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DECENTRALIZATION AS A GLOBAL PHENOMENON IN THE REFORM OF GOVERNANCE STRUCTURE

Summary: The article presents the problem of decentralization in the public sector in the context of good governance and proper architecture of the fiscal policy. We can observe discussion that has attracted attention to the growing gap between the tax systems that the policymakers of some countries might wish to have and those that global forces are forcing them to adopt. In the last decade many economies in the world have experienced currency, debt, financial and banking crises and most of the public finance had to be able to bear it by creating policy framework for reducing the moral hazard risks.

Keywords: decentralization, fiscal decentralization, fiscal policy, governance, motivation.

1. Introduction

During the past two decades, a silent revolution in public sector governance has swept across the globe. If Alexis de Tocqueville, Rousseau, Mill, Montesquieu and Madison were alive today, they would be surprised to find that a wave of decentralization of government has spread throughout the world after decades of centralized economies and states. This revolution aims to move decision-making for local public services closer to the people to improve efficiency of decisions in the public sector. The interest in this new paradigm of public governance has first of all been heightened by the information revolution and globalization of economic activity, which tends to weaken central government at the expense of supra-national regimes and local governments. However, the success of fiscal decentralization as a development strategy is decidedly unclear, and there is growing skepticism about the effectiveness of (fiscal) decentralization as a main reform in 21st century strategy in public finance.

2. The meaning of decentralization

According to Cheema and Rondinelli [1983, p. 319]: "decentralization means different things to different people"[1] and it is very hard not to agree with this remark. Decentralization is a broad concept[2] and there are wide spectrums of general strategies and governance policy goals involved with this concept. Decentralization has been exercised through many cross-disciplinary approaches such as economics, public policy, political science, sociology, anthropology and public administration.

In the literature there are various definitions of decentralization, which cover the range of perspectives and dimensions. Among the various definitions of decentralization, there are at least three commonly accepted interpretations.

The United Nations' (UN) definition on decentralization appears in the UN report, *Decentralization for national and local development* (ST/TAO/M/19), which in 1962 became the standard and was even refined since then by various scholars [Kumssa, Edralin and Oyugi 2003, p. 43]. The United Nations defined decentralization as "the transfer of authority on a geographic basis whether by de concentration (i.e. delegation) of administrative authority to field units of the same department or level of Government or by the political devolution of authority to local Government units or special statutory bodies" [World Bank 2006].

The second interpretation was suggested by Rondinelli and Cheema [1983], which has became a cornerstone and cited by many scholars. They provide the term of decentralization as "the transfer of responsibility for planning, management, and resource-raising and allocation from the central Government to its field organizations, local Governments, or non-governmental organizations" [Rondinelli and Cheema 1983, pp. 319].

[1] A similar interpretation is presented by Bird [1993, p. 208]: "decentralization seems often to mean whatever the person using the term wants it to mean".

[2] Decentralization is known as a broad term encompassing several arrangements of intergovernmental affairs. There are three basic variants: "delegation", "devolution", and "de-concentration". "Delegation" is an intermediate level between devolution and de-concentration. Through delegation, central governments transfer responsibility for decision-making and administration of public functions to sub-national governments. But the powers still belong to the center. Lower levels of government act as agents of central government. Delegation is a more extensive form of decentralization. "Devolution" is the most complete form of decentralization: independently established sub-national governments are given the responsibility for delivery of a set of public services along with the authority to impose fees and taxes to finance those services. Devolved governments have considerable flexibility to select the mix and level of services to provide to their citizens. Devolution is used most frequently in federal countries. On the other hand, "de-concentration" refers to the decentralization of central government ministries. In most unitary countries this is known as regulation. There are two kinds of de-concentration. De-concentration with authority means that regional branches of central offices are created with some ability to make independent decisions. Deconcentration without authority occurs when regional offices are created with no independent capacity from the center. All deviations from normal practice must be approved by the center.

