

## Why decentralization works and does not works? A systematic literature review

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### ABSTRACT

This systematic literature review is purposed to elaborate why decentralization works and does not works? The results show that decentralization will increase public services at sub national level or local government when certain conditions exist. Empirical findings across developing countries in last decades show that decentralization will benefit for improving local public services when competitive and fair local election, transparency, checks and balance, citizen participation and community social capital exists. Capacity of public servants and availability of basic infrastructures is also key conditions for effective decentralization across developing countries.

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### 1. Introduction

In her book “Going local: decentralization, democratization, and the promise of good governance” (2007), Merilee S. Grindle writes that in the early twenty first century the quality of local governments presents new relevance to the well-being of people across developing countries. Although having long played some role in the management of local affairs, they have now been given many new responsibilities, provided with increased resources, and allowed greater autonomy to decide local policies and services aimed at promoting citizen well-being. Decentralization of fiscal, administrative, and political responsibilities has transformed local government into the central actor in delivering local public services and enhancing citizen well-being. Bardhan and Mookherjee (2006) explain that this phenomenon is geographically widespread, from Latin America, Africa, and Asia to Eastern Europe. The earliest changes were initiated in the 1970s, picked

up momentum in the 1980s, and accelerated after the 1990s (World Bank, 2008a).

There is a long theoretical literature on the advantages of decentralization to improve public services. The following are some of the advantages that decentralization will make information revelation as citizen preferences are easier to perceive at the local level (Manin & Stokes, 1999), improve accountability since it is easier to link the performance of local services to local political representatives (Peterson, 1997), match with citizens and policy preferences as decision making move to local jurisdictions, improve fiscal management, and improve economic growth and market security (Wibbels, 2000). All these benefits lead to enhance efficient and less corrupt governments (Fisman & Gatti, 2002), and to increase democratization and participation (Crook & Manor, 1998).

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While there is an array of theoretical reasons why decentralization should be expected to improve local public services performance, the empirical evidence has not been as supportive. The empirical results of decentralization throughout the world have been mixed at best (see Agrawal & Ostrom, 2001, Bardhan & Mookherjee, 2003, and Ribot, 2004). Litvack, Ahmad, and Bird (1998) present evidence from Eastern and Central Europe and suggest that public services can suffer because of decentralization, at least in the short run. In a similar vein, Crook and Sverrisson (1999) have provided evidence that despite extensive strides of devolution of authority and resources to democratically elected local governments, decentralization in Colombia, West Bengal and Brazil has achieved little in improving service delivery. Rather than improving local government performance, some authors find that decentralization increased potential for elite capture in Nepal and Bangladesh (Bienen *et al.*, 1990, Sarker, 2008), rent seeking and corruption in Russia (Triesman 2000, Blanchard & Schleifer, 2000), exclusion of local minority populations, and conflict for new resources in local government in other developing countries (Prud'homme, 1995; Ribot, 2004).

This study aims to review existing empirical evidence of decentralization and public services across developing countries and identify why decentralization works in some countries and does not work in other countries. It proposed a conceptual framework to explain the mechanisms by which decentralization lead to increase or decrease public services.

## 2. Discussion

Even though decentralization is continuing to be implemented in many of these countries, a systematic and robust quantitative and qualitative evidence on its impact on public services is rather scarce. There are a number of scattered studies that I will try to arrange in terms of the nature of empirical methodology followed. Overall, the conclusions are mixed and the relationship they attempt to establish is at times elusive. This section provides a summary of some of the prominent studies in this area from the last two decades that show contrast evidence of the relationships between decentralization and public services across developing countries.

### 2.1. Decentralization lead to better public services

A number of studies have found the effect of decentralization on public services to be positive. Two case studies - Porto Alegre in Brazil, and Bolivia - are success stories that have become well known worldwide. Santos (1998) states that between 1989 and 1996, decentralization in Porto Alegre resulted in substantial impact on the pattern of resource allocation across localities, particularly poorer ones, and in the lessening of the misappropriation of resources compared both to the past and to other areas in Brazil. Faguet (2001) reports that in 1994, after decentralization in Bolivia, public investment in education, clean water and sanitation rose significantly in three-quarters of all municipalities, and that investments responded to measures of local need. For example, the expansion in public education spending was larger on average in municipalities with a lower literacy rate or with fewer private schools<sup>8</sup>. In the studies of Porto Alegre and Bolivia, little information is available on the allocation of resources within a community across households belonging to different socio-economic classes. This means that issues such as the cost-effectiveness of programs, targeting performance or the extent of capture of local governments cannot be addressed. Without household level data on access to public services, these crucial aspects of the impact of decentralization cannot be properly assessed.

