

Session 2.2. Fiscal Decentralisation

INTRODUCTION

The second part of the morning will introduce fiscal decentralisation and own revenues as a way to strengthen accountability. Theories of second-generation fiscal federalism will be discussed and the four pillars of intergovernmental finance—(1) expenditure responsibilities, (2) revenue assignments, (3) intergovernmental transfers and (4) sub-national debt and borrowing—will be introduced. The focus will be on supporting strategies for decentralisation, harmonisation and alignment.

You will engage in group discussions and are actively invited to relate and share your experiences.

BACKGROUND INFORMATION

Part 1: Understanding the context of fiscal decentralisation

The session starts with an introduction to the context of fiscal decentralisation and a brief explanation of the major issues.

Definition of fiscal decentralisation: 1st generation. The 1st generation of fiscal decentralisation, or "fiscal federalism", sets forth an active and positive role for the government in terms of correcting various forms of market failure, establishing equitable distribution of income and stabilising the macro-economy at high levels of employment with stable prices. According to Oates (2005), the implicit assumption is that government agencies, as "custodians of the public interest", will seek to maximise social welfare, either because of some kind of benevolence or because of electoral pressures in a democratic system. In short, where market failure prevails, there is a presumed need for public intervention. Another implicit assumption is the political stability of a sustainable nation-state, which provides the context for the theory.

Based on these premises, Litvack and Seddon (1999) define fiscal decentralisation as follows: "Decentralisation is the transfer of authority and responsibility for public functions from the central government to subordinate or quasi-independent organisations or the private sector."

Definition of fiscal decentralisation: 2nd generation. It is often history and politics—not economics—that determine the sub-national structure of government and drive fiscal decentralisation reforms. Many fiscal decentralisation reforms have shifted financial resources to the local government level but failed to decentralise the discretion to manage these resources.

As described by Oates (2005), second-generation fiscal federalism examines the workings of different political and fiscal institutions in a setting of imperfect information and control, with a

basic focus on the incentives that these institutions embody and the resulting behaviour they induce from utility-maximising participants. It builds on first-generation fiscal federalism but assumes that public officials have goals induced by political institutions that often systematically diverge from maximising the welfare of the citizenry.

This new perspective implies that fiscal decentralisation requires more than just a “pushing down” of financial resources: control over these financial resources matters just as much. Additionally, if you look at things through this new lens, decentralisation is tied much more closely to governance and poverty reduction (empowerment). This new—more people-centred—line of thinking about fiscal decentralisation is reflected in Bahl’s (2005) definition of fiscal decentralisation: “[Fiscal] decentralisation is the empowerment of people by the [fiscal] empowerment of their local governments.”

Potential benefits of fiscal decentralisation. Several potential benefits of fiscal decentralisation follow from these two bodies of work. According to Oates (2005), the two main benefits are (1) *more accountability on the part of government officials* because they are on the hook for service delivery to the local population that elected them and (2) *more willingness on the part of the local population to pay for services* because they get what they want.

Another important benefit is the *promise of increased revenue mobilisation*. This happens because decentralisation can broaden the aggregate tax base by reaching the traditional tax bases of income, consumption and wealth in ways that a central government cannot.

Finally, some argue that successful fiscal decentralisation *stimulates innovation in economic decision making* because it allows a variety of experiments and initiatives that can, through comparison and learning, improve the overall performance of the system. Furthermore, competition between jurisdictions may enhance the overall performance of the government.

Costs associated with fiscal decentralisation (adapted from Oates, 2005). There can also be costs associated with fiscal decentralisation, which is, perhaps, why not all places choose this route.

Heading the list is *macroeconomic control*. Central governments would like the flexibility to respond quickly to changes in the economy—to raise taxes or cut expenditures to deal with a deficit, for example. If the government is locked into a fixed share of revenue allocated to local governments, the ability to cut the deficit by reducing expenditures is significantly reduced.

Another line of thinking is that *national priorities for capital investment do not conform to local government choices*. The national government is interested in investments in infrastructure that have regional and national benefits, such as irrigation, national roads and energy. Sub-national governments will be focused on capital investments with regional and local benefits.

