



## THE IMPACT OF DECENTRALISATION ON SERVICE DELIVERY, CORRUPTION, FISCAL MANAGEMENT AND GROWTH IN DEVELOPING AND EMERGING MARKET ECONOMIES: A SYNTHESIS OF EMPIRICAL EVIDENCE

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Decentralised public management continues to invite controversy and debate. Proponents of decentralisation consider it a panacea for reforming public sector in developing countries (Shah, 1994, 1998) whereas opponents consider it as a road to wrecks and ruins (Tanzi, 1995). These disagreements primarily arise from perspectives on the potential impact of such policies in the institutional environment of developing countries. Regrettably, the literature provides little guidance to inform this debate. This note is intended to fill a critical gap in this literature by providing a synthesis of the empirical literature on the impact of decentralisation. The paper reviews the empirical literature on the impact of decentralisations and provides a summary of the conclusions on its impacts on service delivery, corruption, fiscal management and growth

### Service delivery

A number of recent studies have explored the impact of decentralisation in various countries. In the following paragraphs, we have grouped these studies by their results – positive, negative and inconclusive.

### Positive impacts

Alderman (1998) found that decentralisation had a positive impact on targeting of social assistance in Albania. Bardhan and Mookherjee (2003) similarly find that decentralised management advanced poverty alleviation goals in West Bengal, India. The same results were confirmed by Galasso and Ravallion (2001) for Bangladesh. Habibi et al (2001) studied the impact of devolution on social sector outcomes in Argentina for the period 1970-94 and concluded that fiscal decentralisation had a positive impact on delivery of education and health services as well as reducing intra-regional disparities. Eskeland and Filmer (2002) using a cross section data from Argentine schools also found that decentralisation of education led to improvement in school achievement scores. Faguet (2001) also found that decentralisation in Bolivia helped improve consistency of public services with local preferences and quality and access of social services. Foster and Rosenzweig (2001) concluded that in India democratic decentralisation led to improved allocation for pro-poor local services. Santos (1998) discovered the same effect in Porto Alegre, Brazil with participatory budgeting. Isham and Kahkonen (1999) observed improvements in water services in Central Java, Indonesia with local community management. King and Ozler (1998) observed that decentralised management of schools led to improvement in achievement scores in Nicaragua. Estache and Sinha (1995) using data on a cross-section of industrial and developing countries found that decentralisation leads to increased spending on public infrastructure. Huther and Shah (1996) and Enikolopov and Zhuravskaya (2003) using cross-section and time series data for a large number of countries find that decentralisation contributed to improved delivery of public goods provision.

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### Negative impacts

Ravallion (1998) found that in Argentina, poorer provinces were less successful in favor of their poor areas and decentralisation generated substantial inequality in public spending in poor areas. Azfar and Livingston (2002) did not find any positive impacts of decentralisation on efficiency and equity of local public service provision in Uganda. West and Wong (1995) found that in rural China, decentralisation resulted in lower level of public services in poorer regions.

### Inconclusive impacts

Several studies observed mixed or inconclusive impacts of decentralisation. Azfar et al. (2000) for Philippines and Uganda, concluded that while local governments do appear to be aware of local preferences, their response is often inadequate as they are hamstrung by procedural, financing and governance constraints. Khaleghian (2003) using data for 140 countries found that while decentralisation improved the coverage of immunisation in low income countries, opposite results were obtained for middle income countries. Winkler and Rounds (1996) reviewed Chile's experience with education decentralisation and concluded that it resulted in improvement in efficiency of provision but also experienced decline in score on cognitive tests.

### Corruption

#### Positive impacts

A number of studies provide support for the positive influence of decentralisation in controlling corruption. Crook and Manor (2000) examined the process of political decentralisation in India (Karnataka state), Bangladesh, Côte d'Ivoire and Ghana and found that decentralisation led to enhanced transparency and reduced incidence of corruption. They conclude that decentralisation reduces grand theft but increases petty corruption in the short run but in the long run, both may go down. Fiszbein (1997) based upon a review of political decentralisation 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 the local level. Kuncoro (2000) found that in Indonesia, administrative

decentralisation led to lower corruption as firms relocated to areas with lower bribes.