Similar findings are also presented from Albania, where Alderman (1998) found that there were modest gains in efficiency and cost-effectiveness following decentralization, that local authorities use some additional information in allocating programs benefits among households, but that the central allocation of social assistance funds to local authorities is ad hoc and not strongly correlated with the level of poverty in the local communities.

In India, Foster and Rosenzweig (2001) use a panel dataset of villages across India to examine the consequences of democratization and fiscal decentralization. They find that an increase in the demographic weight of the landless households in a village under democratic decentralization has a positive effect on allocation of public resources to road construction and a negative effect on that to irrigation facilities. However, their dataset does not reveal the many severe institutional lapses in the implementation of decentralization across India. Bardhan and Mookherjee (2003) and that decentralized management

through the panchayat advanced poverty alleviation goals in West Bengal. Galasso and Ravallion (2001) for Bangladesh confirmed the same results. They find that a decentralized food-for-education programs in Bangladesh was mildly pro-poor (i.e. taking all villages involved into account, a somewhat larger fraction of the poor received benefits from the programs than the non-poor). In Argentina, Eskeland and Filmer (2002) find that the decentralization of education led to an improvement in school achievement scores: school autonomy and parents' participation raise student test scores for a given level of inputs in a multiplicative way. Autonomy has a direct effect on learning (but not when levels of parent participation are very low), while participation affects learning only when it is implemented concurrently with school autonomy. In Nicaragua, King and Ozler (1998) also observe that decentralized management of schools led to improvement in achievement scores.

The positive association of decentralization and the improvement of public services is also shown in a number of cross-country analyses. For example, Estache and Sinha (1995) study 20 countries over the period 1970-92 and find a significant positive effect of expenditure decentralization on per capita infrastructure delivery. They also find that the effect is stronger in developing countries compared with developed countries, and is weaker when local governments rely more on central funds than on their own revenues. The World Development Report 1994 on Infrastructure cited several cases of quality improvement and cost savings in infrastructure projects after decentralization. A World Bank review examining 42 developing countries finds that where road maintenance was decentralized, backlogs were lower and the condition of roads better. Data pertaining to water projects in a group of developing countries revealed that the per capita cost of water in World Bank-funded water projects was four times higher in centralized than in fully decentralized systems. Narayan (1998) study of 121 completed rural water supply projects, financed by various agencies, showed that those with a greater degree of beneficiary participation in project selection and design were much more likely to result in a well-maintained water supply than those where decision-making was more centralized. Huther and Shah (1995) assembled a diverse set of indexes for 80 countries. These indexes cover a wide variety of measures of economic and political structures and performance: quality of governance, political

freedom, political stability, debt-to-gross domestic product ratios, measures of income, the degree of equality of the distribution of income, and many more. They find in nearly every case a statistically significant association between increased decentralization and improved performance.

Scholars also find there to be benefits of decentralization in terms of controlling corruption and quality of governance. Crook and Manor (2000) examine the process of political decentralization in India, Bangladesh, Cote d'Ivoire and Ghana and find that decentralization led to enhanced transparency and reduced incidence of corruption. They conclude that decentralization reduces grand theft but increases petty corruption in the short run but in the long run, both may go down. Wade (1997) reports that over-centralized top-down management accompanied by weak monitoring contributed to corruption and poor delivery performance of canal irrigation in India. Fiszbein (1997), based on a review of political decentralization in Colombia, concluded that competition for political office opened the door for responsible and innovative leadership that in turn became the driving force behind capacity building, improved service delivery and reduced corruption at local level. In Indonesia, Henderson and Kuncoro (2004) reporting on a survey of 1,808 firms in 2001-2 found that administrative decentralization led to reduced corruption as firms relocated to areas where the prerequisite bribes tended to be lower.

Mello and Barenstein (2001) examine cross-country data and conclude that tax decentralization is positively associated with improved quality of governance. By applying instrumental variable regression, Fisman and Gatti (2002) examine the relation between the same measure of expenditure decentralization and measures of corruption (based on subjective perceptions of businesspeople and investors) across 59 countries for the period 1980-1995. They find a significant negative effect between expenditure decentralization and corruption measures. Gurgur (2002) identify major drivers of corruption in order to isolate the effect of decentralization. For a non-industrial country, these are lack of service orientation in the public sector, weak democratic institutions and a closed economy. They concluded that decentralization supports greater accountability in the public sector and reduces corruption.