A third cost of decentralisation is that the *centre will lose some control over infrastructure development* because local governments will have some discretionary spending power. The

net result of fiscal decentralisation could be a shift of resources from central governments, which have higher rates of savings and investment, to provincial and local governments, which spend at a greater rate on consumption of goods and services.

A fourth point is that *revenue centralisation gives greater potential for equalisation*. However, just because the central government has more funds to allocate, it does not necessarily follow that it will allocate these funds on an equalising basis. In fact, most countries do very little equalisation through their grant systems.

Linkages between fiscal, administrative and political decentralisation. In order to attain the full benefits of fiscal decentralisation, it is important to acknowledge that supporting fiscal decentralisation alone is not enough. To truly empower local communities and to achieve pro-poor outcomes, it is crucial to take account of the linkages of fiscal decentralisation with administrative and political decentralisation.

Introducing the four pillars of fiscal decentralisation. Fiscal decentralisation and fiscal empowerment of local governments is traditionally divided into four elements or “pillars”: (1) the assignment of responsibilities for expenditure, (2) revenue assignments and local revenue administration, (3) the design and provision of inter-governmental fiscal transfers and (4) local government borrowing and debt.

Part 2: Assigning expenditure responsibilities

Although assigning expenditure responsibilities is an important pillar of fiscal decentralisation, this topic will only be touched upon briefly in this session, since it is discussed in depth in the session on administrative decentralisation.

Functions of the state. According to Musgrave (1959), as discussed in the session on administrative decentralisation, there are three main roles or branches of the public-sector budget:

- *To provide a stable economic environment.* The maintenance of high employment and price stability should be assigned to the central government. This is true for two reasons. First, the economically and fiscally open character of economies in sub-national jurisdictions prevents sub-national governments from effectively addressing macro-economic concerns such as employment and price levels. Second, the institutional economic reality is that one of the basic tools of stabilisation policy—control over the money supply through a monetary authority—rests with a central bank.
- *To promote a more equitable distribution of income/resources.* For much the same reason, because sub-national economies are “open”, securing equity in the distribution of income and wealth should largely be a central responsibility.
- *To assure a more efficient allocation of resources (when markets fail).* The efficiency argument (i.e., allocation policy) is the *raison d’être* for a sub-national

role. Allocation focuses on two topics: (1) the manner in which the public sector intervenes in how an economy uses (allocates) its scarce resources by collectively purchasing not only final goods but also the services of the factors of production (labour, capital and land) and (2) the determination of which type or level of government shall be responsible for which purchases.

This third role involves establishing criteria, according to a set of principles and objectives, for sorting out which government does what with respect to the allocation function. This leads us to the most important guiding principle of revenue assignment: finance should follow function (for examples see Table 2.2.1). The country specific-guiding principles of the DPWG-LGD describe three main reasons for this:

- One cannot establish the required level of sub-national government revenues without an estimate of expenditure needs.
- If finance does not follow function, it becomes difficult to effectively impose hard budget constraints at the sub-national level if there is an insufficient assignment of revenues.
- The economically efficient assignment of revenues requires prior knowledge of the assignment of expenditures.

Table 2.2.1: Expenditures Related to the Assignment of Revenues

| | Local government expenditure (local service delivery and/or local infrastructure) | Examples | Appropriate funding source |
|---|---|--|--|
| 1 | Local government services that are excludable and that do not have any spill-overs or equity implications | Excludable club goods, such as public swimming pools; Local utilities | User fees or quasi-user fees |
| 2 | Local government services that are not excludable or those that have local spill-overs ("truly" local services) | Local parks, minor local roads; Refuse collection in urban areas | Local taxes |
| 3 | Local government services that have spill-overs between local jurisdictions | District roads; Mosquito control | Local taxes combined with inter-governmental (matching) grants |
| 4 | Local spending on national priority programmes (i.e., national priorities where provision is delegated or devolved to local government) | Public education; Public health care | Sectoral/conditional inter-governmental grants (supplemented by local revenues as demanded by political priorities) |
| 5 | Local spending on programmes that have important equity implications, or national implications for spill-overs | Social welfare programs; Public education; Pure public goods | Sectoral/conditional inter-governmental grants, equalising general-purpose grants |
| 6 | Local spending on local capital development | Capital-development programs | Borrowing (if possible); Intergovernmental grants |

Part 3: Instruments for financing sub-national governments

The second pillar of intergovernmental finance: Revenue assignment. The second pillar of inter-governmental finance—revenue assignment—refers to the mix of user charges, taxes and transfers assigned to each level. Local governments in developed as well as developing countries rely to a greater or lesser degree on a number of local own-source revenues to fund expenditures within the local realm of responsibility.