The last, widely accepted, interpretation of decentralization was provided by The World Bank as a "transfer of authority and responsibility for public functions from the central Government to subordinate or quasi-independent Government organizations and/or the private sector" [World Bank 2006] The World Bank divides also decentralization into four broad categories, namely: political, administrative, fiscal, and market decentralization

The definition proposed by The World Bank considers the private sector as an actor of decentralization, which itself is driven by the concept of market-based decentralization. In the most current literature on decentralization, this market-based decentralization is categorized as economic decentralization [Bennet 1990; Faguet 1997, p. 21]. However, certain scholars argue that this type of decentralization is not formally defined as decentralization [Ribot 2004]. In the Polish literature we can find also arguments which disagree with such a point of view [Begg 2006]. According to Begg [2006] the main problem focuses on specific character and nature of public services and goods which cannot be provided by the private sector.

Falleti [2005, p. 328-330] propose a "sequential theory of decentralization" that has three main characteristics: a) it defines decentralization as a "process"; b) it takes into account the "territorial interests" of bargaining actors; and c) by incorporating "policy feedback effects", it provides a dynamic account of institutional evolution.

But decentralization should not be just defined as the shifting of resources and fiscal authority to the subnational level, but rather as the empowerment of people through the fiscal empowerment of their local governments. As such, a consensus is gradually emerging around a "second generation theory of fiscal federalism" (SGFF), which emphasizes that "institutions matter" and calls for the field of fiscal decentralization to look beyond the traditional fiscal pillars of decentralization that emerged from the early public finance and public choice literatures [Weingast 2006]. SGFF models place greater emphasis on the importance of revenue generation by subnational governments.

A recipe for success of fiscal decentralization covers typically approached from one of four angles [Boex 2009, p. 405]. The first, fiscal decentralization can be approached as a relatively narrow public finance reform with the limited goal of encouraging fiscal discipline and improving the efficiency, equity and effectiveness of public finances.

The second angle from which fiscal decentralization is pursued in international development is in the context of wider governance reforms. This should come as no surprise, as decentralization reforms in many countries (particularly in most transition economies and in post-conflict situations) are spurred by governance considerations; decentralization is often used as a strategy to reduce the monopoly of the central level over political and economic space by distributing is generally treated merely as one of several dimensions needed to achieve a more decentralized governance structure in a country. In contrast to the public finance-driven fiscal decentralization reforms, governance-driven decentralization reforms have tended to focus on the pursuit of policy objectives such as improving participatory governance, achieving community empowerment, ensuring accountability, or supporting poverty reduction. The primary role of fiscal decentralization in such broader decentralization reforms tends to be to ensure that funds flow to the subnational level. This requirement sometimes comes at the expense of the level of attention that is paid to the design of the intergovernmental funding flows and the efficiency aspect of public finances.

The third, sectoral decentralization reforms have tended to be pursued as a public administration or public management reform driven from within the sector, typically as an attempt to enhance the efficiency and equity with which sectoral resources are managed. The reach of sectoral programs is almost always limited to a single sector, and as a result, seldom has the ability to systematically improve intergovernmental fiscal structures or subnational governance institutions. Finally, the fourth motivation for fiscal decentralization reform is specifically to strengthen local public administration and local service delivery.

A successful fiscal decentralization strategy should address all four dimensions of fiscal decentralization noted before: public finance and intergovernmental fiscal relations, governance, sectoral reform and local government strengthening. Fiscal decentralization reforms will fail when devolution of fiscal resources is not

Table 1. Motivations for decentralization

Motivation	Countries and/or regions
Political and economic transformation	Central and Eastern Europe, Russia
Political crisis due to ethnic conflict	Bosnia-Herzegovina, Ethiopia, Yugoslavia, Nigeria, Sri Lanka, South Africa, Philippines
Political crisis due to regional conflicts	Indonesia, Madagascar, Mali, Senegal, Uganda, Mexico, Philippines
Enhancing participation	Argentina, Brazil, Bolivia, Colombia, India, Pakistan, Philippines
Interest in EU Accession	Czech Republic, Slovakia, Hungary, Poland
Political maneuvering	Peru, Pakistan
Fiscal crisis	Russia, Indonesia, Pakistan
Improving service delivery	Chile, Uganda, Cote D'Ivoire
To centralize Shifting deficits downwards	China, Turkey, European Union Eastern and Central Europe, Russia
Shifting responsibility for unpopular adjustment programs	Africa
Prevent return to autocracy	Latin America
Preservation of communist rule	China
Globalization and information revolution	Most countries

Source: [Shah, and Thompson 2004, p. 3].

accompanied by appropriate local governance mechanisms, which ensure that local finances are properly prioritized and administered at the local level.