Prior studies also show the beneficial impact of decentralization on well-being. Using local government panel data, Kruse *et al.* (2012) for example find a positive effect of decentralized health spending on improving healthcare use by the poor in Indonesia. Blas and Limbambala (2001) show that decentralization in the health sector leading to increased local control of resources could be an alternative to the traditional vertical disease programs approach for priority interventions in Zambia. Baiocchi (2001) shows how decentralization reform through a participatory budgeting process has increased the welfare of local citizens in Porto Alegre, Brazil. Bardhan and Mookherjee (2003) find that decentralization of the delivery system promotes cost-effectiveness and improves intra-regional targeting. Using annual cross-country data from 1900, 1997 and 2003, Rajkumar and Swaroop (2007) find that public spending matters for increasing health outcomes and primary education attainment in countries with good governance. Bjornskov *et al.* (2008), using cross-country analysis, find that more spending or revenue decentralization raises well-being, while greater local autonomy is beneficial only via government consumption spending. Likewise, Diaz-Serrano and Rodriguez-Pose (2012) use cross-country data to show the positive relation between decentralization and individual happiness in 29 European countries.

## 2.2. Decentralization decreases public services

However, the negative effect of decentralization on public services and well-being is also shown in several studies. Galasso and Ravallion (1998) find that in Argentina decentralization generated substantial inequality in public spending in poor areas and that this deepened poverty in those areas. In China, West and Wong (1995) also report that decentralization is associated with reduced public services in poor regions. Soerojo and Wilson (2001) show that decentralization increased disparities in spending between curative and preventive health services in Indonesia. Litvack *et al.* (1998) present evidence from Eastern and Central Europe and suggest that public services can suffer because of decentralization. Long bereft of authority and resources by highly centralized political systems, localities throughout Eastern and Central Europe grappled with how to take on responsibilities for routine administration, public service provision and economic

development. Decentralization in itself is not guaranteed to result in improved public services and well-being.

Crook and Sverrisson (1999) have provided evidence that despite extensive strides in the devolution of authority and resources to democratically elected local governments, decentralization in Colombia has achieved little in improving service delivery. Crook and Sverrisson (1999) concludes that decentralization is unlikely to lead to more pro-poor outcomes unless it is accompanied by a serious effort to strengthen and broaden accountability mechanisms at both local and national levels. Based on case studies from six municipalities in Mexico, Grindle (2007) found that public services could suffer because of decentralization. Combining quantitative and qualitative methods, this study examines data based on a random sample of Mexican municipalities, and discovers that decentralization not only allows public leaders to make significant reforms quickly, but that at the same time institutional weaknesses undermine the durability of change, and that the legacies of the past can continue to affect how effectively public problems are addressed. Citizens participate, but they are more successful at extracting resources from government than in holding local agencies accountable for their actions.

A number of scholars find that decentralization can risk a rise in corruption and local conflict. Treisman (2000), from an analysis of cross-country data, concludes that decentralized countries have higher perceived corruption and poorer service delivery performance in public health services. Heller (2001), in his study of decentralization in South Africa, shows that there was no inherent reason why decentralized governments should be any more democratic than centralized ones or any a priori reason why local elections should guarantee the emergence of more effective leadership. Heller (2001) demonstrates that local governments in several developing countries often reflected the social, political, and economic conflicts that divided local communities after decentralization. In Uganda for example, decentralization, while helping to reduce national-level conflict, has nonetheless replaced it with local-level conflict due to struggles over district leadership positions and altering relations between local ethnic groups.

The negative effect of decentralization on regional equality, macro-economic stability and national growth is reported in some studies. Using data from 2000,

Baiocchi in Bardhan (2007) reports that fiscal decentralization is associated with increased regional inequality in Brazil. De Mello (2000), using a sample of 30 countries, found that coordination failures in intergovernmental relations were likely to result in a deficit bias in decentralized policy-making. Burki *et al.* (1999) show that decentralization can lead to increased fiscal deficit and imperil macroeconomic stability. In some cases, rather than increasing the robustness of local taxation, local governments have increased their demands on central government for more revenue (Wibbels, 2005). Davoodi and Zou (1998) and Xie *et al.* (1999), using various data sets for developing countries, developed countries, and time series data from the United States, discovered that decentralization was associated with slower growth. Rodriguez-Pose and Bwire (2003) found a negative impact of decentralization on economic growth for Mexico and the United States but no impact for Germany, India, Italy and Spain. Zhang and Zou (1998) found that fiscal decentralization in China contributed to lower provincial growth. According to Davoodi and Zou (1998) and Zhang and Zou (1998), this negative association may indicate that in practice local governments may not be responsive to the preferences and needs of citizens at local level.