The DPWG-LGD (2009) calls for strengthening the mobilisation and foreseeable nature of local governments' resources. Why does this need to happen?

- Sub-national governments are often more accountable for controlling spending if they are also responsible for revenues.
- It reduces excessive demand by sub-national governments for transfers from the centre.
- It allows tax policies (tax levels and structure) to be tailored to the conditions and preferences of sub-national governments.

Features of an ideal local revenue source. As mentioned earlier, the DPWG-LGD (2009) recommends fostering the sustainable mobilisation of own resources by local authorities in connection with the relevant services.

Taxes that are “ideal” for local governments to mobilise, are taxes

- that achieve a “correspondence” between the tax and the benefits from local government services
- are relatively easy to administer
- do not easily give “perverse incentives” to taxpayers

Revenues commonly assigned to the local level include taxes such as property taxes, user fees (for example, utility fees, fees for garbage collection or market fees), licensing and permit fees, and rent on local government property, such as buildings and equipment.

Lessons learned. Complete local autonomy for generating revenue would imply that local governments are able to assess and set the tax base, set the tax rate and administer or collect the revenue. Few countries provide their local authorities with such a high degree of discretion unless there are substantial mechanisms for public and social accountability in place to make sure the collection and utilisation of these funds occurs in accordance with local priorities. Unfortunately, it is frequently true that there are fewer good local revenue options available for local governments in developing countries compared to their counterparts in more-developed economies. Steffensen (2010) points out that in Uganda and Tanzania, for example, several local taxes have been abolished recently without sufficient consideration of alternative sources. In other countries (e.g., Zambia), the central government strongly controls local government tax rates and the tax base, and there are numerous examples of political interference in the mobilisation of local government revenues.

Part 4: Inter-governmental fiscal transfers

The third pillar refers to inter-governmental transfers, which are needed in the variety of circumstances in which sub-national governments operate—explicitly or implicitly—as agents of the national government.

The DPWG-LGD's (2009) country-specific guiding principles advise establishing mechanisms that ensure that financial transfers from the State to sub-national governments are done in a regular, transparent and foreseeable way, along with supporting modalities for equalisation aimed at reinforcing balance and solidarity between territories.

Reasons for intergovernmental transfers. The revenues from local taxes are almost always insufficient for carrying out the functions assigned to local governments. Thus, inter-governmental transfers are required to mitigate this imbalance. There are many different kinds of inter-governmental transfer systems, and they have different types of impacts on local government finances. Some stimulate local spending, some are substituted for local revenue efforts, some are equalising and some lead to more fiscal autonomy for the local government than others. The DPWG-LGD's (2009) guiding principles say that countries too often enter into the process of grant design without clear objectives for what the transfer system is to accomplish. Well-designed transfers typically have three objectives (adapted from Ebel and Péteri, 2007):

1. providing incentives for efficient spending and utilisation of the municipal revenue base
2. guaranteeing sufficient funds for managing local functions by mitigating vertical imbalances
3. supporting regional equalisation of communities by mitigating horizontal imbalances

Design. As with any fiscal policy, intergovernmental transfer systems differ in the quality of their design. If designed poorly, the system will not only fail to address imbalances, it will create additional problems. However, a well-designed and well-implemented rule-based system of inter-governmental fiscal transfers brings greater stability, predictability and discretion to local government finances, and thereby promotes good planning and efficient local service delivery.

There are two steps to the design of grants. First, the amount of the grant must be determined; that is, the total amount to be transferred among the sub-national governments must be determined. This is referred to as determining the “distributable pool”. The second step is that of determining how the pool will then be distributed between the different sub-national governments.

1. Determining the distributable pool. There are three ways to determine the total amount to be transferred: (1) as a fixed share of national government revenues, (2) as part of the annual budget decision and (3) as a proportion of approved, specific local expenditures to be reimbursed.