Wade (1997) found that over-centralised top-down management accompanied by weak communications and monitoring system contributed to corruption and poor delivery performance for canal irrigation in India. Huther and Shah (1998) using international cross-section and time series data found that fiscal decentralisation was associated with enhanced quality of governance as measured by citizen participation, political and bureaucratic accountability, social justice, improved economic management and reduced corruption. Arikian (2000) reconfirms the same result. De Mello and Barenstein (2001) based upon cross-country data concluded that tax decentralisation was positively associated with improved quality of governance. Fisman and Gatti (1999) found a negative relation between fiscal decentralisation and corruption.

Gurgur and Shah (2002) identify major drivers of corruption in order to isolate the effect of decentralisation. In a sample of industrial and non-industrial countries, lack of service orientation in the public sector, weak democratic institutions, economic isolation (closed economy), colonial past, internal bureaucratic controls and centralised decision making are identified as the major causes of corruption. For a non-industrial countries sample, drivers for corruption are lack of service orientation in the public sector, weak democratic institutions and closed economy. Decentralisation led to a greater reduction in the incidence of corruption in unitary countries than in federal countries. They concluded that decentralisation was confirmed here to support greater accountability in the public sector and reduced corruption.

#### Negative impacts

Triesman (2000) from analysis of cross-country data concluded that decentralised countries have higher perceived corruption and poorer service delivery performance in public health services.

#### Macro management and fiscal discipline

There is scant empirical evidence on the relationship between decentralisation and macroeconomic management. Shah (1998) found that decentralised fiscal system had a better record in con-

trolling inflation and deficits and debts. These results were later confirmed by King and Ma (2001). Huther and Shah (1998) using a sample of 85 countries found positive association between fiscal decentralisation and macroeconomic management. De Mello (2000), on the contrary, using a smaller sample of 30 countries, found that coordination failures in inter-governmental relations were likely to result in a deficit bias in decentralised policy making.

### Economic growth

#### Positive Impacts

Several studies found a positive impact of decentralisation on growth. Akai and Sakata (2002) using state level data for the USA concluded that fiscal decentralisation contributed positively to the US growth. These results are further confirmed by Akai, Skata and Ma (2003). Lin and Liu (2000) found that fiscal decentralisation had a positive impact on China's growth. Thiessen (2000) found a positive and direct relationship between decentralisation and growth for panels of high income, Western European and middle-income countries. Zhang and Zou (1997) found the same for regional growth in India.

#### Negative or inconclusive impacts

Several other studies find that the impact of decentralisation on growth is either negative or inconclusive. Davoodi and Zou (1998) and Xie, Zou and Davoodi (1999) using various data sets for the developing countries, developed countries, and time series data of the US discovered that decentralisation was associated with slower growth. Zhang and Zou (1998) found that fiscal decentralisation in China contributed to lower provincial growth. According to Davoodi and Zou (1998) and Zhang and Zou (1998), the negative association between fiscal decentralisation and economic growth may indicate that in practice local governments may not be responsive to local citizens' preferences and needs. This can occur when local officials are not elected by local citizens and when local citizens may be too poor to "vote with their feet."

For the case of China, the central government is constantly constrained by the limited resources for public investment in national priorities such as highways, railways, power stations, telecommunica-

tions, and energy. Such key infrastructure projects may have a far more significant impact on growth across Chinese provinces than their counterparts in each province. This finding has some implications for other developing countries and transitional economies. The merit of fiscal decentralisation have to be measured relative to existing revenue and expenditure assignments and the stage of economic development. The central government may be in a much better position to undertake public investment with nation-wide externalities in the early stage of economic development. More importantly, if local shares in total fiscal revenue and expenditure are already high, according to Zhang and Zou (1998), further decentralisation may result in slower overall economic growth. Rodriguez-Pose and Bwire (2003) found a negative impact of decentralisation on economic growth for Mexico and the USA but no impact for Germany, India, Italy and Spain. Phillips and Woller (1997) and Matinez-Vazquez and McNab (2003) could not find a statistically significant relationship between fiscal decentralisation and economic growth for a cross-section of countries.

### Conclusions

Decentralisation whereby local governments are empowered to make all policy and program decisions on behalf of their resident-voters represents a complex system of political, administrative and fiscal autonomy and associated accountability mechanisms to ensure responsiveness and accountability to voters. While in theory, such a system is expected to have positive impacts on the efficiency and equity of public service provision, in practice, these outcomes depend upon the existing institutional arrangements (including power relations) and coherence of decentralisation policies to create the proper incentive environment for bottom-up accountability. This explains the myriad of outcomes that we see in practice. Nevertheless, the empirical evidence presented here is broadly supportive of a positive influence of decentralisation policies in reforming public sector in developing countries.

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