Some studies found associations with decentralization to be inconclusive. In Uganda, for example, Azfar *et al.* (2000) found no positive associations with efficiency and equity of local public service provision. Based on review of 19 developing countries, Jutting *et al.* (2004) show mixed impact of decentralization on poverty reduction. Decentralization reduce poverty through either participation, decline in vulnerability or improved access to services. However, no positive impact could be identified in the majority of the countries. On the contrary, in some poorest countries with lacks of institutional capacity and post-conflict situations decentralization has had negative impacts. Khaleghian (2003), referring to data for 140 countries, found that while decentralization improved the coverage of immunization in low income countries, opposite results were obtained for middle income countries. Winkler and Rounds (1996) reviewed Chile's experience of education decentralization and concluded that it resulted in improvement to efficiency of provision but also led to a decline in cognitive test scores. World Bank (2008b) did not find any positive association of the effect of decentralized health spending with health

outcomes and healthcare demand in Indonesia. Phillips and Woller (1997) and Martinez-Vazquez and McNab (2003) examined a cross-section of countries, and could not find a statistically significant relationship between fiscal decentralization and economic growth.

### 2.3. Why decentralization works and does not work?

All these mixed findings raise the question: Why does decentralization work and not work? Bardhan (2006) explains that decentralization of public services is typically compared with the alternative: public provision by a centralized governance structure. Extensive literature debates the advantages and disadvantages of both. The advantages of centralization include the ability of a national government to control for interregional externalities, to realize economies of scale types of public goods and to better provide redistributive goods. One of the most significant disadvantages is the tendency of centralized systems to provide a single universal standard without the capacity to adjust to diverse local needs and conditions (Oates, 1972). Early on in this debate, researchers questioned the supposed inherent superiority of decentralized decision-making (Hayek, 1948; Wildavsky, 1976). Researchers also have questioned why centralized delivery systems cannot simply incorporate local information, enabling them to adjust policies to local needs. Bardhan and Mookherjee (2000) suggest that there are more fundamental reasons for the failure of central governments to respond to local needs than failing to match service to demand. They believe the underlying problem is rather the difficulty in creating the specific institutional arrangements and incentive structures that oblige political units to be accountable to their citizens. Bardhan and Mookherjee (2002) argue that centralized delivery systems are prone to bureaucratic corruption due to problems in monitoring performance, whereas local decision-makers who are closer to the people may be more easily monitored.

The main argument in favor of decentralization is that it brings decision-making closer to local people. Tiebout (1956), Coase (1960), and Oates (1972) argued that decentralization would increase allocative efficiency by subjecting public spending priorities to local demand. They indicated that because information regarding the performance of government institutions is more readily available to citizens in decentralized systems, this puts them in the best position to make demands for effective services and to reward and punish

local politicians. Information on local preferences also becomes more readily available to decision-makers under decentralization because their sphere of activity is coterminous with that of the citizens they represent. Moreover, taxing citizens for local services creates the incentive for them to insist on good quality, and to hold officials and service providers accountable for their actions.

However, theoretical literature also puts forward a number of reasons why decentralization can degrade the provision of public services. Oates (1972) explains that decentralization forfeits certain economies of scale available in central provision, while Smith (1985) argues that decentralization may worsen outcomes when local governments are less technically able than central government to administer the delivery of public services. Bardhan and Mookherjee (2005) examine the possibility of capture and misallocation of public resources by local elites to their preferred uses, and argue that capture by locally strong interest groups is easier under decentralization. In cases such as these, the non-elite have little voice in local decisions and their preferences and needs go unfulfilled. For example, if local elites do not use the public schools in their area, they are likely to lobby for public resources to be used differently.