Establishing a fixed percentage of total national revenues to be transferred is the best way of providing some degree of stability and transparency. However, some governments prefer to

decide the total amount in the distributable pool in accordance with budgetary priorities as part of the annual budget decision. With this system, the central government exercises a significant amount of control over sub-national governments, and determination of the pool becomes an ad hoc exercise. In addition, in the event of a national recession or decrease in central revenues, sub-national governments will face big revenue cuts.

There are various methods for determining the distributable pool where reimbursement of certain expenditures (cost reimbursement) is opted for. This third type of transfer system is always closed-ended because the central government decides what kinds of expenditures are eligible for reimbursement. Consequently, in such cost-reimbursement transfer schemes, the decisions tend to be ad hoc.

2. Distribution of the pool among sub-national governments. There are three basic models for allocating the total amount of transfers from national to local government budgets. These methods generate different types of incentives for local governments (adapted from Ebel and Péteri, 2007):

- *Gap-filling model:* The gap-filling model is the *most centralising* form of grant allocation, where both municipal budget expenditure for particular services and total local government revenue, including own-source revenue, are estimated for each local government. Under gap-filling arrangements, there is little or no incentive to raise own-source revenues because transfers are automatically decreased by the amount of any surplus above the planned own-revenue appropriations.
- *Local government respects hard budget constraints:* This model, used for calculating general grants, provides greater autonomy in deciding municipal expenditures and creates incentives for raising own-source revenues. Under this model, national budget grants are calculated by formulae and carry with them a high degree of fiscal flexibility and autonomy. Methods used for distributing general grants include population size and number of users of services (e.g., students, elderly in health-care facilities, welfare assistance).
- *Fiscal capacity-based methods:* This is the most “policy neutral” model for grants, and it is built on the difference between expenditure needs and own-source revenue capacity. This method calculates local expenditures through formulae and, at the same time, takes into account standardised estimates of potential revenues that a sub-national government could mobilise if it applied average national tax rates (and revenue charges) to its available revenue bases. Consequently, methods of transfer serve equalisation purposes (municipalities with low revenue potential and/or higher expenditure needs receive higher grants) without destroying local incentives for own-source revenue efforts (local governments get no compensation for uncollected revenue below the average level, and the surplus in own revenue does not automatically decrease the transfers).

Design implications. In addition to the design-related concerns that were mentioned above, Boex & Yilmaz (2010) warn that, if the distribution of inter-governmental transfers is determined by the central government in an *ad hoc* and opaque manner, transfer systems can give rise to inefficiencies in allocation and poor budget execution due to uncertainty at the local level regarding the receipt of resources. Such uncertainties can lead to poor budgeting practices and can weaken the accountability of local governments to their citizens. Similarly, excessive restrictions imposed by the centre on the use of funds transferred to the local government frequently diminish the ability of local governments to respond to the preferences of their citizens. It is not uncommon, for example, for inter-governmental transfers to be ear-marked for specific, centrally approved infrastructure projects or for specific local expenditures, such as salaries for local staff recruited and hired by the central government. Such centralised control and the uncertainty associated with it undermine stability and predictability in local policy making the system more prone to political pressures.

Lessons learned. In the publication “Fiscal Decentralisation and Sector Funding Principles and Practices”, Steffensen (2010) says that implementation of reforms for inter-governmental transfers teaches us that it is important to ensure the following:

- close dialogue among all core stakeholders in the design work
- proper buy-in to the introduction of the reforms from core stakeholders and champions of the reform, as well as a clear institutional framework for the inter-governmental transfer system
- current follow-up and support to the administration of the inter-governmental transfer system, particularly regarding performance-based systems that are more demanding
- transparency and accountability in all phases of the work on inter-governmental transfer systems: transfers are about funds, and funding is important for power. Hence, it is important, but challenging, to avoid political capture of the inter-governmental transfer system

Part 5: Sub-national debt and borrowing

Local borrowing can act as a significant and sound source of financing, especially in countries where own-source revenues and inter-governmental transfers fall short of responding to local investment needs. However, sub-national governments should borrow only for financing capital (investment) expenditures, such as improvements in infrastructure, which provide a flow of benefits over time.