We have to point out a very substantial problem – in theory it is easy to create a range of models of decentralization like: fiscal, administrative or political which should be implemented in a real economy. But, in fact, decentralization is very complicated without any standard form. This is a process which is different in each country because of motivations which shift organizational structure of public administrations from central level to local goverments. Table 1 presents the prime motivations in recent decentralization moves.

Given the current state of knowledge on (fiscal) decentralization and the seemingly pervasive skepticism about its positive impact, it is appropriate to be at least concerned with the benefits of fiscal decentralization reforms in developing and transition economies and the ability of the development community to effectively support such fiscal decentralization reforms.

3. Good governance as a key element of decentralization

Moving decision-making closer to people requires that citizens have a voice and exit options for local governance (political decentralization). In addition, local governments that they elect should be allowed home rule in fiscal, regulatory and administrative matters (fiscal and administrative decentralization). All of these elements must be in place to ensure effective decision-making at the local level. But we have to answer the question of how to understand effectiveness.

In the literature we can find several approaches to decentralization in the contexts of effectiveness but the most sugnificant is the issue of good governance. However, the starting point in this issue is transfer of power in the sense of how to do it to meet interests of central and local level of governance. As William Riker rightly pointed out thirty years ago, power is an elusive and complex concept [Riker 1964, pp. 328-331]. It is also important to mention what is efficient or even optimal from an economic viewpoint might not always be sustainable politically. That is why the main problem in decentralization in the aspect of efficiency or effectiveness is: when to decentralize, how, and to whom questions regularly raised by the policy literature might not be best answered by examining policy efficiency.

On the basis of the structuralist and behavioralist traditions on power, we can say that “intergovernmental power” is dependent on: (a) “economic resources”, which enhance the capacity of political actors to pursue their desired courses of action; (b) “legal authority”, which sets the institutional limit that economic resources can reach; and (c) “organizational capacities”, which facilitate the co-ordination and flow of information at each level of government [Falleti 2005, pp. 328-331]. This point of view requires (according to Falleti) intergovernmental balance of power, which reflects the degree of autonomy of sub-national officials relative to national officials. If we meet such conditions, probably we can use the words: “good governance”.

The main changes in the process of current governance rely on shifting models of governance from bureaucratic and centralized to participatory and localized structures. This is a changing of the 20th century governance character into 21st character and is commonly regarded as basic components of good governance (see Figure 1).

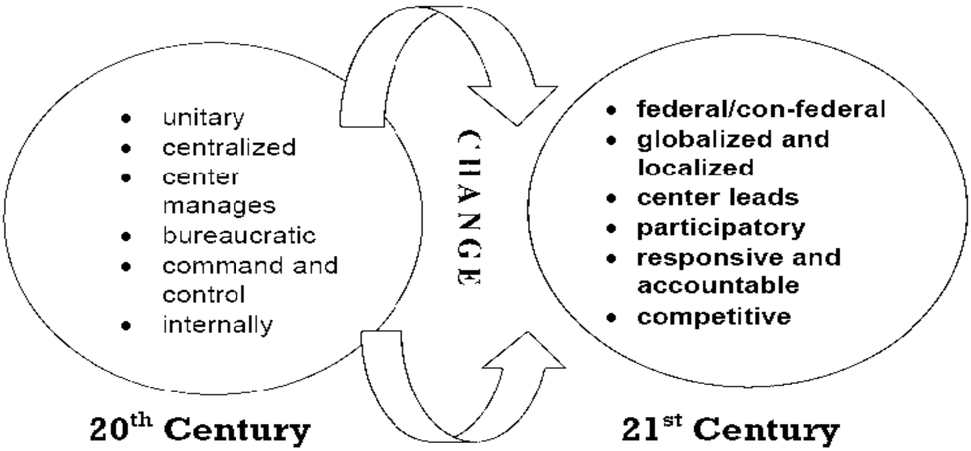

Figure 1. Governance Structure: 20th and 21st century

Source: [Siry 2007, p. 9].