Studies have identified some channels or mechanisms determining effective or ineffective decentralization for improving public services and well-being. These channels or mechanisms can be divided into three theoretical streams. First, they who are focused on the structure of political institutions as condition for effective decentralization. This stream is particularly dominated by the work of political scientists. They suggest that for decentralization to work it requires the existence of democratically functioning local governments and institutional constraints that hold politicians to account (Agrawal and Ribot, 2000; Ostrom, 2000; Anderson, 2003; Rodden *et al.*, 2003). Second, they who are stressed the capacity of local government's management and administration to respond to demands as condition of effective decentralization. This is particularly dominated by the public administration scholars and economists (Rondinelli, 1989; Crook and Manor 1998a, 1998b; Ribot, 200; Grindle, 2007). Third, they who believe that the success of decentralization is determined by the structure of society itself, and the action of citizens

rather than political and administrative structures. According to this view, social groups in a community exert pressure on the public sector to provide better services or more opportunities for participating in the policy-making process (Putnam, 1993; Heller, 2001; Faquet, 2001).

Some researchers have focused on structure of political institutions to understand condition of effective or ineffective decentralization for improving local public services and well-being. Those who stress the significance of formal political institutions for understanding the impact of decentralization reforms on public services have tended to emphasize many of the same institutional arrangements that are more broadly associated with democratization (Crook and Manor, 1998a; Ribot, 2002). According to these scholars, for decentralization to work it requires the existence of democratically functioning local governments and institutional constraints that hold politicians to account (Agrawal and Ribot, 2000; Ostrom, 2000; Anderson, 2003; Rodden *et al.*, 2003). Thus, in a well-functioning democratic system residents are able to exert pressure on local, elected representatives to provide essential goods. With dysfunctional local governments, the fundamental prerequisites of a democratic institution are often missing (Crook and Manor, 1998a; Bardhan and Mookherjee, 2000). Such a lack of degree of accountability can lead to disproportionate elite influence, as discussed earlier; this can (according to Seabright, 1996; Bardhan and Mookherjee, 2003) increase local rent seeking (Seabright, 1996; Bardhan and Mookherjee, 2003). A system of accountability is clearly essential to enable communities to monitor local government performance effectively and to react appropriately to that performance. Such a system also provides politicians and local officials with the incentive to be responsive. The political institution that would seem the one most obvious to guarantee accountability is that of the local election, and the link between electoral politics and local government is suggested in Riker (1964). According to this view, where local elections are competitive and opposition party members have a real opportunity to win positions of authority, incumbents will be motivated to prove their competence in the management of public affairs and will seek to find new ways of addressing real problems. Subsequent authors have also pointed to the importance of competitive and contestable local elections as an institutional mechanism to counter corruption and to

prevent the capture of local politics by elites (Rondinelli *et al.*, 1989; Manor, 1999; Rose-Ackerman, 2000). They suggest that decentralization reforms without accompanying change at local level, designed to ensure effective functioning democratic governance, will simply increase the power of local political elites rather than improving local service delivery and strengthening democracy (Prud'homme, 1995; Crook and Manor, 1998a; Crook and Manor, 1998b; Manor, 1999). Empirical investigation on the relationship between structure of political institution, public services and well-being however is very limited. Another body of research has focused not on the structure of political institutions, but on the degree of institutional authority or local administrative capacity. A number of researchers have suggested that the reason some public services are not delivered well by local governments is that decentralization is rarely complete (Rondinelli *et al.*, 1989).

costs of their decisions. However, in many cases, responsibility is given to local governments without the accompanying fiscal authority either to raise revenue or to exercise discretionary power over spending decisions (Dillinger, 1995; Seabright, 1996; Agrawal and Ribot, 1999). The link between decentralization, and fiscal responsibility and efficiency relies on a complex array of financing, spending and resource allocation relationships between central and local governments.

Others have stressed that it is not institutional authority that matters, but rather the capacity of local governments to respond to demands. In many cases staff, training and basic administrative infrastructure is severely lacking and even if given the authority, the resources available do not allow for effective response to citizens' needs (Larson, 2002; Deininger and Mpuga, 2005). Some scholars emphasize local leadership capacity as an important determinant for effective decentralization (see for example Wallis (1999) and Grindle (2007).

