pre-LGC delivery of extension services was viewed as non-standardized, poorly managed, and often not adapted to local realities. Staff were unfamiliar with local conditions. With devolution, a rationalization of personnel took place, resulting in more area-specific programs and more productive fieldwork. However, there are serious concerns from LGUs that the Department of Agriculture (DA) is continuing to execute national projects, and is reluctant to provide LGUs access to technical assistance. LGUs have limited control over planning, implementation, monitoring and evaluation of projects funded from the national budget and from official development assistance. As a result, LGUs typically source their own technical assistance outside the DA structure. Unlike the DA, the Department of Agrarian Reform, whose functions are not devolved, cooperates closely with LGUs to implement their projects and helps build governance capacity at the local level.

In the health sector, LGUs have assumed 62 percent of the Department of Health's staff and 41 percent of its budget, including 12,560 rural health units, municipal health centers and barangay health stations, and 595 hospitals. Devolution in the health sector has resulted in (i) significant improvement in the timely procurement of medicines and supplies, (ii) a reorientation towards more flexible basic health programs, (iii) more innovative mechanisms for revenue generation, and (iv) more integrated and client relevant area-focused planning and services delivery. On the negative side, funding shortfalls and increasing inequity between richer and poorer jurisdictions endure as major concerns. Less developed LGUs often find it difficult to maintain quality of health standards due to lack of funds.

Unlike agriculture and health, the devolution of social welfare functions is perceived in most respects as successful. The four reasons for this smooth devolution were that (i) the Department of Social Welfare Development (DSWD) carefully managed the devolution of its personnel into local organizational structures, (ii) along with the devolution of responsibilities, the DSWD has devolved substantial funding to LGUs, and provided further opportunities to access external funds¹⁴, (iii) DSWD personnel were equipped to immediately work at the local and field level, and (iv) LGUs (often together

¹⁴ E.g. The Early Childhood Development Program, supported by ADB, channeled funds directly to LGUs with DSWD as the executing agency.

with NGOs) have expanded the demand for social services. The implementation of the Minimum Basic Needs data system and the thrust given to poverty reduction under the localized Social Reform Agenda have further accelerated the process of sound decentralization.

Environmental and natural resources management offers the greatest new challenge to LGUs. There is (i) a growing concern over the effectiveness of the Department of Environment and Natural Resources to carry out its functions, and over the lack of LGU involvement in planning and management of national programs, (ii) increased interest of LGUs to exercise greater authority over solving environmental programs, (iii) a growing awareness at the LGU level that environmental management skills are lacking, and (iv) a rapid rise in ad hoc efforts addressing multi-sectoral environmental issues at the local levels.

Sources of LGU financing are the internal revenue allotments (IRA), local taxes and revenues, loans and grants from donors, and borrowings. The LGUs are classified according to their income levels. Although the LGC provides for the allocation of significant national revenues to LGUs, a large unfinished agenda remains to insure the real autonomy of LGUs. For example, officials most involved in LGU financial management remain appointed by national agencies. While the LGC limits the control of central agencies over the local planning process and tax policy, it does not eliminate it.

The major source of LGU finance is the IRA. LGUs receive 40 percent (up from 11 percent in 1991) of the IRA based on total collections of the third fiscal year preceding the current fiscal year. However, this 40 percent share is less than 15 percent¹⁵ of total public expenditure. There are moves to increase the IRA to 60 percent, and to change the calculation procedures to be based on the current year's collections. The IRA is allocated among different levels of LGUs, giving 23 percent each to provinces and cities, 34 percent to municipalities, and 20 percent to barangays. Each LGU level gets its share based on population (50 percent), area (25 percent), and equal sharing (25 percent). The criteria favor cities, as well as municipalities with small populations and large land areas. In addition to the IRA, LGUs receive a 40 percent share of the cross collection derived from mining taxes, forestry charges, and others.

While the IRA remains the main source of LGU revenue, selected LGUs have been increasingly tapping their own sources, including the issuing of municipal bonds. However, the IRA has become a more important share of LGU income under devolution. Whereas the share of locally generated resources declined from 49 percent of total LGU income to 37 percent in 1994, the IRA share increased in the same years from 37 to 61 percent. In less developed LGUs, the IRA share can reach 95 percent of the total.