Many scholars and organizations emphasized that decentralization is a process leading to good governance. But the point is that decentralization has many dimensions, each of which may have different impacts on the quality of governance; thus, for example, Schneider [2003, p. 21] distinguishes among administrative, fiscal, and political decentralization, and Treisman [2002] considers structural, decision, resource, electoral and institutional decentralization.

On the other hand, good governance is also a multifaceted concept; thus, for example, Kaufmann et al. [2006] consider six dimensions governance (voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law and control of corruption) and La Porta et al. [1999] classify good government performance variables into five different groups (interference with the private sector, efficiency, output of public goods, size of public sector and political freedom).

Through the process of structural and policy reforms towards a decentralized system, decentralization brings improvements in local governance, delivery of services, allocation of fiscal resources, and promotes public participation as well as enhances government responsiveness. In this sense, it will lead to more creative, innovative and responsive programs by allowing local experimentation and citizens to better control public programs at the local level. As the UNDP pointed out, decentralization is "the logical application of the core characteristics of good governance at the sub-national and local levels which ensures that political, social and economic priorities are based on a broad consensus in society and that the voices of the poorest and the most vulnerable are heard in decision-making over the allocation of development resources" [United Nation 1962, p. 246].

Another case for decentralized government was articulated by Wolman [1990]. He cites three perspectives on the values of decentralization, namely: an economic or efficiency perspective, a governance perspective, and a political or distributive perspective. From an efficiency perspective, decentralization allows local governments greater leeway in determining local needs and preferences of their constituents thereby making decision-making more effective in terms of the utilization of resources. From a governance perspective, decentralization promotes greater responsiveness among policy makers in addressing the needs and concerns of their constituents. Decentralization allows for greater citizen participation, which can result in more robust policy initiatives, more effective exercise of democracy, healthier and more productive national-local interaction, and greater accountability of elected officials. From a political or distributive perspective, a decentralized arrangement can better address the interests of the poor, minorities, the labor sector and others similarly situated [Wolman 1990].

In most definitions of decentralization it is pointed out that efficiency or effectiveness must be measured before we judge the quality of governance and then the success of decentralization. Decentralization is a multifaceted concept that spans fiscal, political, and administrative dimensions. Measuring decentralization is equally complex. Measures of governance can be broadly categorized as process and performance measures [Knack and Manning 2000], the former capturing the institutional arrangements associated with better government performance, whereas the latter assess government effectiveness [Malik 2002]. Institutional performance in turn falls into three categories: economic, political and cultural, which in some sense can respectively be related with efficiency, distribution and beliefs [La Porta et al. 1999].

As an alternative to these broad approaches and while remaining aware that many aspects of the quality of government are non-economic, other more functionalist concepts of quality can be used in order to facilitate policy design and implementation. For the European Commission [2004], quality of public finances concerns the allocation of resources and the most effective and efficient use of those resources in relation to identified strategic priorities. Priorities can be related to the academic functions of government, such as stabilization, allocation, distribution and other public administration goals [Alfonso et al. 2003] or based on a concrete agenda such as the Lisbon strategy for growth and employment [European Commission 2002].

4. Fiscal decentralization

Fiscal policy in the sense of the size of government deficits and the time path of debt is of central importance to the political discussions that shape economic policies in most countries. Governments around the world must formulate and implement policies for taxation and public spending. These policies can have major impacts on economic growth, income distribution, and poverty. Successful fiscal adjustments have been identified based on their duration and their effectiveness in restoring the fiscal balance and reducing the public debt. Growing evidence from transition economies shows that fiscal adjustments supported by expenditure cuts have been more successful and long-lasting than those supported by revenue-increasing measures [Alfonso et al. 2006; Purfield 2003].