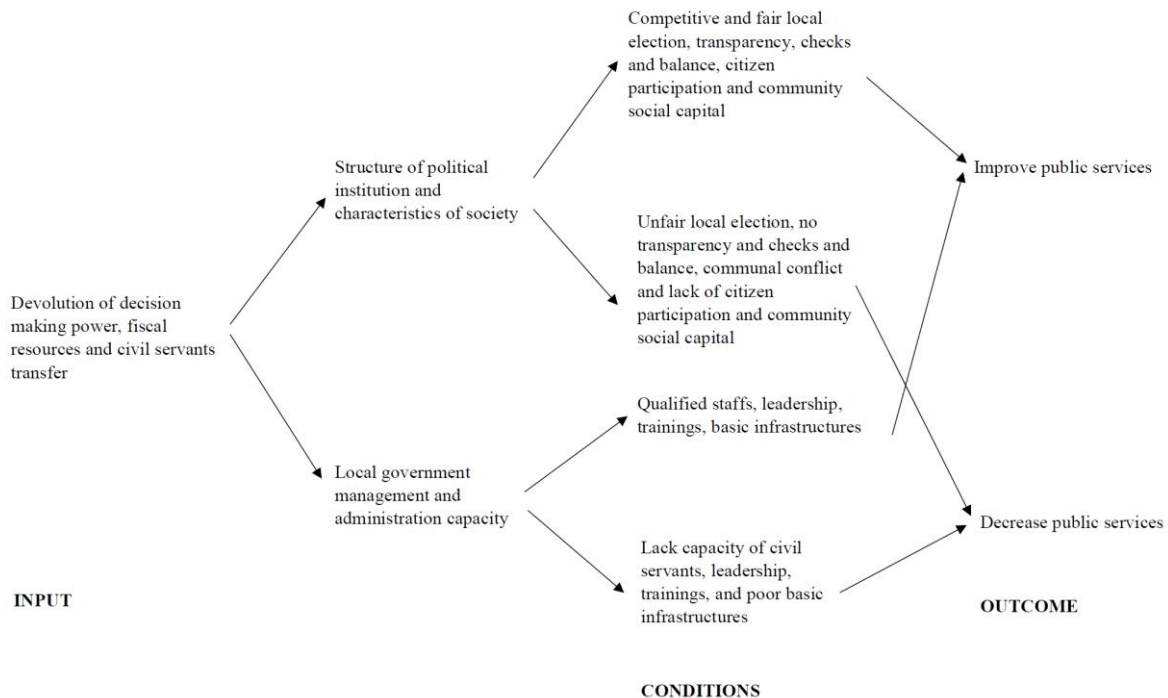


Figure 1. Theoretical linkage between decentralization and public services

They suggests that any decentralization framework must link, at the margin, the local financing and fiscal authority to the service provision responsibilities and functions of the local government, so that local politicians can deliver on their promises and bear the

In their view, the state, in the guise of reform leaders and their teams, identifies particular problems and promotes policies, programs and organizational solutions to local government. In Mexico, Grindle (2007) finds that ideas, leadership skills, and the

strategic choices made to promote a reform agenda and acquire resources play a central role in effective decentralization and improving well-being.

Other researchers attempting to explain the success of decentralization have focused on the structure of society itself, and the action of citizens rather than political and administrative structures. According to this view, social groups in a community exert pressure on the public sector to provide better services or more opportunities for participating in the policy-making process. These groups not only demand good performance, they can also provide models of how improvements can be made, participate in decision-making and implementation activities, and take an active role in monitoring the performance of elected and administrative officials. Localities without active civil societies are less likely to take on the difficult task of providing better services, to be innovating in their activities, or to be responsive to local needs. The most well-known is Putnam's analysis of Italy's local government and the impact of civil society and social capital (Putnam, 1993). Putnam posits that the degree to which devolution of authority leads to better local government is concomitant with the level of organization of civil society and the extent to which civil actors are able to monitor and hold local officials accountable. The success of decentralization in Porto Alegre, Brazil and Illave, Peru also shows the important role which civil society engagement plays in ensuring the positive impact of decentralization (see for example Heller (2001); Faguet (2001)). This bottom-up approach places agency not with politicians, but rather with citizens themselves and their ability to organize and interact with the formal political structure. The impact of the organization of civil society on a broad array of democratic reforms and public services is supported in subsequent empirical research (Booth and Richard, 1998; Woolcock, 1998; Bowles and Gintis, 2002).

### 3. Conclusion

This study concludes that decentralization will increase public services at local level when certain conditions exist. Experience across developing countries shows that competitive and fair local election, transparency, checks and balance, citizen participation and community social capital as well as capacity of public servants and existing basic infrastructures is key factors for effective decentralization for improving public services.

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