Some cities are taking loans from government finance institutions, normally of less than \$1 million and with interest rates exceeding 20 percent. UGU loans from this source have increased from P1 billion in 1992 to about P18 billion in 1997. However, LGUs get less than one fourth of their estimated capital requirements from this source, with poorer LGUs getting much less than this.

¹⁵ As of 1997.

The LGC provides LGUs with the authority to access private capital markets. A few Build-Operate-Transfer (BOT) and Build-Operate-Own arrangements have been used so far. In 1997, the BOT center in the Department of Finance had identified 79 potential local BOT projects.

Although LGUs can legally borrow from donors such as the ADB, they cannot access these funds directly because the national government does not give its sovereign guarantee. Whereas a number of functions have been devolved to LGUs, the funds often remain at the national level. Particularly in health and agriculture, LGUs have the devolved staff, but central agencies still control the funds.

To summarize, devolution appears to have improved the capacities of LGUs to carry out new functions, including inter-governmental cooperation. However, there are still major concerns regarding LGU capacity to (i) prepare comprehensive urban development plans, (ii) effectively link the local planning exercise with public investment plans and expenditure surveys, (iii) join into more efficient economic planning units, (iv) organize effective participatory consultation and (v) re-engineer local bureaucracies and develop quantitative indicators to measure the efficiency and effectiveness of local institutions.

Thailand

Thailand is divided into 76 provinces (*changwat*). Bangkok has an elected governor, while the Ministry of Interior appoints governors for the other provinces. Provinces are subdivided into 811 districts (*amphoe*), each administered by a chief district officer appointed by the Ministry of Interior. The districts are further divided into 7,409 subdistricts (*tambon*), which are broken down into approximately 67,581 villages (*muban*), both traditionally headed by local chiefs and village headmen. In addition, a number of special municipal or local authorities operate semi-autonomously. Policymaking and major policy implementation functions are centralized in Bangkok, but some responsibilities are decentralized to local governments. Some functions are the joint responsibility of the central government and local governments, while others are either provided by the central government or are monitored and controlled by the central government (Nelson 2000). Local governments are allowed to obtain revenues from a limited number of sources, primarily property taxes.

Provincial governors, their deputies and assistants are appointed from the staff of the Department of Local Administration of the Ministry of Interior. Tambon councils are made up of village headmen, departmental officials, and local notables. Scott points out that the councils have the symbolic power of bringing together key figures in a forum that appears to have authoritative status; but they generally have little income or real power. Since the councils are dominated by centrally appointed officials, they help to strengthen central control, and maintain national unity.

Thailand achieved its rapid growth and poverty reduction in the 1980s and 1990s for many of the same reasons as other countries in the region: including sharp increases in labor-intensive exports, market-friendly policies, large inflows of foreign capital, rapid development of physical and social infrastructure, and improvements in service delivery.

These improvements were achieved in a highly centralized administrative and fiscal structure.

Yet despite the gains, there has been a growing public desire for political change and democratic government, widely characterized as "turning government by the politicians to government by the people" (Bowornsak and Burns 1998, p. 241).¹⁶ Following the military takeover and violence of 1992, consensus crystallized in support of fundamental reforms of the political system to halt the 60-year cycle of military coups overthrowing elected governments. In 1993 the House of Representatives set up the Constitutional Reform Committee, which in 1995 presented a reform constitution, eventually approved by parliament in 1997.

Several unique features of the new constitution set it apart from its predecessors, including strengthening the rule of law and human rights; enhancing accountability mechanisms and enforcing much stronger conflict of interest standards; and improving transparency, participation, and decentralization. The constitution also provides one of Asia's most liberal codes of individual freedom, including both political rights (freedom of speech, religion, association, and assembly) and social rights (the right to receive health care and 12 years of education at the state's expense).

The constitution embraces decentralization while being vague about specifics, which are to be addressed through separate legislation and administrative actions. It seeks to end the practice of guided democracy at the local level by specifying that most local government bodies will be elected. This contrasts with previous practice, whereby many local employees were appointed from Bangkok and owed their allegiance to individual ministries. In the past, the only elected officials were councilors in the municipalities of Bangkok and Pattaya. Under the new arrangements, each of Thailand's 7,951 appointed local councils will be replaced by elected ones when their current terms expire. The power to transfer, promote, increase salaries, and punish local officials will be vested with local governments, although the approval of a local officials committee is required. This committee will consist of an equal number of representatives of relevant government agencies and LGOs. Public services such as health, education and police will be placed under local control. Local governments will also be responsible for conserving local arts, customs, knowledge, and culture; and managing and preserving natural resources and the environment.