But we have to mention that fiscal policy is not solely concerned with promoting economic growth and there are many other objectives, for example social improvement, redistribution, and equity concerns. One of the solution which reformed many public finance is "fiscal decentralization or fiscal federalism", which according to for example Kee [2007], means "the devolution by the central government to local governments (states, regions, municipalities) of specific functions with the administrative authority and fiscal revenue to perform those functions" [Kee 2007, p. 3]. Fiscal decentralization is commonly defined as the transfer of fiscal power and resources from central government to subordinate or quasi-independent (sub-national) government units. Fiscal decentralization is also used to achieve a certain degree of fiscal autonomy and responsibility given to sub-national governments. Hence, central government has to transfer public resources and responsibility to a different level of sub-national government and the sub-national government is needed to set up a budgeting system that is able to get the revenue and to allocate them. The fiscal resources should be derived from local own resources and grant from central government.

In fact, on the basis of "decentralization instrument", there are two strands in the literature that argue for two different approaches to measure fiscal autonomy. One gives more weightage to devolution of tax authority as an instrument of decentralization and hold it crucial for subnational autonomy, the other gives more weight to the nature of intergovernmental transfers (discretionary or not) as an instrument impacting upon the subnational behaviour and effecting their autonomy and accountability. Thus the former chooses to focus on fiscal policy i.e., the relationship between expenditure and allocated revenues (vertical imbalance) while the latter pays attention to regulatory or financial mechanisms, i.e. the nature of inter-governmental transfers for instance Nice [1987], Ahmad [1997].

Out of these two approaches, it can be observed that when it comes to the measurement of fiscal decentralization the share of sub-national expenditures and revenues is considered the best indicator. This is because fiscal instruments are easier to measure while regulatory and financial instruments are extremely complex and difficult to measure statistically because nowhere transfers remain strictly confined to the technical objectives.

Although fiscal decentralization reforms and intergovernmental finance were an important element of international development activities over the past 25 years, fiscal decentralization and subnational finance have not always been approached with the same level of enthusiasm by the international development community. Almost invariably, the road to greater fiscal decentralization is described as having "dangers" [Prud'homme 1994], "pitfalls" [Tanzi 2001] and in need of "rethinking" [Litvack, Ahmad, and Bird 1998].

The fiscal federalism literature [e.g. Oates 1999] names numerous economic benefits that arise from shifting public finances "closer to the people", including a more efficiently sized (smaller) public sector, improved allocative efficiency (as a result of a better match between the services supplied by the public sector and the needs of local communities), and a more competitive and innovative public sector. Whereas the potential benefits of fiscal decentralization reforms as presented in the fiscal federalism literature have been hard to measure and relatively abstract, anecdotal evidence of the practical concerns and potential costs of decentralized finance – macroeconomic instability, the lack of fiscal discipline, inefficient public spending due to weak local administrative capacity, local corruption and local elite capture – often carry significant weight in policy debates surrounding the topic.

Kee [2007] indicates three basic reasons to implement fiscal decentralization:

1. Central governments increasingly are finding that it is impossible for them to meet all of the competing needs of their various constituencies, and are attempting to build local capacity by delegating responsibilities downward to their regional governments.

2. Central governments are looking to local and regional governments to assist them on national economic development strategies.

3. Regional and local political leaders are demanding more autonomy and want the taxation powers that go along with their expenditure responsibility.

The "proper" distribution of tax authority and expenditure responsibility is an extremely complex issue. Economists generally focus on issues of efficiency and equity while public administration and political science scholars tend to focus on distribution of powers, responsiveness and accountability, and tax competition and co-ordination. In the literature we can find models of tax allocation.

Expenditure assignment is the first step in designing an intergovernmental fiscal system. Designing revenue and transfer components of a decentralized intergovernmental fiscal system in the absence of concrete expenditure responsibilities would weaken the decentralization process [Martinez and McNab 2001]. The theory provides broad guidance in delineating expenditure responsibilities between various levels of governments. However, the key to the success of a decentralized system is matching expenditure responsibilities with the objectives of service assignment.

In fiscal decentralization, taxation is the most important single source of revenue – it determines the volume of proper financial resources which can be used by the member states and regions/municipalities themselves away from financial transfers, thus the extent of their financial independence. Some kinds of taxes: value added tax (VAT), business income tax, individual income tax, foreign trade taxes, retail sales taxes, property tax, and user charges. Another source of revenue is borrowing and intergovernmental transfer. There are many ways to design a grant system. The grant could be distributed based on a formula (population, land area, etc.), based on derivation (where the money is collected), based on cost reimbursement (how much is spent for roads, etc.), or even on a political basis [Hamzah 2004]. Kee [2007] proposes the following allocation of tax revenues (see Table 2).