The main arguments for using borrowed money for capital projects may be summarised as follows (adapted from Swianiewicz, 2007):

- *Efficiency.* Because capital (investment) expenditures provide a flow of current benefits over time (the life of the project), it is efficient to spread the recovery of capital costs over that same time period.
- *Equity.* Equity or fiscal “fairness” is enhanced by spreading out the payment of the capital costs over successive generations that benefit from the subsequent year-to-year flow of services.
- *Timing.* Borrowing allows for faster implementation of projects, and benefits derived from investments can be enjoyed earlier. Indeed, in some cases, earlier

completion of a project may generate additional revenues or reduce current expenditures (e.g., new, more efficient lighting or heating systems). Moreover, faster implementation often reduces the total cost of an investment project.

- *Practicality.* Borrowing often enables the use of external grants that require pre-financing.

However, irresponsible borrowing or excessive reliance on sub-national borrowing can create negative incentives for local governments and could potentially put macro-economic stability at risk. National governments have addressed this problem by attempting to regulate the level of local borrowing, by limiting, controlling or prohibiting the issuance of debt by local governments.

Lessons learned. Steffensen (2010) outlines the following lessons learned on local government borrowing:

- Local government borrowing should be backed by a robust and transparent legal framework, as well as systems and procedures for where to borrow and for which purposes—and possible ceilings and frameworks for monitoring and supervision.
- It is critical that central governments establish a reputation for maintaining a hard line against sub-national debt relief. By alerting potential lenders that aid will not be forthcoming, governments can ensure that sub-national borrowing is confined to levels that sub-national governments themselves are able and willing to repay.
- Intermediate borrowing institutions may be a step on the road towards private credit to local governments, but can also be a stumbling block (when agencies are not properly designed, displacing private capital, when central government representatives put themselves in managing positions/boards or when agencies are not driven by competitive methods).
- Local governments are not in a good position to function as lending institutions for others, such as bodies for delivery of micro-credit to community groups. This is risky business and often linked to patronage and lack of transparency.
- Strong incentives for local governments to ensure creditworthiness should be supported by initiatives on local government borrowing. In this regard, performance-based grant systems—with a system of assessment of indicators of public financial management (PFM) and links to allocations—may be an important intermediate tool for promoting a higher level of local government creditworthiness and fiscal discipline.
- Debt thresholds may be established in a manner to ensure that local government borrowing is not getting out of hand. There are good reasons to restrict local government borrowing to development-oriented areas, such as capital investments in infrastructure (e.g., roads and utilities) and services (e.g., schools and health centres), and to establish some ceilings, particularly in the first phases.
- In cases where there is no formal regime in place for local government borrowing, there are examples of severe informal borrowing, often leading to problematic fiscal positions and a large amount of outstanding arrears (unpaid bills and credits) in local government. This is observed in various countries like China, Uganda, Zambia and the Solomon Islands.

Part 6: Public financial management

PFM of local governments is very important. It is closely related to the issue of fiscal decentralisation and to links with administration and national development priorities. Local government systems for financial management are highly diverse and complex. They reflect complicated tradeoffs among competing demands and interests, and they maintain a range of relationships with a variety of stakeholders from national government regulators to service providers, civil servants and the public at large.

These mechanisms have the potential to balance political and economic risks, by providing the following:

- a reliable account of money spent and received
- evidence that finance is being used responsibly for the public good and in compliance with regulations
- a demonstration of “value for money” and good governance in terms of economy, efficiency, effectiveness and equity
- support to good decision making and assistance to leaders and managers in assessing the financial consequences of policy choices
- a basis for planning for the future, maximising income sources and aligning these resources with objectives of service delivery

In recent years, there has been a shift from “traditional” ex ante control of budgetary inputs to ex post accountability on the basis of results. Table 2.2.2 provides an overview of the differences between traditional and output-based grants. A good example of the latter is performance-based budgeting, where decision makers try to choose outputs that will lead to desired policy outcomes. That is, they seek improved performance. With the traditional approach to budgeting, appropriations focus largely on inputs, and decision makers have little incentive to strive for better performance. In a performance-based system, there is a need to monitor the quantity and quality of outputs and to measure the result (or outcome) of delivering these outputs.