The National Decentralization Act came into effect on 18 November 1999. This act defines the role of the NDC, which is responsible for preparing the decentralization framework. NDC has 36 members and is chaired by the prime minister and deputy prime minister.

NDC is to recommend procedures for decentralizing administrative power to local administrations by preparing an action plan. Once the cabinet has approved the plan it will be submitted to parliament for consideration and announced in the *Government Gazette*. Once it has been signed into law, it will be legally binding in terms of agencies' operations.

¹⁶ The discussion of the constitution in this paper draws heavily on this work, and on Klein (1998).

To comply with the Decentralization Act, the government proposed gradually increasing the budgetary allocations to and the responsibilities of LGOs in three phases as follows:

- *Phase 1, FY2001.* During this period the Bureau of Budget would ensure that LGOs have the equivalent of 20 percent of national revenues (approximately B160 billion) to finance local activities.¹⁷ Of this amount, LGOs would manage B40 billion under the Procurement Management Regulation, whereby the central government provides local governments with training in estimating future budgets. This phase has been completed. Impressionistic evidence is that although the targets may have been met in terms of spending at the local level, that most budget implementation was fully controlled by central ministries, as had been the case in the past.
- *Phase 2, FY2002–FY2004.* During this period local governments will be required to respond to the increased budgetary allocations by providing strategic plans and the manpower to manage them. During this period the Bureau of Budget will ensure that LGOs have the equivalent of -- percent of national revenues
- *Phase 3, FY2005–FY2009.* During this period all activities to be decentralized will be transferred to local governments. The Bureau of Budget will ensure that LGOs have the equivalent of 35percent percent of national revenues by the end of the 9th Plan period (2006).

If these budgetary allocations are met, Lao-Araya points out potential risks to macroeconomic stability, and the need for increased revenues. Yet, as indicated above, these risks could also be addressed by central ministries continuing to retain control over budget implementation at the local level.

Overall, DOLA estimates that as of early 2000, less than 10 percent of total governmental spending in Thailand took place at the municipal level compared to 14 percent for all local governments. If Bangkok is excluded from the calculation, municipalities are responsible for only about 2 percent of total government spending. Approximately 60 percent of municipal spending is dedicated to recurrent purposes, with salaries and supplies accounting for almost two-thirds of this amount, or approximately 40 percent of the municipal budget. The remaining 40 percent of municipal budgets are used for public works spending. However, since most local expenditures are not linked with a specific revenue source, municipalities tend to finance a large portion of their capital projects from recurrent revenues in a “pay-as-you-go” fashion.

In general, though, central and local governments have overlapping expenditure functions and responsibilities, which usually result in central government dominated administration. Due to these overlapping functions and responsibilities of central government ministries and local governments, the central government usually assumes responsibility for most large expenditures. The NDC supports mandates for assigning more direct responsibility to local governments for specific, well-defined expenditures. These expenditure assignments should result in minimal administrative overlap of responsibility among central and local governments.

¹⁷ National revenues exclude revenues raised by LGOs, administrative fees charged by the Revenue Department to collect taxes, and government borrowing.

Fiscal decentralization in Thailand is in its early days. Whether the proposed measures will contribute to economic growth and poverty reduction is unknown. Results will depend, in part, on how implementation proceeds with respect to six issues: local revenue authority, central government transfers, local expenditure, citizen participation, Civil Service Reforms and Personnel, Public Auditing of Local Accounts, and Borrowing.

Part III: Preliminary conclusions on East Asian Experience

In terms of revenue raising and expenditure powers, governments of developing countries are generally less than fifty percent as decentralized as countries of the OECD group. East Asian nations, in particular, have a history of strong central rule although it is also true that the roots of local government and decentralized arrangements in some cases reach back to the early period of state formation. It is certainly the case that some, such as Vietnam, have maintained long-standing arrangements for fiscal equalization across a highly diverse national terrain and in some of the most difficult political and economic environments imaginable (cf. Porter 1995). Whether the decentralizations applied in East Asia have positive or negative results for citizen participation, let alone at the ambitious reach of 'economic growth' and 'poverty reduction' is uncertain. Decentralization policies, and the variety of forms policy takes in practice, are adopted for range of, at times incompatible, reasons. Some underpinnings to policy echo past experiments (e.g., Rondinelli 1983), others clearly reflect recent global pressures on the nation state which are played out in changing state-society relations in East Asia in particular, country specific ways (Kerkvliet and Porter 1995). The recent upsurge in interest in intensifying these arrangements seems to have occurred in the case study countries for a mix of four main reasons.