Table 2. Model tax allocation system

Central Government Regional/ Local Government	Central Government Regional/ Local Government
Income Tax	Property Tax
Import and Export Duties	Business Taxes
	Charges and Fees
Shared/Joint Taxes	Gaming/lottery
Natural Resource Taxes	Income or VAT (piggybacked on national tax)
VAT	Excise Taxes

Source: [Kee 2007, pp. 51-52].

The design of a decentralized system requires the sorting out of public sector responsibilities into different types of governments and the process of sorting out entails the transfer of some decision-making powers from central to sub-national governments. To achieve the relevant policy objectives, intergovernmental fiscal system should be designed based on each country's specific circumstances. The policy objectives should include not only the public finance goals of efficiency, transparency, and accountability, but also they should aim at maintaining national integrity and political stability and being equitable to different people and places. As such, a design is based on four pillars: expenditure assignment, revenue assignment, intergovernmental transfers/grants and sub-national debt/borrowing [Bird 2010].

The choice of focusing on fiscal instruments however is not just methodological but also substantial because "by using both expenditures and revenues, we tap into the main attributes implied by the concept of fiscal decentralization" [Schneider 2003, p. 21]. Aspects of fiscal decentralization process can be worked out in the context of each individual country, the common components of designing a decentralized system of intergovernmental fiscal relations in all countries are an assignment of responsibilities for governmental functions, an assignment of the power among levels of government to tax people and collect revenues, the nature of intergovernmental transfers system and the ability of sub-national governments to borrow. The failure to design these interrelated components in a consistent way may lead to undesirable results. However, the issue of designing an effective intergovernmental structure is not limited to these components. It involves electing local government officials, having an approved budget locally, absence of mandates on local governments as regards to employment and salaries, keeping adequate books of account and monitoring, and monitoring progress towards an effective fiscal decentralization.

5. Conclusions

The literature reviewed earlier in context of the degree, design and outcomes of decentralization shows that decentralization has been approached by a variety of intellectual traditions with little agreement. To quote Auron Schneider [2003, p. 21]: "the differences in kind and degree of decentralization have produced a conceptual muddle. The muddle has multiplied the conceptualizations of decentralization, imbued it with positive normative value, conflated it with other concepts and ignored its multi-dimensionality. There has also been an explosion of units of analysis in studying this concept".

Decentralization is considered to have the potential to improve the performance of the public sector. Fiscal federalism theory holds that decentralized provision of public goods can increase efficiency in resource allocation because local governments can be better tailored to the geographical benefit areas of public goods, local governments are better positioned to recognize local preferences and needs, and pressure from interjurisdictional competition may motivate local governments to be innovative and accountable to their residents. However, some recent studies have challenged this conventional argument. Bahl et al. [1999; after Kwon 2002] hold that political, fiscal, and administrative structures in developing countries are organized in such a way that local voter preferences may not be readily revealed into local budget outcomes. As a result, decentralized provision of public goods may not improve efficiency, which was mentioned in many definitions of decentralization.

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DECENTRALIZACJA JAKO GLOBALNY FENOMEN W REFORMIE ZARZĄDZANIA FINANSAMI PUBLICZNYMI

Streszczenie: W artykule przedstawiono problem decentralizacji w sektorze publicznym w kontekście efektywności i skuteczności podejmowania decyzji ze szczególnym uwzględnieniem kształtu polityki fiskalnej. W ostatnich latach wiele gospodarek doświadczyło kryzysów finansowych i bankowych o różnym podłożu i nasileniu. Skutki tych kryzysów istotnie obciążyły finanse publiczne wielu państw, stąd też ogół wysiłków koncentruje się obecnie m.in. na wokół koncepcji zarządzania w finansach publicznych, które pozwoliły na ograniczanie konsekwencji zjawiska moralnego hazardu.