Table 2.2.2: Traditional versus Output-Based Grants

| Feature | Traditional grant | Output-based grant |
|---|---|--|
| Grant objectives | Spending levels | Quality and access to public services |
| Grant design and administration | Complex | Simple and transparent |
| Eligibility | Recipient government departments/agencies | Recipient government provides funds to all government and nongovernment providers |
| Conditions | Expenditures on authorized functions and objects | Outputs-service delivery results |
| Allocation criteria | Program or project proposal approvals with expenditure details | Demographic data on potential clients |
| Compliance verification | Higher level inspections and audits | Client feedback and redress, comparison of baseline and postgrant data on quality and access |
| Penalties | Audit observations on financial compliance | Public censure, competitive pressures, voice and exit options for clients |
| Managerial flexibility | Little or none. No tolerance for risk and no accountability for failure | Absolute. Rewards for risks but penalties for persistent failure |
| Local government autonomy and budgetary flexibility | Little | Absolute |
| Transparency | Little | Absolute |
| Focus | Internal | External, competition, innovation, and benchmarking |
| Accountability | Hierarchical to higher-level government, controls on inputs and process with little or no concern for results | Results based, bottom-up, client driven |

Source: Shah, A. 2006. A Practitioner's Guide to Intergovernmental Fiscal Transfers

International experience has also shown that performance-based grant systems are valuable and innovative elements in overall reforms of inter-governmental fiscal relations, and that they can have a positive impact on the overall reform agenda in many countries (UNCDF, 2010).

The following lessons can be learned from local government PFM reforms (Steffensen, 2010). PFM reforms should:

- be part of the overall support to fiscal decentralisation and other components of decentralisation in a mutually strengthening manner
- focus on incentives in addition to the more traditional focus on technical improvements
- apply a step-wise approach where there is a focus on the basic issues, while preparing for more advanced reforms
- support the inter-governmental fiscal-transfer system, as it is often a useful entry point to other reforms, including PFM improvements
- use a learning-by-doing approach whenever appropriate. Lack of capacity, including PFM capacity, should not be used as an argument for not pursuing fiscal decentralisation. Much of the improvement only takes place through the actual learning process, provided that sufficient incentives for improvements are in place and operating. It should be noted that capacity at the central level often leaves great room for improvement, but this is typically less easy to document.

Part 7: Harmonisation and alignment of support to decentralisation

The findings from an OECD survey in 2004 revealed that support to fiscal decentralisation reforms is often fragmented, scattered and without an overall strategy and action plan. According to Steffensen (2010), these findings are still valid today. He also points at some examples of aid modalities that show potential for improved harmonisation and alignment of support, such as the performance-based grant systems mentioned above and joint financing agreements. Furthermore, a briefing paper from the German Development Institute (DIE, 2010) points to the potential of integrated fiscal decentralisation (IFD) for harmonisation and alignment. IFD refers to a nation-wide transfer (distribution) system whereby a central government allocates resources to local government bodies in accordance with a single distribution formula. In other words, IFD is a unified fiscal framework for local development that integrates both sectoral and regional perspectives. This approach offers an interesting opportunity for improving harmonisation and alignment:

- The existence of such a mechanism would reflect the partner country's spending priorities, and it would allow donor agencies to finance such an account jointly.
- IFD could also help to reduce disbursement pressures experienced by individual donors, while at the same time, improving the predictability of overseas development aid.

KEY READINGS AND BACKGROUND MATERIAL

Bahl, R. 1999. Implementation Rules for Fiscal Decentralisation. International Studies Program Working Paper Series. GSU paper 9901. Andrew Young School of Policy Studies, Georgia State University, Atlanta.

<http://siteresources.worldbank.org/INTDSRE/Resources/3p.pdf>

There are many analyses of fiscal decentralisation as a policy strategy. Most focus on evaluating the decentralisation experience around the world and looking for the match between theory and practice. Far less attention has been given to implementation strategies. This leading paper offers some rough guidelines for implementation: 12 “rules” that can form the basis of a decentralisation strategy. It begins with a discussion of the rationale for fiscal decentralisation (i.e., a statement of the objectives that should lead the design of a decentralisation program). It then turns to the guidelines that could form the backbone of a strategy.