First of all is the particular experience of East Asian nations undergoing the expansion of democratic models of governance, an emerging middle class and, accompanying this, the consensus that decision making should be located closer to the people. The increasing prominence of democratic movements, for example, in Indonesia, Philippines, Taipei (China), Thailand, South Korea, has affected the evolution of decentralization in the region. Initially in most countries, central governments attempted to cope with these pressures through consultative forums rather than elected or empowered local governments. Where there were elected local officials, they were usually supporters of the central regime. In recent years, this pattern has started to change in some countries. In Taipei (China), for example, an opposition party received 41 per cent of the vote in mayoral and country magistrates elections of 1993; six years before, the country had been under martial law and ruled by a single party. The 1991 Local Government Code in the Philippines promised to increase democratization, and would probably not have been passed under the Marcos regime. In the Cambodia case, the 1991 UN peace accords included a provision for elected local government (first realized in 2002), as a step in Cambodia's transition to become a liberal market oriented democratic country.

A second trigger for decentralization has been a belief that assignment of functions to lower level, smaller administrative units (e.g., provinces, districts, and municipalities) will bring efficiency gains, thus benefiting both service delivery and cash strapped central government budgets. There are typically two aspects to this. The economic efficiency argument, where it is claimed that shifting to local governments

decisions about the level and mix of taxes and expenditures will ensure people get more of what they want, that they will pay taxes against value received, and services will be provided more efficiently. Closely connected, the revenue mobilization argument has it that a decentralized tax structure will lead to an increase in the overall rate of revenue mobilization. In the PRC for example, fiscal decentralization was prompted starting in the 1980s by market reforms, and the growth of township and village enterprises as sources of revenue. It was so "successful" for some prosperous provinces that the share of revenue passed on to the central government needed to be renegotiated upward in the 1990s. Decentralization, for other states, was prompted by changing international economic conditions, including structural adjustment programs, which lead to serious fiscal difficulties for central governments and the often rather desperate need to pass on service obligations to local governments. The disappointing performance of centralized systems has directed attention to both the untapped fiscal and other local resources it is believed can be exploited through greater disbursement of state power. More positively, it is believed decentralization will foster greater responsiveness to local situations and possibilities than may be displayed by decision makers in a distant capital. Related technical arguments also extend to the devolution of authority, which is said to increase accountability, participation, and result in improved performance, including allocative and financial efficiency. Allowing local governments to raise funds through taxation or borrowing makes them more accountable for the fiscal and financial consequences of their policies. When obliged to compete among themselves for access to financial resources, they experience fully the costs of any unsound economic policies or decisions.

Thirdly, there are many examples in the region where government agencies at all levels have delegated authority to private firms, NGOs, and development agency funded implementation units. This includes a variety of public-private partnership arrangements to provide water, electricity, communications, refuse collection, municipal markets, toll roads, urban transport, airports, and shipping ports among many others. There are also many partnership arrangements in rural areas, and in many countries NGOs manage and directly finance a large share of public services, including health and education, farmer extension, environment and natural resource management initiatives. Some countries have delegated to professional associations responsibility to license, regulate and supervise their members. Urban residents groups are delegated tasks of implementing sites-and-service housing schemes. These contractual arrangements are made on the understanding that government units lack sufficient managerial and technical capacity or equipment to effectively provide such services, and are overly hampered by bureaucratic politics and practices or that non-government agencies have access to sources of funds, and legitimacy, not available to government. Private businesses and NGOs are thought to be able to provide services more effectively and efficiently than government, since they aren't as hampered by these constraints. These contractual arrangements usually include user charges, though governments must often in addition provide hefty subsidies. Service provision with some competition among public, private, national, regional and local providers can provide incentives for good performance.

Fourthly, aside from electoral pressures and arguments on technical grounds, there has been an increased articulation of demands from sub-national groups for autonomy and here we see decentralization being promoted for reasons of central

regime stability. There are cases where certain geographical areas of countries become more closely linked economically to the markets of other countries than to the national market, thus leading to calls for greater devolution of authority. Contrarily, it is a fact of contemporary geopolitics that not all areas are equally well connected and favoured by regional economic growth or endowed with public services available elsewhere in the country. The demands of certain regions for greater autonomy backed up by ongoing civil conflicts (e.g. Mindanao Philippines, Aceh Indonesia, Bougainville, Solomon Islands) have encouraged central regimes to adopt various types of decentralization in order to maintain wider stability. Yet there is always the risk that transferring decision-making power and resources to fractious localities may destabilize the regions, and possibly fuel demands for full independence. There is also evidence in, for example, PRC, that fiscal decentralization has served to enhance the powers of more affluent provinces, and thus may be exacerbating tensions in poor provinces with large, minority populations.

These preliminary findings underscore how simple definitions of ‘decentralization’ bely an extraordinary range of relationships, different meanings and forms, often overlaid and occurring simultaneously. Decentralization has become the acceptable face of governments of all political persuasions – consider the range from Thailand, to China to the Philippines – such that leaders advocating decentralization may not quite know what decentralization is, even less how it might work, but they do know that decentralization is regarded world wide as a good thing. It is hoped that the case study research, set in the company of a burgeoning comparative literature on decentralizations, will encourage an appreciation of the slippery and polysemous nature of this policy instrument and that this may be used by policy makers in the region to advantage, and encourage continual experimentation rather than doctrinaire application of single definitions issued on the basis of OECD country experience. There is in the Asia Pacific region no convergence towards one type of center-local, state-society relations, though there is certainly universal interest in these matters and they are typically framed up in the discourse of decentralization. It is important then to recognize that the slippage that is apparent at the rhetorical level is also rife at the practical level – and our hope is that this research will raise and sustain some critical suspicions about much of what is being taken for granted in policy discourse on the virtues of decentralized governance across the region.

Overall trends in decentralization

The case studies presented here show that fiscal decentralization varies greatly depending on circumstances and institutions. Typically, several different forms of decentralization co-exist within a country. No form is inherently better or worse than another; what matters is that the form selected is appropriate to the cultural and administrative context where it is applied, and that responsibilities are balanced by accountability, resources, and institutional capacity

Has economic growth and poverty reduction in the region been affected by decentralization? Over the last 20 years, the East Asia and Pacific region recorded the highest growth rate and best performance on poverty reduction of any region in the world. Numerous studies have shown that this strong growth and poverty reduction performance in Asia-Pacific has resulted from many factors, including market-friendly policies, fiscal balance, macroeconomic stability, sharp increases in labor-intensive

exports, and large inflows of foreign capital. In no case available to us has economic growth been attributed to decentralization.

Rapid development of physical and social infrastructure, and improvements in service delivery were also important, but these public goods and services were delivered largely through central institutions. PRC is perhaps an exception, but the experience is idiosyncratic to that country, and not easily transferred. Indeed, it could be argued that the low level of decentralization in most countries has helped to promote fiscal balance and macroeconomic stability by avoiding the soft budget constraint and moral hazard evident in some countries more advanced in their decentralization. This has, in turn, contributed to the market-friendly environment in Asia-Pacific countries, and in turn, to high rates of growth and poverty reduction.

Part IV: Questions for further Case Study Research

While there is a great deal of disagreement, both about decentralization and the larger economic policy convergence of which it is a part, there is some evidence, albeit more conjectural than empirical in nature, pointing to a number of possible benefits of decentralization in East Asian nations. The proposed case studies will each pull together this evidence for particular countries. Yet it will not be possible, given the constraints bearing on these case studies, to resolve significant issues of causality and attribution, not least due to the fact that decentralization policy is never pursued consistently, nor unaffected by countervailing policy commitments, such as overbearing imperatives toward fiscal stabilization. Whilst some definitional disputes about 'decentralization' have been sufficiently resolved for cross country comparison, work will be required to clarify what is referred to by 'citizen participation', before disassembling key parameters of association between the two. Although some recent studies (e.g., Blair 2000) positively associate decentralization with citizen participation (according to various measures), it is by no means a necessary condition or outcome. There are many instances where national governments have initiated decentralization, as a 'centralising strategy', not at all primarily to foster local participation (see Apthorpe and Conyers 1982). Furthermore Guess et al., (1997) point out the challenges of comparing decentralization experiences with varying objectives across countries so different in size, historical background, social cohesion and cultural values.