DIE. 2010. Integrated Fiscal Decentralisation: Taking New Aid Modalities to the Local Level. German Development Institute Briefing Paper. German Development Institute, Bonn.

[http://www.die-gdi.de/CMS-Homepage/openwebcms3.nsf/\(ynDK_contentByKey\)/ANES-89YFH4?Open](http://www.die-gdi.de/CMS-Homepage/openwebcms3.nsf/(ynDK_contentByKey)/ANES-89YFH4?Open)

The question of combining the implementation of the new aid agenda with the challenges of advancing subsidiarity oriented decentralisation in many developing countries has been neglected for some years, as most of the discussion on ownership, the use of partner country systems, donor harmonisation and alignment has been focused on the central government level. This being the case, this document discusses the opportunities for and challenges to integrated fiscal

decentralisation (IFD) from a domestic and a donor perspective, considering its potential in terms of alignment, coordination and the absorption of ODA funds.

DPWG-LGD. 2009. Fiscal Decentralisation and Options for Donor Harmonisation.

www.dpwg-lgd.org/cms/upload/pdf/Fiscal_Decentralisation.pdf

The DPWG-LGD Secretariat has commissioned a desk study in the area of fiscal decentralisation with a focus on local taxation, in order to produce recommendations on two levels: (1) simplification and optimisation of fiscal systems and (2) harmonisation of development partners' interventions. Reference is made to positive as well as negative experiences in a range of countries, including states at different stages of fiscal decentralisation. With regard to revenue generation at sub-national levels, the focus is on real property tax and market fees and taxes. Selected examples regarding innovative modalities for performance-based grants, sub-national borrowing and public-private partnerships are also analysed.

Shah, A. 2004. Fiscal Decentralisation in Developing and Transition Economies: Progress, Problems, and the Promise. Policy Research Working Paper 3282. World Bank, Washington DC

<http://ideas.repec.org/p/wbk/wbrwps/3282.html>

Developing and transition economies (DTEs) have undergone a major transformation in their public sectors in the last decade. This World Bank Policy Research Working Paper examines the reasons for the rekindling of interest in fiscal rearrangements in DTEs. It reviews progress to date by using a systematic framework and presents general and institutional lessons on creating an enabling environment for responsive and accountable local governance.

Steffenson, J. 2010. Fiscal Decentralisation and Sector Funding Principles and Practices. DANIDA, Copenhagen.

www.danidadevforum.um.dk/NR/rdonlyres/3EAEF553-A8D7-4868-94C0-168E1671E5BC/0/FISCALDECENTRALISATIONfinalversion.pdf

This paper provides a general introduction to the subject of fiscal decentralisation (FD) as well as lessons learned from a number of developing countries with recent experiences with FD. It introduces the main principles behind and components of FD and the links to sector funding. It also introduces some experiences from various modalities for support to FD, based on experiences from a large number of reforms in developing countries in Africa, Asia and Latin America. A number of technical annexes provide more detailed information on some of the core issues.

OTHER LITERATURE

Boex, J. and S. Yilmaz. 2010. An Analytical Framework for Assessing Decentralised Local Governance and the Local Public Sector. Working Paper 2010-06. Urban Institute Centre on International Development and Governance, Washington DC.

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GUIDELINES AND HANDBOOKS

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The authors argue that the sequencing of decentralisation policies is an important determinant of success. The paper raises two questions. First, is there an optimal sequencing for decentralisation policies and implementation? The answer is that there is and that following these sequencing rules can reduce the costs and risks of implementing fiscal decentralisation. Second, to what extent do countries follow these optimal sequencing rules? The answer is, in general, they do not. The gap between theory and practice is a result of the complexity of sequencing design, which discourages fiscal planners from implementing the full process. In addition, sequencing requires a sustained discipline and vision for its implementation, as well as overcoming pressures from political actors, especially in developing countries.

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The IMF Government Finance Statistics Manual describes the standards used for the compilation and presentation of fiscal statistics. The manual covers the concepts, definitions, classifications and accounting rules used to compile the database, and is intended as a reference volume for compilers of government finance statistics, fiscal analysts and other users of fiscal data. The 2001 edition of the manual replaces the 1986 version and introduces major changes in the methodology for the compilation of government finance statistics.

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