Despite these challenges, it may still be possible to analyze patterns in decentralization across country case studies using comparable methodologies. With this in mind, each case study should achieve two things: first, provide a mapping of what's happened on key descriptive parameters, and second, analyse, against a consistent methodology, existing evidence on the relations between decentralizations pursued in each country, highlighting fiscal devolution, and their impact on citizen participation. The mapping of experience will aim to assist comparative assessment of the following questions:

- What has triggered decentralization in the different East Asian countries? To what degree may this be attributed to internal pressures for democratization, externally driven factors, such as impact of globalization, or other factors?

- What processes were followed? To what degree did decentralization emerge from ‘top-down’ or ‘bottom-up’ processes? What is the historic background? Are there clear typologies of how decentralization is introduced or phased over time?
- How far has fiscal decentralization gone? What are the measures?
- What types of spending do sub-national levels of government carry out in the different countries?
- Are there annual recurrent budgets for local spending units with clear expenditure classifications? Is the budget execution process, internal control, external audit requirements, and enforcement powers clearly legislated?
- Are local government units assigned to them some sources of revenue which derive from their own constituents? Do they have control over tax rates and tax bases of their own taxes?
- How are intergovernmental grants and revenue sharing schemes are being used to bridge the gap between the cost of assigned responsibilities and own revenues at sub-national levels?
- Is there a set formula for revenue sharing which relates revenue to be shared with needs and fiscal capacity? Are revenues assigned to local governmental units stable and predictable?
- How is this financial assistance being given without resulting in a “disincentive” to local fiscal effort and responsibility?;
- Do laws clearly specify revenue sources and responsibilities?
- How was the sequencing of the decentralization process? Expenditure responsibilities first and then revenues?
- Are sub-national governments allowed to borrow? Are there limits and controls? Bailouts have occurred? How is the moral hazard issue dealt with?
- Is local capacity to grant fiscal incentives in the form of tax and fee exemptions limited to own-source revenue? Are there explicit limits placed on tax and exemption competition between jurisdiction to avoid run-to-the-bottom outcomes? Are sub-national governments encouraged to compete by providing better and cheaper services?

The second section should analyze the experience, drawing on available empirical evidence, and building on the methodology in Guess et al, (1997) and Blair (2001) to explore the associations between fiscal decentralization and citizen participation. Questions to be addressed include:

- Has fiscal decentralization brought efficiency gains and revenue collection and/or expenditure management? Are there differential gains from different types of decentralization (e.g. deconcentration, delegation [to public, private, or NGO providers], or devolution)?
- Is expenditure assignment provided to the jurisdiction having control over the minimum geographic area that would internalize benefits and costs? Are centralized services restricted by the principle of subsidiarity to the following: where there are impediments to the movement of people, spillovers are significant, economies of scale are present, and administrative and compliance costs are high at the local level.
- Has fiscal decentralization gone along with increased citizen participation? If so, how has participation increased? Has it improved the representativeness of local politics, either through electoral representation, the kinds of voices heard and

considered in political processes, or patterns of investment and service delivery made by local authorities?

- To what extent is citizen participation in local governance influenced by the share of local government revenue raised locally or transferred from higher levels of government?
- If participation has increased, is there any evidence of corresponding improved systems of accountability? Is there evidence of greater responsiveness of both administrative and political organs of government to local needs and as a result improved allocative efficiency in public resource use?
- Has fiscal decentralization had any negative fiscal or macro-economic effects, such as worsening inter-regional equity, and the uncertain accountability and poor service outcomes that may result from poorly defined mandates and jurisdictions, and under funded mandates.
- Are sub-national governments technically prepared to face the challenge of fiscal decentralization? What kind of institutional building is necessary to allow them to face it? How are they made accountable?
- Is there any evidence that failure to tailor the degree, form and pace of decentralization to particular historical and cultural contexts may have undermined the effectiveness of decentralized governance reforms¹⁸

These analytical findings will be examined at a workshop in September to explore patterns in the East Asian experience, and, the extent to which they correspond to patterns in the Latin American experience.

¹⁸ As evidenced in Crook and Sverrisson (2000); Smoke (2000, 4), Ahrens (1998); Rodrik (2001: 35); Samoff (1990).

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